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Steel makers irked by FBR

The steel manufacturers have urged the Federal Board of Revenue (FBR) to ensure level playing field to all the stakeholders in steel trade.

A spokesman of the Pakistan Steel Manufacturer's Association (PSMA) said on Monday that presently ship-plates supplied by ship breaking industry enjoy huge price advantage of around Rs15,000 per tonne over billets manufactured by steel melting industry.

This was not only causing huge financial loss to a large number of steel melting furnaces across the country but is also one the major reasons for financial crisis being faced by the Pakistan Steel which could not compete with cheap ship-plates.

The recent hike in electricity rates has further made steel melting furnaces products costly by Rs10,200 per tonne, therefore, with such a huge imbalance in pricing, the industry would not survive, the spokesman added.

In the past the government always used to impose customs duty along with specific duty per tonne on ships imported for scrap and this helped to keep a balance between the two sectors in the same trade.

"Traditionally there had always been a difference of $5 per tonne between the shredded scrap and LDT (light dead weigh tonnage) of a scrap vessel but this also assumed wide difference. Therefore, it is imperative that the government should mop up the surplus by imposing federal excise duty (FED) on ship-plates and ship items to narrow down the wide different of around Rs15,000 to Rs20,000 per tonne between ship-plates and billets manufactured by steel melting furnaces," the spokesman maintained.

Similarly, PSMA demanded that proper customs duty per tonne be imposed on incoming scrap vessels to give equal competition and level playing field to steel manufacturers and steel furnaces.

The PSMA spokesman reminded the government that as per agreement between the ship breakers, steel melting industry, re-rollers, Engineering Development Board, Pakistan Steel the difference between ship-plates and billets was agreed at Rs1200 per tonne only.

Under a formula the government was supposed to maintain this nominal price edge by making adjustments in customs duty and specific duty per tonne on ships imported for scrap.

However, over a period of time the FBR started to ignore the formula and despite repeated reminders to concerned authorities no action was taken to rectify the situation, he added. – *Courtesy Dawn*

Strike call Committee to talk with customs agents

The Federal Board of Revenue (FBR) has set up a four-member committee for holding talks with customs agents who are going on a country wide strike from today (Tuesday).

In a letter addressed to the Chief Collector of Customs South, the FBR informed that a committee comprising collectors of customs appraisement (west and east), preventive and Port Qasim has been formed to redress the grievances of customs agents.

Senior Vice-Chairman All Pakistan Customs Agents Association (APCCA) M Arshad Jamal has also been informed through a separate message and advised to discuss problems with the committee for an early resolution.

The Karachi Customs Agents Association (KCAA) and the APCCA last Friday announced schedule for a country-wide strike from September 10 for an indefinite period.

Arshad Jamal told Dawn on Monday that there was no question of withdrawing the strike call still such a time the FBR and customs authorities withdraw all show-cause notices issued against KCAA and APCCA members in Afghan Transit Trade (ATT) missing containers scam.

Mr Jamal said that a meeting with the FBR committee was scheduled Monday late night. However, he said the committee had clearly been told that the strike would not be called off on verbal assurances. – *Courtesy Dawn*

56 senior officials of FBR reshuffled

Following a reshuffle in the Federal Board of Revenue (FBR), 56 officers would assume the charge of their new offices and 46 Customs Officers would report in the new Customs Collectorate.

The 14 senior officers of Inland Revenue Service would assume new responsibilities in Large Taxpayer Units and 19 would report in Regional Tax offices. Eleven officials of BPS-19 would assume responsibilities in Karachi, Lahore, Hyderabad, Peshawar and Islamabad. The name and their posts are: Muhammad Asghar

Khan (Additional Director Post- Clearance Audit, Islamabad), Muhammad Saadiq (Director OPS – OIC Lahore), Muhammad Adnan Akram (Additional Director Internal Audit, Customs Lahore), Miss Shazia Akram (Additional Director Evaluation, Karachi), Khalid Hussain Jamali (Additional Director Internal Audit, Karachi), Malik Kamran Azam Khan (Additional Collector model Customs Collecorate, Peshawar), Muhammad Mohsin Rafique (Additional Chief Collector Customs Central, Lahore), Ashraf Ali (Additional Director OIC O, Lahore), Muhammad Jamil Nasir (Additional Collector Model Customs Collectorate, Peshawar), Engineer Riaz Ahmed (Additional Collector, Model Customs Collectorate, Hyderabad), Muhammad Irfan Wahid (Additional Collector Model Collectorate Appraisement, Lahore). The 31 officers of BPS-17 and BPS-18, who would assume their new responsibilities, are: Khawaja Khurrum Naeem (Additional Director OPS Training, Research Customs, Lahore), Abid Hussain Kalro (Deputy Director Input, Karachi), Ghulam Mustafa (Secretary FBR, Islamabad), Ms Belum Ramazan (Deputy Director Customs Collectorate of Preventive, Lahore), Muhammad Haris Ansari (Secretary FBR, Islamabad), Farid Ahmed Khan (Deputy Director Model Customs Collectorate, Peshawar), S Ali Zaman Gardezi (Secretary FBR, Islamabad), Miss Ayesha Bashit Wani (Deputy Collector, Model Customs Collectorate, Islamabad), Muhammad Ahsan Khan (Deputy Director Intelligence and Investigation FBR, Karachi), Yasin Murtaza (Secretary FBR, Islamabad), Dr Nauman Man (Deputy Collector, Model Customs Appraisement West, Karachi), Jehan Bahadar (Secretary Legal FBR, Islamabad), Fahdullah Chaudhry (Deputy Director Internal Audit Customs, Islamabad) and Miss Dr Kaukab Farooq (Deputy Director Customs Adjudication, Islamabad). – *Courtesy International The News*

Customs agents announce nationwide strike from today

Supplies through Afghan Transit Trade (ATT) to Afghanistan, besides supplies to North Atlantic Treaty Organisation (NATO) forces and to Khyber Pakhtunkhwa (KP) would be badly effected during Tuesday's (today) countrywide indefinite strike call by All Pakistan Customs Clearance Agents Association (APCCA), Karachi Customs Agents Association (KCAA) and All Pakistan Bonded Carrier Association (APBCA).

This will be an indefinite period strike against the Federal Board of Revenue's (FBR) move of issuing recovery notices to customs agents and bonded carriers in International Security Assistance Force's (ISAF) missing containers scam.

More than 1,200 imports and 800 exports Goods Declarations (GDs) at Karachi and Bin Qasim Ports on daily basis would come to a standstill.

The strike would effect transportation and goods declaration for import or export file by the customs agents from Karachi to Torkham and would continue till the acceptance of demands, an APCCA representative said.

More than 28,5000 containers are reported missing for the last two years and the government functionaries were blaming us for the act, he added.

Model Customs Collectorate Port Qasim is reported to have been charging more than 800 companies in missing containers scam.

In this regard customs authorities issued Order in Originals (ONOs) to customs agents for the recovery of around Rs 2.5 million per missing container for the total recovery of Rs 53 billion.

It is unjust that ONOs were issued on September 4, 2013 but the date mentioned in the orders was June 26, which depicts malafide intentions of customs authorities to malign the customs clearing agents.

We have no role in missing containers scam because handing over the consignment or container is not our business.

It is the responsibility of the national carrier to take the consignment safely to its destination and collectorates at entry and exit points to settle the delivery.

They demanded of the government and Supreme Court of Pakistan to constitute a team each from Customs Intelligence, National Accountability Bureau and Federal Investigating Agency to conduct an inquiry in all the cases. – *Courtesy Daily Times*

Draft IT return form for companies issued

The Federal Board of Revenue on Monday issued a draft of income tax return form for companies for Tax Year 2013. In this connection, the FBR issued a SRO.772 (I)/2013. The Board has notified the draft income tax return form for companies by devising separate annexure like Annex- A-1, Annex B-1, Annex C-

1, Annex D-1 Annex-E-1, Annex- F-1, Annex- G-1, Annex- H-1, Annex- J-1, Annex- K-1 and Annex- L-1, Annex M-1, Annex N-1 and Annex O-1.

Sources said the major advantage of simplifying main page of return will be to the small and medium companies with limited transactions/scope of business. Such categories of companies will comfortably complete the income tax return because in the electronic filing system of the FBR, the respective annexures are filled by the companies only when they conduct transaction of that particular nature. Now, the companies will only fill the relevant annexures saving their time by submitting a simple income return form.

According to the SRO.772(I)/2013, the draft of certain further amendment to the Income Tax Rules, 2002, which the Federal Board of Revenue proposed to make in exercise of the powers conferred by sub-section (1) of section 237 of the Income Tax Ordinance, 2001(XLIX of 2001) has been published for the information of all persons likely to be affected, as required by sub-section (3) of the said section, and notice is hereby given that the draft will be taken into consideration by the Federal Board of Revenue after seven days of its publication in the official Gazette. Any objection or suggestion, which may be received from any person, in respect of the said draft, before the expiry of the aforesaid period, shall be considered by the Federal Board of Revenue, the FBR added.

The review of the draft income tax return form revealed that the Annex- A-1 is related to the depreciation, initial allowance and amortisation (purchased assets); Annex B-1 deals with the carry forward and brought forward of unabsorbed depreciation, initial allowance, amortization and business losses (other than speculation business); Annex C-1 is related to the tax already paid including adjustments (including surcharge); Annex D-1 covers break-up of sales in case of multiple business; Annex-E-1 is related to the statement of assets and liabilities; Annex- F-1 deals with the foreign income; Annex- G-1 is related to the income/ (loss) from other sources; Annex- H-1 covers details of stock detail; Annex- J-1 is related to the transactions with non residents (to be filled by taxpayers whose transactions, in aggregate, with non-residents are more than 50 million during the tax year); Annex- K-1 deals with the bifurcation of income/ (loss) from business attributable to sales/receipts, etc, subject to final taxation and Annex- L-1 is related to the admissible/inadmissible deductions and adjustments; Annex M-1 deals with the determination of minimum tax payable on certain transactions; Annex N-1 is related to the request of taxpayers falling under PTR regime for availing normal tax regime (NTR) and Annex O-1 is related to the tax credits u/s 65B, 65D & 65E, experts added. – *Courtesy Business Recorder*

PTAA seeks 75-day extension in date for tax return

Since the Federal Board of Revenue has not discharged its duty in time, taxpayers and legal fraternity should not be penalised for the completion of an uphill task pertaining to filing of income tax return/wealth statement for tax year 2013. This is the crux of the suggestions forwarded by Pakistan Tax Advisors Association (PTAA) to Member (Inland Revenue-Policy), FBR, Islamabad on SRO 739(I)/2013 of August 29, 2013 pertaining to draft/amendment for Income Tax Return/Wealth Statement proposed for tax year 2013.

They have demanded that the date for submission of returns be extended by 75 days to compensate for the time wasted by FBR in preparation of returns/annual statements. According to details available here on Monday, in a meeting of the Pakistan Tax Advisors Association held at Lahore the proposed draft/amendments were considered and following objections/suggestions conveyed “in the best interest of the country and for the facilitation of the taxpayers.”

-That the proposed draft/amendments should have been issued in April/May, 2013, the Return of Total Income/Wealth Statement should have been finalised by 30th June, 2013 relevant to Tax Year 2013 and made available on the e-portal by July 1, 2013 enabling the tax practitioners/advocates/tax advisors to start their work of preparation/submission of returns to complete their job well in time.

-That the FBR has not discharged its duty in time as such the taxpayers and legal fraternity should not be penalised for the completion of an uphill task. -That as the proposed draft has been released by the FBR on 26.08.2013 the period relevant to tax year 2014 no returns for tax year 2013 can be submitted on such returns/wealth statements forms which were not available on the statute Book as on 30.06.20 13.

-That in case of non-salary class, ie, the business community the returns/wealth statements are always prepared by the tax practitioners/advocates/tax advisors and they have not been mentally prepared by the FBR especially in cases where wealth statements have not been filed by taxpayers for the last many years. The burden shifted on the said community by the FBR by not making awareness to the taxpayers is a big fault on the part of FBR.

PTAA has also raised legal objections as under: Any change in law made retrospectively which affects the vested rights of the taxpayer is not sustainable in law and has repeatedly been declared unconstitutional by the higher judiciary in the past.

-That in the Finance Bill 2013 the declaration under the provisional collection of Taxes Act, 1931 (XVI of 1931) clause (4) of the Bill ie Income Tax Ordinance, 2001 was not made effective for tax year 2013 rather it was made effective 01.07.2013 ie for Tax Year 2014 as such the amendments made in section 114 & 116 through Finance Act, 2013 cannot be applied retrospectively for Tax Year 2013. Hence the proposed draft/amendment pertains to tax year 2014 & not to tax year 2013.

-That the FBR can collect reasonable amount of tax as projected in the Budget by Finance Act 2013 by making resort to section 122(5) & 122(5A) of the Income Tax Ordinance 2001 by appointing Officers of integrity and effective use of data available with it. -That for the Tax Year 2013 the old return forms/wealth statement forms be used and returns be put on e-portal so that the taxpayer/legal fraternity may start the preparation of returns.

-That the taxpayer/public at large through chambers/trade associations be mentally prepared for the submissions of wealth statements/balance sheets for tax year 2014.

-That the taxpayers may not be harassed by the FBR at this time when the new govt has taken over the charge and the public is being burdened with huge bills of electricity, gas & petrol, etc.

-That Income Support Levy Act 2013 which has been enacted retrospectively is also against the vested rights of the taxpayer, hence be implemented from tax year 2014 and not 2013. PTAA has also proposed that a meeting between the officials of FBR and its office-bearers be held which could lead to playing a positive role for the cause of collection of tax and judicial administrative system of taxation in the country. In view of the situation which has developed on account of the above reasons, PTAA has suggested as under:

i. That the date of submission of returns be extended by 75 days the time wasted by the FBR in preparation of returns/annual statements.

ii. That the draft/amendment rules be implemented for tax year 2014 and not for tax year 2013.

iii. Those instructions be issued to the Chief Commissioners/Zonal Commissioners for issuance of exemption certificates/disposal of rectification applications promptly and the officers who caused unnecessary delays be taken to the task. – *Courtesy Business Recorder*

Trade, industry: KCCI team discusses procedural issues with Dar

A delegation comprising Muhammad Haroon Agar, President Karachi chamber of Commerce and Industry (KCCI) Anjum Nisar, former President KCCI, Muhammad Zubair Motiwala, Chairman Sindh Board of Invest, Siraj Kasim Teli, and Haroon Farooq called on Finance Minister Senator Muhammad Ishaq Dar at his office. During the meeting they discussed various matters relating to the procedural issues facing trade and industry in the country.

The Finance Minister assured the delegation that the government was committed to support and facilitate trade and business in the country and believes in simplifying procedures so that the business community can pay their dues without any problem. The Finance Minister directed the Federal Board of Revenue to meet the delegation and look into their grievances.

The delegation assured the Finance Minister that the industry would extend all possible co-operation in the achievement of revenue target sets by government. Member Customs FBR Nisar Ahmad and senior officials of Ministry of Finance were also present during the meeting. – *Courtesy Business Recorder*

2013 TRI 1548 (Trib. Ind.)

INCOME TAX APPELLATE TRIBUNAL
DELHI "I" BENCH, DELHI

R.P. Tolani, Judicial Member and Shamim Yahya, Accountant Member

FACTS/HELD

Transfer Pricing: Scope in the context of expenditure (royalty payment) explained

1. The assessee paid royalty at the rate of 5% to its associated enterprise and claimed that the same was at arm's length basis by applying the CUP method. The TPO and DRP determined the ALP of the royalty at Nil on the basis that (a) the approval given by the Government for payment of royalty did not automatically mean that the transaction was at arm's length; (b) the assessee had not furnished a cost benefit analysis, (c) the technology had in fact not helped the assessee in earning better margins. It was held that as the technology had not contributed to the assessee's profitability and there was no commercial benefit received, no independent enterprise would have make payment for royalty for the technology and so its ALP had to be determined at Nil. On appeal by the assessee to the Tribunal, HELD reversing the TPO & DRP:

   (a) The TPO's argument that the assessee need not have paid for the technology as it did not derive any benefit therefrom is not acceptable. The assessee is free to conduct business in the manner it deems fit and the commercial and business expediency of incurring any expenditure has to be seen from the assessee's point of view. The Revenue cannot step into the shoe of the assessee and decide what is prudent for the business. On facts, the very survival of the assessee in the industry depended upon the licence and technology & know how provided by the AE. There has been a considerable increase in the sales figures and the growth in revenue clearly demonstrates the benefits derived by the assessee from the use of technology;

(b) the payment of royalty was approved by the Government of India. Though it is not conclusive proof, the said approval of the Government has to be given consideration while considering the arms length price of the transaction;

(c) Under Rule 10B(1)/ s. 92C(2), the arm's length price has to be determined by one of the five methods which is found to be most appropriate method. While the assessee rightly considered the CUP method for determining the ALP, the TPO's conclusion that the arms length price of the royalty payment should be NIL without specifying any cogent basis is not sustainable (EKL Appliances 345 ITR 241 (Del), Ericsson 146 TTJ 708 (Del), ThyssenKrupp Industries 154 TTJ 689(Mum), Dresser Rand 55 SOT 167 (Mum), SC Enviro Agro 143 ITD 195 (Mum) etc followed)

Appeal allowed.

I.T.A. No. 5857/Del/2012 (Assessment Year : 2008-09)

Decided on: 14th June, 2013.

Present at hearing: Ajay Vohra & Neeraj Jain, Advocates, Ramit Katyal, CA & Abhishek Aggarwal, CA, for Appellant. Peeyush Jain, C.I.T.(D.R.)/TP, for Respondent.

JUDGMENT

Per Shamim Yahya:– (Accountant Member)

This appeal by the Assessee is directed against the Order of the Assessing Officer passed u/s. 143(3) read with section 144C of the I.T. Act and pertains to Asstt. Year 2008-09.

2. The issues raised in the appeal reads as under:–

(1). Transfer Pricing Issue:–

In this regard, it has been urged that Assessing Officer has erred in making the addition to the income of the assessee to the extent of Rs. 65,00,83,653/- on account of difference in the arm's length price of international transactions. The break-up of the above addition by way of Transfer Pricing Adjustment is as under:–

i) Advertisement, marketing and sales promotion expenses (AMP expenses) Rs. 49,72,06,126/-

ii) Royalty expenses Rs. 15,28,77,527/-

(2) The other issue raised pertains to Corporate Tax issue. In this regard it has been urged that the Assessing Officer has erred in disallowing a sum of Rs. 36,69,882/- u/s. 40(a)(ia).

(3) Another issue raised is that Assessing Officer has erred in levying interest u/s. 234B and 234C of the Act.

The assessee company is engaged in the business of trading of footwear, apparel, accessories, sports equipments etc. and providing exports related consultancy services on behalf of group companies. It is a subsidiary company of M/s Reebok Mauritius Company Ltd. The international transaction entered into by the assessee company are as under:–

S.No.	**Nature of transaction**	**Method used by assessee**	**Amount**
1	Import of apparels and footwear for resale.	RPM	34,75,63,922/-
2	Royalty	CUP	15,28,77,527/-
3	Identification of factories in India for sourcing/exporting the goods.	TNMM	73,87,878/-
4	Reimbursement of advertisement and other expenses.	No benchmarking	44,67,273/-
	Total		**51,22,96,600/-**

3. TPO considered the above transactions. TPO proposed an upward adjustment of Rs. 51,82,80,551/- to the income of the assessee being the difference between the arm's length price of reimbursement of AMP expenses and the reimbursement expenses received by the assessee from Associated Enterprises(AEs). Assessing Officer further made an upward adjustment of Rs. 15,28,77,527/- to be made on account of payment of royalty. Accordingly, the TPO recommended the addition of Rs. 66,11,58,078 for A.Y. 2008-09.

4. Against the above, assessee made the objections before the DRP. The DRP in principle affirmed the action of the TPO. However, the TPO has charged markup of 15% on AMP expenses. The DRP held that it should be 12.5%. Pursuant to the directions of the DRP, Assessing Officer modified the total upward adjustment in international transactions. The total adjustment came to AMP Rs. 49,72,06,126/- + royalty of Rs. 15,28,77,527/- = 65,00,83,653/-.

5. In the background of the aforesaid, we adjudicate the issues as under:–

I. Transfer Pricing Adjustment of Rs. 49,72,06,126/ 49,72,06,126/- on account of advertisement and marketing expenses (AMP expenses)

5.1 The assessee during the relevant previous year incurred the following expenses for the purpose of its business:–

Particulars	Amount (Rs.)
Advertisement & Publicity	39,01,24,915/-
Selling and distribution	16,61,12,065/-
Total	**55,62,36,980/-**

5.2 The Transfer Pricing Officer (TPO) has undertaken benchmarking analysis of the above Advertisement, Marketing and Publicity expenses (AMP) incurred by the appellant applying bright line test and held that any expenditure in excess of the bright line is for promotion of the brand / trade name (which is owned by the AE) that needs to be suitably compensated by the AE. The TPO, for applying bright line test, accordingly compared AMP expenditure of 12.33% (as a percentage of total turnover) incurred by the appellant with average AMP expenditure of 2.51% of the following comparable companies:

S.No.	Name of the comparable companies	AMP/Sales
1.	Bhartiya Global Marketing Ltd.	2.15%
2.	Globus Stores Pvt. Ltd.	4.66%
3.	Pokarna Fashions Ltd.	1.49%
4.	Snowhite Apparels Ltd.	1.72%
	Average	**2.51%**

5.3 The TPO held that, since AMP expenses incurred by the appellant as percentage of sales was more than similar percentage for comparable companies, the assessee had incurred both routine and non routine advertisement and marketing expenditure on brand promotion and development of marketing intangible for the AE. The TPO further charged mark up of 15% and accordingly proposed an adjustment of Rs. 50,82,80,551/- on account of the alleged brand building activity undertaken by the assessee for the AE. The DRP directed the Assessing Officer to reduce the mark up to 12.50% and accordingly reduced the adjustment to Rs. 49,72,06,126/-.

6. Now the assessee is in appeal before us. We have heard the rival contentions and perused the records.

7. We find that a Special Bench of the Tribunal was constituted by the President, in the case of *LG Electronics India Pvt. Ltd. Noida vs. ACIT*, Circle-3, Noida bearing I.T.A. No. 5140/Del/2011 to decide as to whether the Assessing Officer /TPO was justified in making transfer

pricing adjustment in relation to advertisement, marketing and promotion expenses incurred by the assessee. The appellant had also intervened before the Special Bench.

7.1 The Special Bench has recently pronounced its decision vide order dated 15.1.2013. The Special Bench has in principle held that benchmarking of AMP expenses, being an international transaction was permissible under the TP regulations. The matter has been sent back to the TPO to readjudicate the ALP in the light of the factors enumerated in para 17.4 of the majority judgement. We find that this Tribunal in I.T.A. No. 4602/Del/2010 & Ors. in the case of *Cannon India Pvt. Ltd. vs. DCIT* vide order dated 03.05.2013 has considered the impact of aforesaid Special Bench decision and held as under:–

> *"7. We have heard rival contentions made on behalf of the parties and gone through the relevant material available on record.*
>
> *7.1. First of all we will take up the legal issues as raised in the grounds of appeal regarding the retrospective applicability of sec. 92CA(2B) to the years in question in the case of the assessee as also the powers of assessing officer to make such reference and the powers of TPO to furnish report in this behalf and all other related issues. The Special Bench in the case of LG Electronics India (supra) adjudicated such issues as is evident in para 6 of the order:*
>
> *"6. Though both the questions referred to this special bench are inter-linked, still we are taking up question no. 1 first. The ld. Counsel for the assessee ahs assailed the impugned order on various legal and factual issues. In so far as the first question is concerned, we have divided such submissions into seven broader parts for the sake of convenience, which will be dealt with one by one.*
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> *I. JURISDICTION OF TPO*
>
> *II. RULE 29*
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> *III. TRANSACTION*
>
> *IV. INTERNATIONAL TRANSACTION*
>
> *V. COST/ VALUE OF TRANSACTION*
>
> *VI. METHODS FOR DETERMINATION OF ALP OF INTERNATIONAL TRANSACTION*
>
> *VII. MARUTI SUZUKI'S CASE"*
>
> *7.2. In the wake of these criterias the Special Bench proceeded to decide various issues by a very lengthy order, which is conveniently reproduced for the sake of brevity. The issue of retrospective application, jurisdiction, AO/TPO's powers etc. etc.*

have been decided in favour of revenue and against the assessee in L.G. Electronics India Pvt. Ltd. by following observations:

"7.19. Here it is relevant to note that the Finance Act, 2012 introduced sub-sec. (2C) along with sub-sec. (2B) of section 92CA. Whereas sub-section (2B) has been made retrospectively applicable from 1.6.2002, sub-section (2C) has been given effect from 1-7-2012. The reason is obvious when we see the contents of both the provisions. Under sub-section (2C), the power of the AO to make assessment or reassessment U/S 147 or pass order U/S 154 to enhance the assessment completed before 1-7-2012, has been curtailed to the extent the subject matter is covered by sub-section (2B). It shows that abundant caution has been taken by the legislature in not disturbing the finality of the assessment due to retrospective operation of subsection (2B) in cases set out in subsection (2C). The acceptance of the contention of the ld. AR to consider subsection (2B) as prospective, would not only make sub-section (2B) but subsection (2C) also as dormant and nonexistent. Obviously an interpretation which makes a valid piece of legislation as redundant, does not merit acceptance. The purpose intended to be achieved in validating the jurisdiction of the TPO on the earlier transactions not referred to him by the AO on one hand and also not disturbing the finality of assessments already. completed on the other, has been properly achieved by the respective dates from which subsections (2A), (2B) and (2C) have been given effect to.

7.20. The Id. counsel for the appellant also contended that if sub- section (2B) is considered as retrospective in operation, then all other sub-sections of sec. 92CA will loose the worth of their existence. This argument was developed to contend that if the TPO is to be permitted to determine ALP in respect of any transaction, then sub- sec. (1) requiring reference to him by the AO, will be rendered useless. In our considered opinion, this contention misses the wood from the tree. The jurisdiction of the TPO is activate only when the AO makes reference to him under sub-section (1) for determining ALP in respect of certain transactions. Sub-sees, (2A) and (2B) come into play only when sub-sec. (1) has already been set into motion. Thus, it is only when the AO makes a reference to the TPO in terms of sub-sec. (1) for determination of ALP in respect of the referred international .transactions, that the TPO gets power under sub-sections (2A) and (2B) to determine ALP *in respect of non-referred international transactions as well. In the absence of any such reference under sub-section (1), the TPO cannot suo motu undertake the determination of ALP in respect of other international transactions not referred to him. It is a different matter that the reference by the AO may be for one international transaction and the TPO while determining . ALP in respect of that one international transaction, also comes across certain. other international transactions requiring determination of ALP. Thus, reference by the AO to the TPO for at least one international transaction is a necessary stipulation to assume power for determining ALP in respect of other transactions.*

7.21. Another point urged by the ld. Counsel for the appellant was that sub-sec. (I) requires making a reference by the AO with the previous approval of the Commissioner. It was contended that insofar as suo motu exercise of power by the TPO on other international transactions is concerned, the requirement of seeking approval from the CIT will be lacking, rendering the assumption of jurisdiction by the TPO over such other international transactions as invalid. Here again we find ourselves in respectful disagreement with the submission. What sub-sec. (1) requires is that the AO should seek previous approval of the Commissioner in respect of the transactions for which he is making reference to the TPO. There is no requirement of previous approval of the Commissioner in respect of the international transactions which come to the notice of the TPO during the course of proceedings before him. The prerequisite of seeking approval of the Commissioner is incorporated in sub-sec. (1) alone and the same cannot be read into sub-secs. (2A) and (2B) by the doctrine of incorporation. Our view is fortified by the judgment of the Hon'ble Supreme Court in the case of CIT Vs. Pawan Kumar Laddha [(2010) 324ITR 324 (SC)).

7.22. Now we take up the contention raised by the Id. counsel for some of the interveners on harmoniously interpreting sub-section (2B) by limiting its scope only to such transactions which the assessee perceives as international transactions but fails to report. We are not convinced with such interpretation. A line of distinction sought to be drawn by. the ld. counsel between two types of international transactions for which the assessee has not furnished audit report, viz., which is an international transaction as. per assessee's version and which is not so, has no statutory *sanction. There is no such cue, even remotely, in the language of sub-sec. (2B). The reference to international transaction in sub-sec. (2B), for which the assessee has not furnished report u/s 92E is unqualified. If we interpret sub-sec. (2B) in the way suggested by the Id. AR, it would amount to doing violence to the unambiguous language of the provision by importing certain words in it, which is obviously impermissible; The primary rule is that of strict or literal interpretation, as per which a provision should be read as it is unless manifestly absurd results follow from such interpretation.*

7.23. We are equally conscious of the rule of harmonious construction as reiterated in Sultana Begum (supra). Principle 3 in para 15 of the judgment is that "it is to be borne in mind by all the courts all the times that when there are two conflicting provisions in an Act which cannot be reconciled with each other, it should be interpreted as if possible, effect should be given to both". In our considered opinion, the rule of harmonious construction can be applied instantly by excluding the cases in which the assessee has not furnished report in respect of international transactions, whether or not it is an international transaction as per the assessee's view point, from the ambit of sub-sec. (2A) and including them in sub-section (2B) of section 92CA. It is relevant to note that sub-sec. (2A) is a general provision on the issue of the TPO suo motu taking up an international transaction not referred by the AO, whereas sub-sec. (2B) is a special provision limited in its scope only to such international transactions in respect of which the assessee did not furnish report u/s 92E. We have thoroughly discussed elsewhere in this order that when there is special provision governing a particular types of cases, then such cases stand excluded from the general provision governing all the cases. As such we are of the considered opinion that the scope of subsec. (2B) covers all types of international transactions in respect of which the assessee has not furnished report, whether or not these are international transactions as per the assessee's version. The contention of the ld. Counsel in this regard is thus sans merits and is hereby rejected. We want to clarify that the above discussion has been made only to deal with the contention raised on behalf of some of the interveners. But for that, it is only academic in so far as we are concerned with the present appeal involving the A.Y. 2007-08, which is a period anterior to A.Y. 2012-13. The extant case is fully and directly covered under sub-

> *section (2B) of section 92CA. In that view of the matter, it becomes evident that no fault can be found with the jurisdiction of the TPO to process the transaction under reference."*

……….

> *14.21. Thus it is palpable that all the three necessary ingredients as culled out from a bare reading of section 92B are fully satisfied in the present case. There is a transaction of creating and improving marketing intangibles by the assessee for and on behalf of its foreign AE; the foreign AE is non-resident; such transaction is in the nature of provision of service. Resultantly, we hold that the Revenue authorities were fully justified in treating the transaction of brand building an international transaction in the facts and circumstances of the present case."*

7.2 Since it is a lengthy order, it will not be desirable to reproduce extensively as the order can be referred independently. The glimpses of the observations and conclusions of Special Bench may be found at various other places also, but we have tried to secure the gist of the conclusions as best possible as above.

7.3 Further the Hon'ble Delhi Bench of the Tribunal in the above case of *Canon India Pvt. Ltd. vs. DCIT* (I.T.A. No. 4602/Del/2010) while remitting the matter, directed the TPO to exclude expenses incurred on trade discount, volume rebate, cash discount, commission etc.

7.4 Further, the Chandigarh Bench of the Tribunal in the case of *GlaxoSmithkline Consumer Healthcare India Ltd. vs. Addl. C.I.T.* (I.T.A. No. 1148/Chd/2011) following the decision of the Special Bench in the case of *LG Electronics India Pvt. Ltd. vs. ACIT* (I.T.A. No. 5140/Del/2011), while remanding the matter, directed the TPO to exclude selling expenses such as discount, sales promotion expenses etc.

8. In light of the aforesaid, it has been submitted by the ld. Counsel of the assessee that the assessee in this case has incurred expenditure aggregating to Rs. 16,61,12,066/- being expenses incurred in connection with the sale, which do not lead to brand promotion. The break up of the expenses are as under:–

S.No.	**Nature of expenses**	**Amount (Rs.)**
1	Commission on sales	15,852,692
2	Common area Maint. Charges	385,206
3	Discount to customers on cash down payment.	566,030
4	Official meetings.	1,346,832
5	Rate/ margin difference credit notes.	3,368,491

6	Sales scheme credit notes.	45,711,507
7	Sales staff business expense	1,811,849
8	Store brokerage charges	1,646,169
9	Store expenses	2,850,634
10	Store Registration Charges	1,895,050
11	Tax reimbursement credit notes	3,493,251
12	VAT paid on purchases	2,960,787
13	Sample courier charges	11,064,039
14	Gym charges	355,988
15	Sample expenses for manufacture, suppliers and trade shows.	23,396,979
16	Export forwarding and clearing expenses	3,569,537
17	Misc. Expenses	3,960,471
18	Sales incentive expenses	2,869,355
19	Warehouse running and maintenance expenses	28,795,393
20	IITTF trade fair stall expenses	1,810,963
21	Store general Merchandising	8,400,943
	Total	166,12,066

8.1 Furthermore, it has been submitted that after excluding the aforesaid expenses aggregating Rs. 166,112,066/- the remaining expenses of Rs. 39,01,24,915/- only is required to be considered for the purpose of benchmarking analysis as undertaken by the TPO.

9. Departmental Representative on the other hand submitted that in view of the Special Bench decision in the case of LG Electronics Ltd. (Supra) the entire AMP expenses should be sent to the file of the TPO to consider the same afresh, in light of the Special Bench decision in LG Electronics Ltd. case (supra).

10. Upon careful consideration, we find that the Special Bench decision has been considered by the other benches of the tribunal as mentioned above and it has been deduced that the selling expenses do not lead to brad promotion and the selling expenses have to be excluded from the AMP expenses for the purpose of bench marking analysis.

11. Accordingly, we remit the issue of AMP expenses to the files of the TPO with the following directions:–

i) Expenditure in connection with the sales as mentioned above cannot be brought within the ambit of advertisement, marketing and promotions expense for determining the cost/value of the international transactions. However, the TPO shall examine the veracity of description and quantification of the amount of selling expenses and accordingly, allow the assessee's claim.

ii) After deducting the selling price from the AMP expenses as mentioned above, the TPO shall decide the issue of AMP expenses by applying the proper comparables after hearing the assessee and keeping in view the Special Bench directions in this behalf.

12. **II. Apropos adjustment on account of royalty expenses: expenses:–**

In this case TPO noted that assessee has made the payment of royalty amounting to Rs. 15,28,77,527/- to the Associated Enterprises. In the transfer pricing report, the transfer of royalty was benchmarked using the CUP method as the most appropriate method. TPO further noted that in the Transfer Pricing Report assessee had submitted that under the FEMA Rules, Indian companies are permitted to remit royalty to their foreign technical corroborators upto 5% on domestic sales and 8% export under the automatic route. However the Indian companies are required to obtain prior approval of Reserve Bank of India in this regard. It was further submitted in the Transfer Pricing Report that any proposal for payment of royalty above the limits specified needed to obtain prior approval from the Secretariat of Industrial Assistance (SIA), Ministry of Industry and Commerce, Government of India.

12.1 TPO further noted that assessee has referred to the Website of SIA to identify comparable royalty rates for the royalty payment by Reebok India Company (RIC) to its AE. The assessee took SIERRA Industrial Enterprises Pvt. Ltd. making royalty payment to Nike International Ltd. USA and rate of 5% as valid CUP.

12.2 Assessee further contended that the royalty payment @ 5% on domestic sales has been paid as a consideration for technology received by RIC from RIL UK and has obtained approval of SIA for payment of royalty.

12.3 TPO noted that assessee has not furnished any cost benefit analysis, as required. In this regard TPO noted that assessee has submitted that assessee was not in a position to comment on ongoing industry rate of royalty for similar technology paid by the other independent companies in India, since, the information is not available in public domain.

12.4 TPO considered the above and observed that the approval given by the Government for payment of royalty did not automatically determine the arms length nature of transactions. In this regard, the TPO referred to the decision of the *Coca Cola India Inc. vs. ACIT* (2108-TIOL-658-HC–P&H-ITAT) by the Punjab & High Court, *Perot Systems TSI (India) Ltd. vs. Ld. Commissioner of Income Tax (A)* (2010-TIOL-51-

ITAT-DEL) by the ITAT, Delhi and also in the case of *Cabot India Ltd.* (2011-TII-58-ITAT-MUM-TP).

12.5 In view of the above TPO held that the approval of the Ministry of Commerce, Department of Industrial Policy and Promotion cannot be treated as a valid CUP as required by Rule 10B(1((a) of the I.T. Rules. He, therefore, rejected the contentions of the assessee.

12.6 TPO further noted that assessee was asked to furnish the information as to the cost benefit analysis with regard to the payment of royalty. TPO noted that no such cost benefit analysis was carried out by the assessee. TPO noted that assessee has referred that royalty is being paid for technology. As per Clause 1 of the Technology License Agreement dated 01.10.2002 between Reebok International Ltd. and Reebok India Company, the assessee has been provided data, documentation, drawings and specifications relating to inventions, designs, formulae, process and similar property, referred to as 'know-how. Clause 2 of the same agreement, grants the assessee non exclusive, non transferable right to utilize the technology in the manufacture and distribution of Reebok Products in India.

12.7 Referring to the above, the TPO observed that the technology should have helped the assessee in earning better margins. However, the TPO noted that it is not reflected in the margin of the assessee over the past three years, inspite of growth in sales. TPO further referred to the following analysis of the profitability of the assessee in the past three years:–

F.Y.s.	**2005-06**	**2006-07**	**2007-08**
Sales (WSP)	252.5	366.2	451.23
Royalty	6.82	9.62	15.29
Net Profit	17.76	32.81	33.34
Net Profit/Sales	7.03%	8.96%	7.4%

12.8 On the basis of the above, Assessing Officer did not accept the contention of the assessee that superiority of technology received by the assessee on payment of royalty was giving commercial benefits. TPO opined that payment of royalty by the assessee to the AE did not bring any commensurate benefit. TPO further observed that in an arms length situation, no independent enterprise would make payment for royalty for technology which is not contributing to its profitability.

12.9 TPO referred to the assessee's submissions that it was not in a position to comment ongoing industry rate of royalty for similar technology paid by the other independent company in India. Since the information is not comparable in public domain. In this regard, TPO referred to the decision of *UCB India Pvt. Ltd.* 317 ITR (AT) 292 (Mum) that it is for the parent company to provide necessary information to help the subsidiary, if it does not then it is not for revenue to conclude in subsidiary's favour. Hence, TPO opined that this was a covert act on the part of the assessee not to furnish this information.

12.10 TPO further noted that even after paying Rs. 15.29 crores towards royalty for the technology transferred by the AE, the margin earned by the taxpayer is only 7.38% on sales, which is much lesser than the margin of the company in the previous year at 8.96%. He opined that the taxpayer did not get any tangible commercial benefit in terms of improved profitability even after paying for technology know-how. The TPO concluded as under:–

> *"In view of the above facts and discussions I have reached following conclusions:–*
>
> - *The taxpayer did not produce any evidence/documentation on how the royalty rate has been fixed. At an arm's length, party receiving technology would like to see the profitability from future revenue streams before fixing a royalty rate.*
> - *The tax payer did not produce any cost benefit analysis at the time of entering into the agreement with its AE showing that the royalty rate is not fixed based on expected benefit.*
> - *There is no proof that the other group concerns or third parties are also charged identical royalty.*
> - *The taxpayer has also not been able to show that it derived any economic benefit from the alleged know how received from the AE.*
> - *The profit that accrues to the licensee may not arise solely through the engine of the technology. There are returns from intangible assets such as distribution systems, trained workforce, etc. Allowances need to be made for them. In the absence of any data provided by the taxpayer, it is impossible to know what percentage of profits the licensee would like to share at an arm's length after removing the returns from assets employed and other economic factors which may not arise solely through the engine of the technology.*
> - *The tax payer did not give the details of royalty rates in the industry.*
>
> *In view of the detailed discussions in the preceding paragraphs the arm's length price of royalty is determined at Rs. NIL in place of Rs. 15,28,77,527/-. The amount of Rs. 15,28,77,527/- is treated as adjustments u/s. 92C as the value of royalty transactions in uncontrolled conditions is treated as Rs. NIL under CUP and in the absence of any substantiation to show that substantial benefit has accrued to the taxpayer."*

12.11 Assessee filed the objections in this regard before the DRP. The DRP affirmed the action of the TPO.

13. Now the assessee is in appeal before us.

14. We have heard the rival contentions in light of the material produced and precedent relied upon.

14.1 Assessee's submissions in this regard are as follows:–

> "The appellant gets the goods manufactured on the basis of technical know – how and designs provided by the associated enterprises. In consideration of provision of such technology and know-how, the appellant pays royalty @ 5% of sales. The appellant has applied CUP method in the Transfer Pricing documentation to benchmark the aforesaid international transaction by comparing the royalty @ 5% paid by it to the AE with royalty @ 6% received by the AE from an independent third party, viz., Reebok South Africa Pty Ltd.
>
> The appellant also furnished the following comparable instances before the DRP to benchmark royalty:
>
> (i) Instances of royalty paid by third party licensees/ distributors
>
> (ii) Agreement between Double D'Import S.A.R.I (France) with Adidas International for payment of royalty @ 12%
>
> (iii) Agreement of sportsvision with Adidas international for payment of royalty @ 10%
>
> (iv) Agreement of Molten Corporation Japan with Adidas International Marketing BV for payment of royalty @ 12%
>
> The TPO/DRP, however, held that since the profits of the appellant for the current year at 7.38% of sales were lower than profits of the previous year at 8.96% of sales, no tangible benefits had been derived by the appellant from the technological know how provided by the associated enterprises. The TPO held that since substantial benefit had not been derived by the appellant from payment of royalty, the ALP of transaction of payment of royalty was determined at Nil applying CUP method.
>
> The adjustment made by the TPO is not sustainable for the following reasons:
>
> **(i) <u>Benefits derived by the appellant</u>**
>
> The appellant gets the goods manufactured on the basis of technical know – how and designs provided by the associated enterprises. In consideration of provision of such technology and know-how, the assessee pays royalty @ 5% of sales.

It is respectfully submitted that the industry in which the appellant operates i.e. the premium sports apparel and footwear industry is highly competitive and in order to survive and grow profitably it is imperative for the appellant to continuously launch new and improved products in the market. The appellant, however, does not undertake any significant research and development activity on its own and solely depends upon the associated enterprise for provision of technology. A description of the technology provided by the associated enterprises is submitted as under:

a. The PUMP technology:

The PUMP technology is proprietary inflatable shoe technology that automatically provides the wearer with a custom fit. A pump chamber that is inflated with air from The Pump wraps around the foot and expands inward eliminating any gaps within the shoe. This uniform glove-like wrapping of the foot results in a customized fit and feel.

b. DMX technology:

The DMX technology provides cushioning using a heel-to-forefoot, active airflow system that delivers Cushioning when and where it is needed. Since the introduction multiple versions of DMX have been developed to meet the performance demands of various activities. In 2004, Reebok introduced its new DMX Micro technology, which provides low-profile cushioning using moving air in a system that does not "bottom-out" on impact. Another important development of DMX is the new DMX Shear which provides horizontal cushioning by allowing the heel of the shoe to move independently from the rest of the shoe, cushioning both vertically and horizontally.

c. 3D Ultralite technology:

The 3D Ultralite technology comprises the Company's proprietary material that allows midsole and outsole to be combined in a single, injection molded unit, into its performance footwear. 3D Ultralite provides a blend of lightweight, flexible and durable properties. It was recently expanded and improved with the introduction of a highly resilient injection EVA midsole version and a lightweight high abrasion3D Ultralite outsole. Reebok has patented various manufacturing methods used in the production of its footwear, e. g. a method of molding cross-linked foamed compositions or an apparatus and method for manufacturing a shoe upper. Other technology-related know-how is reflected in the documentation of the knowledge in certain key areas such as a bestpractice manual and guidelines for the design and production of performance shoes.

These new products are designed and developed largely in the US based R&D and product creation centre (Canton, USA) of the AE. The appellant regularly accesses these Tech Packages for use in local development and manufacturing processes for the footwear and apparel styles manufactured locally in India which are largely the adaptations of the globally developed styles. Hence, most of the intangibles developed overseas are represented unchanged (or in a modified version) in the styles that are manufactured by the appellant.

The aforesaid technology has been patented by the associated enterprise and therefore, cannot be used without the permission of the AE. The appellant therefore derives significant benefits in the form of growing revenue and profitability from the use of above technologies.

It would be appreciated that the entire business of the appellant depends upon the technology provided by the AE and without the license to use such technology, the appellant would not be able to continue its business.

This premium value of the products allows the appellant to increase sales and charge higher prices which leads to higher profitability. It would also be noted that during the relevant previous year the total revenue of the appellant increased to Rs. 451.97 crores from Rs. 360.95 crores in the preceding previous year registering a growth of 25.21%. The growth in the revenue of the appellant clearly demonstrates the benefits derived by the appellant from the use of technology.

It is respectfully submitted that the survival of the business of the appellant depends upon the technology provided by the associated enterprise and in the absence of the technology the appellant would not be able to undertake manufacturing of goods. The appellant has been able to profitably survive and grow in a competitive industry, where continuous innovation is a prerequisite, solely due to the technology provided by the associated enterprise.

The payment of royalty, therefore, it would be appreciated, is a consideration in terms of agreement with the associated enterprises for availing license to use their proprietary technology. In other words, the payment of royalty is necessary cost incurred for obtaining know-how for manufacture of products by the appellant.

The comparative profitability analysis over two years, done by the TPO, cannot lead to the inference that tangible benefit has not been derived by the appellant from the know-how provided by the AE, more so considering that similar payment of royalty has been accepted to be at arm's length in earlier years.

The profitability of the appellant can be lower due to various business reasons and lower profitability in the current year as compared to previous year cannot form the basis for arriving at a conclusion that no benefits were derived by the appellant. The profits during the current year were lower on account of substantial provision for bad debts, higher rent and increase in legal costs. Accordingly, the inference drawn by the TPO that no benefits were derived by the appellant from use of technology and know-how is not tenable.

It is further submitted, that the assessee is free to conduct business in the manner that assessee deems fit and the commercial or business expediency of incurring any expenditure is to be seen from the assessee's point of view. Attention in this regard is invited to the following decisions:

- *CIT vs. Malayalam Plantations Limited*: 53 ITR 140 (SC)
- *CIT v. Walchand & Co. etc.* (1967) 65 ITR 381
- *J K Woollen Manufacturers v. CIT*: 72 ITR 612(SC)
- *CIT v. Birla Cotton Spg. And Wvg. Mills Ltd.*: 82 ITR 166 (SC)
- *Madhav Prasad Jatia v. CIT U.P.*: 118 ITR 200 (SC)
- *S.A. Builders Ltd. vs. CIT*: 288 ITR 1 (SC)
- *CIT V. Bharti Televentures Ltd*: 331 ITR 502 (Del)
- *CIT vs. Padmani Packaging (P) Ltd.*: 155 Taxmann 268 (Del)
- *CIT v. Rockman Cycle Industries Ltd.*: 331 ITR 401 (P&H) (FB)
- *CIT vs. EKL Appliances Ltd.*: ITA No. 1068/2011 & 1070/2011 (Del HC)
- *CIT v. Dalmia Cement (P.) Ltd*: 254 ITR 377 (Del)
- *CIT vs. Dalmia Cement (B) Ltd.* (supra), (Del)

Reliance may be placed on the decision of *DCIT vs Ekla Appliances*: (2011-TII-37-ITAT-Del-TP) Wherein the Hon'ble Tribunal held that the TPO cannot challenge the judgment of the assessee as to the source from which the technology is to be obtained and at what cost etc. The Hon'ble Delhi High Court while upholding the decision of the Hon'ble Tribunal held that as long as an expense is incurred wholly and exclusively for the purpose of business, it is irrelevant as to whether such expenditure actually results in profit or not. The Hon'ble High Court held as under:

"21. The position emerging from the above decisions is that it is not necessary for the assessee to show that any legitimate expenditure incurred by him was also incurred out of necessity. It is also not necessary for the assessee to show that any expenditure incurred by him for the purpose of business carried on by him has actually resulted in profit or income either in the same year or in any of the subsequent years. The only condition is that the expenditure should have been incurred "wholly and exclusively" for the purpose of business and nothing more. It is this principle that inter alia finds expression in the OECD guidelines, in the paragraphs which we have quoted above.

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So long as the expenditure or payment has been demonstrated to have been incurred or laid out for the purposes of business, it is no concern of the TPO to disallow the same on any extraneous reasoning. As provided in the OECD guidelines, he is expected to examine the international transaction as he actually finds the same and then make suitable adjustment but a wholesale disallowance of the expenditure, particularly on the grounds which have been given by the TPO is not contemplated or authorised."

It is respectfully submitted that as long as an item of expenditure has been incurred wholly and exclusively for the purpose of business of the assessee, whether or not such expenditure actually benefits the assessee is an irrelevant consideration for the purpose of determination of ALP.

The Hon'ble Tribunal in the case of *M/s. Ericsson India Pvt. Ltd. vs. DCIT* (ITA No. 5141/Del/2011), too, following the law laid down by the Hon'ble jurisdictional High Court, held that "…………….. it would be wrong to hold that the expenditure should be disallowed only on the ground that these expenses were not required to be incurred by the assessee…………………….."

Further, in the case of Dresser Rand India Pvt Ltd vs Addl. CIT (ITA No 8753/Mum/2010) the Hon'ble Mumbai bench of the Tribunal held that benefits derived by the assessee is not a relevant criteria for determination of arm's length of an expenditure incurred by the assessee.

Further, in the case of LG Polymers India Pvt. Ltd vs Addl. CIT (ITA No 524/Vizag/2010), the Hon'ble Visakhapatnam Bench of the Tribunal held as under

"13. We agree with the views of the Learned A.R on this issue. As submitted by him, it is the prerogative of the assessee to

regulate its business affairs and it is not open for the department to question the same. Similar views have been expressed by the Hon'ble Supreme Court in the case of Dhanrajgiriji Raja Narasingirji, referred (Supra)"

Reliance in this regard is placed on the decision of Ahmadabad Bench of Tribunal in the case of *KHS Machinery (P) Ltd. vs. ITO* : 146 TTJ 692, wherein the Hon'ble Tribunal on the issue of disallowance made by the TPO of payment of royalty, has held as under;

"The assessee had not made the one-time payment but making the continuous payment to the know-how provider which has been accepted by the Department in the past. The assessee has been charging 5 per cent royalty on each and every transaction and therefore the said payment cannot be said to have been paid on the aggregate amount, as argued by learned CIT-Departmental Representative. The findings of the AO in considering the royalty charges as nil as ALP cannot be accepted since the AO in the present case has not brought on record, t5he ordinary profits which can be earned in such type of business. Therefore in our view the payment of royalty is not hit by the provisions of s. 92 of the Act and there is no reason to hold that the expenses should not be allowed under s. 37(1) of the Act, since the expenditure has been incurred by the assessee during the course of business and is having the nexus with the business of the assessee. Therefore the payment of royalty is a business expenditure which has been incurred wholly and exclusively for the purpose of business of the assessee and same is to be allowed in toto as a matter of commercial expediency. Therefore, the case laws relied upon by the learned CIT-Departmental Representative are of no benefit to the Revenue. The reasonableness of expenditure in the present circumstances and facts of case cannot be doubted and accordingly the AO is directed to allow the claim of the assessee and the order of learned CIT(A) is reversed. Thus, ground no. 3 of the assessee is allowed."

Further, recently in the case of SC Enviro Agro India Ltd vs DCIT (ITA No 2057 & 2058/Mum/2009) the Hon'ble Mumbai Bench of the Tribunal held that "*The TPO has to examine whether the price paid or amount paid was at arms length or not under the provisions of Transfer Pricing and its rules. The rule does not authorize the TPO to disallow any expenditure on the ground that it was not necessary or prudent for assessee to have incurred the same.*"

Further, the Hon'ble Delhi Bench of the Tribunal in the case of *AWB India Pvt Ltd vs Addl. CIT* (ITA No 4454/Del/2011) held as under:

> *"As also settled by judicial decisions (supra), the revenue authorities are not empowered to question the commercial wisdom of the assessee and it is entirely for the assessee to take such decisions as favour the advancement of the assessee's business."*

The assessee company had maintained the documentation as per requirement of section 92D read with Rule 10D of the Income-tax Rules in respect of international transaction entered into by the assessee during the relevant previous year. It is a matter of record that the assessee company is manufacturing sports apparel/footwear in India on the basis of technology provided by the AE in terms of the Technical Licence Agreement The adjustment made by the TPO, therefore, is unlawful and not sustainable and is liable to be dropped.

In view of the above, the payment of royalty by the assessee to its AE is entirely for business consideration and it is not justified to hold the arm's length price thereof as NIL.

(ii) <u>Payment of royalty permitted under automatic route by Reserve Bank of India</u>

The Reserve Bank of India accords approval to all industries for foreign technical collaboration, subject to, inter alia, payment of royalty upto 8 per cent on exports and 5 per cent on domestic sales including by wholly owned subsidiaries (WOS) to offshore parent companies is allowed under the automatic route without any restriction on the duration of royalty payments. Reference in this regard is invited to the Manual on FDI in India issued by the Ministry of Commerce and Industry, which states that the Reserve Bank of India accords automatic approval to the foreign technology collaboration agreement, irrespective to the extent of foreign equity in the shareholding, subject to the ceiling provided therein.

In view of the aforesaid, in our respectful submission, the payment of royalty made by the assessee being as per the industrial policy and the expenditure having been incurred wholly and exclusively for the business purpose and the same cannot be said to be not justified.

Reliance in this regard is placed on the decision of Mumbai Bench of Tribunal in the case of *ThyssenKrupp Industries India Ltd vs Addl CIT* (ITA No. 6460/Mum/2012), wherein the Hon'ble Tribunal held as under:

> *"It is in pursuance to the deemed approval by RBI under the automatic approval scheme that the assessee made payment of royalty and technical fee to its AE. It is relevant to note that such payment has been approved or deemed to have been*

approved by the RBI. When a payment is made after obtaining due approval from the RBI, how its ALP can be computed at 'Nil, is anybody's guess. The fact of approval of the payment by the RBI has been succinctly recorded by the TPO in his order as well. He still chose to propose adjustment in respect of full payment. In our considered opinion, when the rate of royalty payment and fee for drawings etc. has been approved or deemed to have been approved by the RBI, then such payment has to be considered at ALP. We, therefore, direct to delete addition of Rs.4.29 crore made by the A.O. in this regard."

Reliance in this regard is also placed on the decision of Delhi Bench of Tribunal in the case of *DCIT vs. Sona Okegawa Precision Forgings Limited* (ITA No. 5386/Del/2010), wherein the Hon'ble Tribunal while dealing with the disallowance of royalty expense made by the TPO, held as under:

"We have duly considered the rival contentions and gone through the record carefully. To our mind, there are two aspects. The first aspect is whether the royalty paid by the assessee @ 3% is excessive and not computed at arm's length price. We find that the assessee has placed on record copy of the letter dated 0.4.1993 written by the RBI, Exchange Control Department to M/s. Sona Steering System Ltd. wherein royalty @3% on domestic sales subject to taxes for a period of five years was allowed to be paid. There are similar other correspondence which have been placed on the paper book. Similarly, on page 51 of the paper book, a press note issued in 2003 issued by the Government of India, Ministry of Commerce & Industries, Department of Industrial Policy and Promotion has been placed. In this press release, royalty payment at 8% on export and 5% on domestic sales has been referred as a reasonable payment for processing the cases for approval. Thus, learned TPO failed to bring any material on the record which can suggests that payment of royalty @ 3% was excessive, one and not at arm's length price.

The similar issue has been upheld in the decision of the Delhi Bench of the Tribunal in the case of Abhishek Auto Industries Ltd. vs. Commissioner of Income Tax (ITA No 1433/Del/2009), where on the basis of the similar facts the Hon'ble Tribunal held as under:

"It is a s ettled proposition of the law that legally binding agreements between unrelated parties cannot be disregarded without assigning any cogent reasons thereto. In this case it has not been imputed that agreements were non genuine or sham, rather they are duly approved by RBI and other

regulatory agencies. It is also a settled proposition that commercial transactions are in the domain of businessman and Income Tax department cannot intervene in realm of intricacies of commercial expediencies involved in these agreements. In this case if the assessee had not entered into joint venture agreement with Takata, it would not have been able to make any sale whatsoever using the technology and raw material and the machines supplied by them. The very existence of this business in AE segment depended upon the joint venture agreement which has been duly approved by the Government of India in accordance with law."

It is respectfully submitted that for the aforesaid reason too, the adjustment made by the TPO is liable to be deleted.

(iii) <u>None of the prescribed methods applied by the TPO:</u>

The Transfer Pricing regulation in India provides for five methods, out of which one of the methods is to be applied as the most appropriate method to determine the arm's length price of the international transaction.

Under the Transfer Pricing regulations contained in sections 92 to 92F of the Act, the mandate of the TPO is to determine the arm's length price of the international transaction.

Section 92C(1) of the Income-tax Act provides five methods for determination of arm's length price of an 'international transaction'. The mandate of the TPO, it is respectfully submitted, is limited to application of any of the five prescribed methods as the most appropriate method.

The aforesaid has been clarified by the CBDT in Instruction No. 3 of 2003 dated 20-05-2003 as under:

"- - - In order to maintain uniformity of procedure and to ensure that work in this important area proceeds smoothly and effectively, the following guidelines are hereby issued:

(i) Reference to Transfer Pricing Officer (TPO): The power to determine arm's length price in an international transaction is contained in sub-section (3) of section 92C. However section 92CA provides that where the Assessing Officer considers it necessary or expedient so to do, he may refer the computation of arm's length price in relation to an international transaction to the TPO. Sub-section (3) of section 92CA provides that the ***TPO after taking into account the material available with him*** *shall, by an order in writing,* ***determine the arm's length price in accordance with sub-section (3) of section 92C****. Sub-section (4) of section 92CA provides that on receipt of the order of the TPO, the*

> *Assessing Officer shall proceed to compute the total income of the assessee having regard to the arm's length price determined by the TPO. Thus, whereas the determination of the arm's length price, - - - is required to be done by the TPO, - - - the computation of total income having regard to the arm's length price so determined by the TPO is required to be done by the Assessing Officer under sub-section (4) of section 92C read with sub-section (4) of section 92CA.*
>
> *(ii) Role of Transfer Pricing Officer: The role of the TPO begins after a reference is received from the Assessing Officer. In terms of section* ***92CA this role is limited to the determination of arm's length price in relation to the international transaction(s) referred to him by the Assessing Officer*** *- - - - - - The price has to be determined by any one of the methods stipulated in sub-section (1) of section 92C and by applying the most appropriate method referred to in sub-section (2) thereof.- - - -" (emphasis supplied)*

Reliance in this regard is placed on the decisions of the Hon'ble Delhi High Court in the case of *CIT vs. EKL Appliances Ltd* (ITA Nos.1068 & 1070/2011) wherein it was held as under:

> *"Rule 10B(1) says that for the purposes of Section 92C(2), the ALP shall be determined by any one of the five methods, which is found to be the most appropriate method, and goes on to lay down the manner of determination of the ALP under each method. The five methods recognized by the rule are (i) comparable uncontrolled price method (CUP), (ii) re-sale price method, (iii) cost plus method, (iv) profit split method and (v) transactional net marginal method (TNMM)."*

Reliance is also placed on the decision of Mumbai Bench of the Tribunal in the case of *CA Computer Associates Pvt. Ltd. vs. DCIT* (ITA Nos. 5420 and 5421/Mum/2006), wherein, while deleting the adjustment made by the TPO by holding payment of royalty to be unjustified, the Hon'ble Tribunal held as under:

> *"8. The manner in which the A.L.P. is to be determined by any of the method prescribed in Sec. 92C in provided in Rule 10B of the I.T. Rules, 2961. After examining the parameters prescribed in Rule 10B, it can be seen that bad debts written off cannot be factor to determine the arm's length price of any international transaction. In our opinion, the TPO has exceeded his limitation by following the method which is not authorized under the Act or rules. We, therefore, hold that the Arm's Length Price determined by the TPO and adopted by the Assessing Officer to the extent of royalty payable to the CA Inc Management, USA is not as per the procedure prescribed*

and same cannot be sustained. We, therefore, direct the Assessing Officer to adopt the Arm's Length Price of the royalty payable to CA Inc Management, USA as declared by the assessee in both the years." (emphasis supplied)

The aforesaid decision has also been affirmed by the Hon'ble High court.

Reliance in this regard is also placed on the decision of Mumbai Bench of Tribunal in the case of *Dresser-Rand India P. Ltd. vs. ACIT* (supra), wherein, the Hon'ble Tribunal has held as under:

"As it is an allocation of costs on the basis of actual costs and the fact of expenditure is not even in dispute, the dispute is confined to the basis on which cost allocations must take place, and since we find the basis of allocation of costs as reasonable, no interference is really called for. In any case, we have noted that the assessee has adopted TNMM as most appropriate method, and the revenue authorities have neither made an effort to show as to how this method is not appropriate to the facts of this case, nor shown as to which other prescribed method of ascertaining arm's length price of services received under CCA will be more appropriate to these facts. In view of these discussions, we hold that arm's length price adjustment of Rs 10,55,00,000 made towards sharing of costs under the cost contribution agreement was unwarranted, and we delete the same."

*** *** ***

"We have further noticed that the Transfer Pricing Officer has made several observations to the effect that, as evident from the analysis of financial performance, the assessee did not benefit, in terms of financial results, from these services. This analysis is also completely irrelevant, because whether a particular expense on services received actually benefits an assessee in monetary terms or not even a consideration for its being allowed as a deduction in computation of income, and, by no stretch of logic, it can have any role in determining arm's length price of that service. When evaluating the arm's length price of a service, it is wholly irrelevant as to whether the assessee benefits from it or not; the real question which is to be determined in such cases is whether the price of this service is what an independent enterprise would have paid for the same. Similarly, whether the AE gave the same services to the assessee in the preceding years without any consideration or not is also irrelevant. The AE may have given the same service on gratuitous basis in the earlier period, but that does not mean that arm's length price of these services is 'nil'. The

> *authorities below have been swayed by the considerations which are not at all relevant in the context of determining the arm's length price of the costs incurred by the assessee in cost contribution arrangement.*

Similarly, the Hon'ble Mumbai Bench of the Tribunal in the case of *Nimbus Communications Ltd vs ACIT* (ITA No 2361/Mum/2007), held adjustment made by the TPO for not charging interest on outstanding bills raised for services rendered to an associated enterprise, without applying any of the prescribed methods as not sustainable. The Hon'ble Tribunal in that case held as under:

> *"8. The TPO in this case has not followed the mandate of the Act. No method has been specified. Under these circumstances, the adjustment made on the basis of the Transfer Pricing Officer under section 92CA(3) of the Act cannot be sustained."(emphasis supplied)*

Reliance in this regard is also placed on the decision of the Hon'ble Delhi Bench of the Tribunal in the case of *Hero Motocorp Ltd vs Addl CIT* (ITA No 5130/Del/2010), wherein the Hon'ble Tribunal, while deleting a similar transfer pricing adjustment, held as under:

> *"Even otherwise, there is no basis or justification for the TPO for arriving at the conclusion that the arm's length price for model fee should have been only to the extent of 25% of the payment made towards model fee. The TPO has not given any basis or justification for his conclusion that only 25% of the model fee paid by the assessee would be the arm's length price. He has not applied any of the methods prescribed under Section 92C(1) of the IT Act for determining the arm's length price."*

Further, the Hon'ble Special Bench in the case of LG Electronics India Pvt Ltd (supra) held as under:

> *"As regards the contention that methods are tools for determining the ALP, we find that there no dispute the main purpose of Chapter X is to determine the ALP of an international transaction, but such determination can be done only by way of the methods specified by thestatute. When the legislature has specifically enshrined a provisionunder section 92C requiring the computation of ALP by any of the prescribed methods, it does not fall in the realm of the TPO or for that matter any other authority to breach such mandate and apply or direct to apply any other method. Going by the dictate of the provision as subsists under sub-*

> *section (1) of section 92C, there can be absolutely no doubt on adoption of any single method of those set out in section"*

Further, relying upon the decision of the Hon'ble Special Bench, the Mumbai Bench of the Tribunal in the case of *Kodak India Pvt Ltd vs ACIT* (ITA No 7349/Mum/2012) held as under:

> *"67. We cannot accept the arguments of the DR that the word any has been used in section 92C(1), which could give leeway to the TPO to ascribe to a non specific method. Word any, is founded on the suffix, "of the following methods being the most appropriate method". Therefore, the ambit of the word any in section 92C(1) has been restricted within the precinct of the five specific methods. This gathers strength from the fact that even in the Rules, relevant Rule 10B provides with the similar wordings.*
>
> *68. Taking into account the clear and unambiguous wordings of the provisions of the Income Tax Act and Rules and respectfully following the decision of the Special Bench in the case of LG (supra), we hold that even on this legal issue, the assessee succeeds.*
>
> *69. We also cannot agree with the DR that the issue be restored to the TPO because the methods, as prescribed by the legislature are mandatory, not directory. When mandatory provision is either superseded or ignored, it straightaway affects the jurisdiction. In the instant case, we have to mention that it was a case of suo moto reference to the TPO and it is the case of the revenue authorities, to import the provisions of Chapter X. In this circumstance, since the TPO did not adhere to the prescribed methods consciously, another innings to rectify the mistake cannot be allowed, as the TPO infringed the relevant provision of the Income Tax Act and Rules."*

In view of the aforesaid, it is respectfully submitted that the TPO on the one hand has rejected the CUP applied by the assessee which is based upon comparable uncontrolled agreements and on the other hand determined the ALP of the transaction at Nil allegedly applying the CUP method.

It is submitted that for application of CUP, availability of comparable uncontrolled transaction is a prerequisite. The TPO, however, determined the arm's length price on the basis of assumptions and surmises. In view of the aforesaid, it is respectfully submitted that the adjustment made by the TPO is liable to be deleted. Reliance in this regard is placed on the decisions of the Hon'ble Delhi Bench of the Tribunal in the case of *AWB India Pvt Ltd vs Addl CIT* (ITA No 4454/Del/2012). The Hon'ble Tribunal held as under:

> *"27. Further, the TPO applied the CUP method for benchmarking the international transaction pertaining to availing of management services, discarding the TNMM applied by the assessee. While doing so, as correctly pointed out, the TPO remained oblivious of the fact that Rule 10B(1)(a) of the Rules stipulates 'comparable' and 'uncontrolled transactions', both of which elements are absent herein. Only a general observation was made by the TPO, to the effect that no independent party would have made payment in uncontrolled circumstances. In 'CIT vs. EKL Appliances Ltd.', vide order dated 29-03-2012 passed in ITA Nos. 1068/2011 and 1070/2011 (copy placed on record), the Hon'ble Delhi High Court has, inter alia, observed that Rule 10B(1)(a) of the Rules does not authorize disallowance of any expenditure on the ground that it was not necessary or prudent fort the assessee to have incurred the same, or that in the view of the revenue, the expenditure was un-remunerative, or that in view of the continued losses suffered by the assessee in his business, he could have faired better, had he not incurred such expenditure; that these are irrelevant considerations for the purpose of Rule 10B; that it is for the assessee to decide whether or not to enter into the transaction; that though the quantum of expenditure can be examined by the TPO as per law, in judging the liability thereof as business expenditure, the TPO has no authority to disallow the entire expenditure or a par thereof on the ground that the assessee has suffered continuous losses; that the financial health of an assessee can never be a criterion to judge the allowability of an expenses; that so long as the expenditure or payment has been demonstrated to have been incurred or laid out for the purpose of business, it is no concern of the TPO to disallow the same on any extraneous reasoning; and that as provided in the OECD guidelines, the TPO is expected to examine the international transaction as he actually finds the same and then make suitable adjustment, but a wholesale disallowance of the expenditure, particularly on extraneous grounds, is neither contemplated, nor authorized."*

In view of the aforesaid cumulative reasons, adjustments on account of payment of royalty, made by the TPO, is unlawful, not sustainable and is liable to be deleted.

Payment of royalty has not been held to be a non-bona fide expenditure in the earlier years. Further, in the earlier years, TNMM has been accepted to be the most appropriate method for the purpose of benchmarking the international transaction of payment of royalty. In assessment year 2004-05, the Transfer Pricing Officer, applying TNMM, determined the arm's length price of international transaction of payment of royalty at Rs 3,12,29,088 as against the actual payment of Rs 4,42,11,041. However, the addition made by the TPO was deleted by the CIT(A).

Reliance in this regard is placed on the decision of the Hon'ble Mumabi Bench of the Tribunal in the case of *SC Enviro Agro India Ltd vs DCIT* (ITA No 704/Mum/2012) wherein the Hon'ble Tribunal held as under:

> *"Facts this year in which royalty has been paid based on the same agreement as in earlier are identical. Therefore, respectfully following the decision of the Tribunal in assessee's own case in assessment years 2003-04 and 2004-05 (supra), we set aside the order of CIT(A) and delete the addition made"*

14.2 Ld. Departmental Representative on the other hand submitted that the international transactions of payment of royalty should satisfy the benefit test. He argued that in this case the payment of royalty has not resulted in benefit to the assessee. He submitted that the benefit must be tangible and not passive. In this regard, Ld. Departmental Representative placed reliance upon the decision of the ITAT, Mumbai Bench in the case of *Deloittee Consulting India Pvt. Ltd. vs. DCIT* I.T.A. No. 579, 1272, 1273/Mum/2011; ITAT, Pune, Bench decision in the case of *Patni Computer Systems Ltd. vs. DCIT* in I.T.A. Nos. 426 & 1131/PN/06 and ITAT, Delhi Bench decision in the case of *Ericsson India Private Ltd. vs. DCIT* in I.T.A. No. 5141/Del/2011.

14.3 Assessee in the rejoinder has made the following submissions:–

> "It is submitted that the entire business of the appellant depends upon the technology provided by the AE and without the license to use such technology, the appellant would not be able to carry on its business. The specific technology obtained by the appellant pursuant to the technology license agreement has been explained at pages 8 to 9 of the submission dated 14.5.2013 placed before the Hon'ble Bench during the course of hearing. The payment of royalty, therefore, is the consideration paid to the associated enterprises for obtaining right and license to use their proprietary technology which is the foundation of the business of the appellant. In other words, the payment of royalty is necessary cost incurred for obtaining know-how for manufacture of products by the appellant. It is respectfully submitted that the survival of the business of the appellant depends upon the technology provided by the associated

enterprise and in the absence of the technology the appellant would not be able to undertake manufacturing of goods.

The appellant has been able to profitably survive and grow in a competitive industry, where continuous innovation is a prerequisite, solely due to the technology provided by the associated enterprise. This premium value of the products allows the appellant to increase sales and charge higher prices which leads to higher profitability.

It would also be noted that during the relevant previous year, total revenue of the appellant increased to Rs. 451.97 crores from Rs. 360.95 crores in the preceding previous year registering a growth of 25.21%. The growth in the revenue of the appellant clearly demonstrates the benefits derived by the appellant from the use of technology.

Reliance may be placed on the decision of *DCIT vs Ekla Appliances*: (2011-TII-37-ITAT-Del-TP) Wherein the Hon'ble Tribunal held that the TPO cannot challenge the judgment of the assessee as to the source from which the technology is to be obtained and at what cost etc. The Hon'ble Delhi High Court while upholding the decision of the Hon'ble Tribunal held "*so long as the expenditure or payment has been demonstrated to have been incurred or laid out for the purposes of business, it is no concern of the TPO to disallow the same on any extraneous reasoning*"

Further, in the case of *Dresser Rand India Pvt Ltd vs Addl. CIT* (ITA No 8753/Mum/2010) the Hon'ble Mumbai bench of the Tribunal held that benefits derived by the assessee is not a relevant criteria for determination of arm's length of an expenditure incurred by the assessee.

Further, recently in the case of *SC Enviro Agro India Ltd vs DCIT* (ITA No 2057 & 2058/Mum/2009) the Hon'ble Mumbai Bench of the Tribunal held that "*The TPO has to examine whether the price paid or amount paid was at arms length or not under the provisions of Transfer Pricing and its rules. The rule does not authorize the TPO to disallow any expenditure on the ground that it was not necessary or prudent for assessee to have incurred the same.*"

Reliance is also placed on the following decisions wherein it has been held that the TPO cannot make transfer pricing adjustment on the basis whether or not an expenditure benefits the assessee is not relevant for determination of ALP:

– *M/s. Ericsson India Pvt. Ltd. vs. DCIT* (ITA No. 5141/Del/2011)

– *Dresser Rand India Pvt Ltd vs Addl. CIT* (ITA No 8753/Mum/2010)
– *LG Polymers India Pvt. Ltd vs Addl. CIT* (ITA No 524/Vizag/2010)
– *KHS Machinery (P) Ltd. vs. ITO* : 146 TTJ 692
– *SC Enviro Agro India Ltd vs DCIT* (ITA No 2057 & 2058/Mum/2009)
– *AWB India Pvt Ltd vs Addl. CIT* (ITA No 4454/Del/2011)

The appellant applied CUP as the most appropriate method for determination of the arm's length price of the international transaction of payment of royalty by placing on record the following comparable uncontrolled benchmark:

i. Agreement between Double D'Import S.A.R.I (France) with Adidas International for payment of royalty @ 12%
ii. Agreement of sportsvision with Adidas international for payment of royalty @ 10%.
iii. Agreement of Molten Corporation Japan with Adidas International Marketing BV for payment of royalty @ 12%
iv. Agreement between Reebok International and Reebok South Africa Pty Ltd for payment of royalty @ 6%

The TPO, however, did not apply any method nor placed on record any material or evidence as per the requirement of section 92CA(3) of the Income-tax Act, 1961. The onus in this regard was entirely on TPO, which was not discharged. The decision of the Hon'ble Mumbai Bench of the Tribunal in the case of Deloitte Consulting replied upon by the TPO is distinguishable on the facts of the appellant's case. In that case, the assessee had not determined the arm's length price of the international transactions. Further, in that case, the assessee failed to demonstrate that any benefit was derived from the payment made to associated enterprise.

The Hon'ble Tribunal in the case of *M/s. Ericsson India Pvt. Ltd. vs. DCIT* (ITA No. 5141/Del/2011), too, following the law laid down by the Hon'ble jurisdictional High Court, held that "…………….. it would be wrong to hold that the expenditure should be disallowed only on the ground that these expenses were not required to be incurred by the assessee……………………..". Under the Transfer Pricing regulations, mandate of the TPO is to determine the arm's length price (or the reasonableness of the payment) by applying any of the prescribed methods. Determination of the reasonableness of the expense is not left open to the subjective judgment of the TPO and the said decision also relied upon by the Ld DR in-fact supports the case of the appellant.

Further, the Hon'ble Pune bench of the Tribunal in the case of *Patni Computer Systems Limited vs. DCIT* (ITA No. 426/PN/2006), held that "in the present case, there is no material to show that any tangible and concrete benefit has accrued to the associated enterprises as a result of the expenditure incurred by the assessee in obtaining consultancy from Mckinsey & Company. Therefore, under these facts and circumstances, in our opinion, the order passed by the TPO on this aspect is based on no evidence and the same is liable to set aside qua the impugned adjustment". The decision of the Hon'ble Tribunal supports the case of the appellant and does not advance the case of the ld. DR. The Hon'ble Tribunal held that that no compensation is warranted if it is shown that no concrete and tangible benefit has accrued to the assessee. However, in the instant case, the appellant has demonstrated that it received significant benefits in the form of technical know-how and assistance in consideration of payment of royalty.

Payment of royalty has not been held to be a non-bona fide expenditure in the earlier years. Further, in the earlier years, TNMM has been accepted to be the most appropriate method for the purpose of benchmarking the international transaction of payment of royalty. In assessment year 2004-05, the Transfer Pricing Officer, applying TNMM, determined the arm's length price of international transaction of payment of royalty at Rs 3,12,29,088 as against the actual payment of Rs 4,42,11,041. However, the addition made by the TPO was deleted by the CIT(A).

Reliance in this regard is placed on the decision of the Hon'ble Mumabi Bench of the Tribunal in the case of *SC Enviro Agro India Ltd vs DCIT* (ITA No 704/Mum/2012) wherein the Hon'ble Tribunal held as under:

> *"Facts this year in which royalty has been paid based on the same agreement as in earlier are identical. Therefore, respectfully following the decision of the Tribunal in assessee's own case in assessment years 2003-04 and 2004-05 (supra), we set aside the order of CIT(A) and delete the addition made"*

14.4 Ld. Departmental Representative further submitted that the RBI approval is not conclusive for determination of arms' length price of international transactions. In this regard, Ld. Departmental Representative referred to the decisions of Perot Systems TSI (India) Ltd.

I.T.A. No. 2320/Del/2008; Nestle India Ltd. 337 ITR 103 (Del.) & SKOL Breweries, Mumbai.

14.5 In reply to the above arguments of the Ld. Departmental Representative, assessee's response was as under:–

> "It has been submitted that, since in the case of the appellant the concerned Ministry of the Government has scrutinized the payment of royalty and granted approval, the payment cannot be regarded as non bonafide. (ref **annexures I & II**) so as to hold the arm's length price thereof as Nil.
>
> In terms of rule 10B(2)(d) of the Rules Government order is to be taken into account for determining the arm's length price as per rule 10B(1). As such the Government approval would at least have a persuasive value.
>
> The decision in the case of Nestle India (supra) relied upon by the Ld DR relates to assessment years 1997-98 and 1998-99, when Transfer Pricing provisions were not on the Statute.
>
> Rule 10B(2)(d) providing for taking into account the laws in Government order in force for determining arm's length price as per rule 10B(1) of the Income-tax Rules did not come up for consideration before the Delhi High Court in the case of Nestle India and all other decisions, relied upon by the DR.
>
> ITAT in the case of Perot Systems (Supra), at paragraph 13 of the order observed that "RBI approval does not put a seal of approval on true character of the transaction from the perspective of Transfer Pricing. The Tribunal in that case did not held that Government approval is not to be taken into consideration for undertaking benchmarking analysis in terms of rule 10B(1) read with rule 10B(2)(d) of the Rules."
>
> The appellant also seeks to place reliance on the following decision, wherein similar international transactions of payment of royalty, pursuant to approval of the Government, has been held to be at arm's length and adjustment made by the TPO holding arm's length price to be NIL, was deleted:
>
> – *DCIT vs. Sona Okegawa Precision Forgings Limited* (ITA No. 5386/Del/2010)
>
> – *Hero Motocorp Limited vs Addl CIT* (ITA No 5130/Del/2010)
>
> – *ThyssenKrupp Industries India Ltd vs Addl CIT* (ITA No. 6460/Mum/2012)
>
> – *Abhishek Auto Industries Ltd. vs. Commissioner of Income Tax* (ITA No 1433/Del/2009)
>
> Further, in the case of SKOL Breweries relied upon by the Ld DR, the assessee justified the transaction of payment of royalty

solely on the basis of press note issued by the government of India without placing on record any comparable uncontrolled transaction. However, the appellant in the Transfer Pricing study and during the assessment proceedings has place on record the comparable uncontrolled transactions for benchmarking of international transactions of royalty."

14.6 We have carefully considered the submissions as above.

14.7 We find that in this case the assessee has made the payment of royalty amounting to Rs. 152877527/- to the AE. In the Transfer of Pricing Report the transfer of royalty was benchmarked using the CUP method as the most appropriate method. The TPO was of the opinion that there was no need of payment of any royalty to the AE in this regard. The TPO observed that approval of the Ministry of Commerce, Department of Industrial, Policy and Promotion can not be treated as a valid CUP as required by Rule 10B(1)(a) of the I.T. Rules. TPO has observed that the assessee was asked to furnish the information as to the cost benefit analysis with regard to the payment of royalty. TPO noted that no such cost benefit analysis was carried out by the Assessee. TPO has further referred that assessee has not submitted the comparable instances. TPO further noted that though there has been increase in the assessee's sales there has been decline in the net profit to sales ratio. On the basis ofabove, TPO did not accept the contention of the assessee that superiority of technology received by the assessee on payment of royalty was giving commercial benefits. TPO opined that payment of royalty by the assessee to the AE did not bring any commensurate benefit. TPO further observed that in an arms' length situation, no independent enterprise would make payment for royalty for technology which is not contributing to its profitability.

14.8 We find that as per Clause 1 of the Technology License Agreement dated 01.10.2002 between Reebok International ltd. and Reebok India Company, the assessee has been provided data, documentation, drawings and specifications relating to inventions, designs, formulae, process and similar property, referred to as know how. Clause 2 of the same agreement, grants the assessee non exclusive, non transferrable right to utilize the technology in the manufacture and distribution of Reebok Products in India. We find that assessee gets goods manufactured on the basis of technology technical know and designs provided by the AEs. In consideration of provision of technology and know how, the assessee pays royalty @ 5%. The industry in which the assessee operates i.e. the premium sports apparel and footwear industry is highly competitive and in order to survive and grow profitably it is imperative for the assessee to continuously launch new and improved products in the market.

14.9 Assessee does not undertake any significant research and development activity on its own and totally depends upon the associated enterprise for provision of technology. The new products are designed and developed largely in the US based Research and Development and product creation centre of the AE. The assessee regularly access this Tech Packages for use in local development and manufacturing processes for the footwear and apparel styles manufactured locally in India which is largely the adaptations of the globally developed styles. The aforesaid technology has been patently by the AEs and therefore, cannot be used with out the permission of the AE. Thus, we agree with the submissions of the assessee that entire business of the assessee depends upon the technology provided by the AE and without the license to use such technology, the assessee would not be able to continue this business.

14.10 Further the premium value of the product allows the assessee to increase the sales and charge higher price which the leads to higher profitability. It would also be noted that during the relevant previous year the total revenue of the assessee increased to Rs. 451.97 crores from Rs. 360.95 crores in the preceding previous year registering a growth of 25.21%. The growth in the revenue of the assessee clearly demonstrates the benefits derived by the assessee from the use of technology. In this regard, Assessing Officer has observed that since there is a fall in the net profit by sales ratio in the relevant previous year as compared to the preceding previous year. This ratio for financial year 2007-08 was 7.4% as against 8.96% in financial year 2006-07. On the strength of these figures Assessing Officer had made a bizarre conclusion that assessee was not deriving any commercial benefit from the payment of royalty and that payment of royalty by the assessee to the AE did not bring any commensurate benefit. In our considered opinion, on the facts and circumstances of the case, the above conclusion by the Assessing Officer is totally unsustainable. It has been clearly demonstrated that the very survival of the assessee in the industry depend upon the licence and technology & know how provided by the AE. There has been a considerable increase in the sales figures. The growth in the revenue of the assessee clearly demonstrates the benefits derived by the assessee from the use of technology.

14.11 In this regard, assessee's submission are note worthy that profitability of the assessee can be lower due to various business reasons and the lower profitability in the current year as compared to previous year cannot form the basis for arriving at a conclusion that no benefits were derived by the assessee. It has been submitted that the profit during the current year were lower on account of substantial provision of bad debt, high rent and increase in legal cost. These averments have not been disputed by the Revenue. Accordingly, the inference drawn by the TPO that no benefits were derived by the assessee for use of technology and technical know how is not tenable.

14.12 We further agree with the contention of the assessee that assessee is free to conduct business in the manner that assessee deems fit and the commercial and business expediency of incurring any expenditure is to be seen from the assessee's point of view. We find that it is a settled law that the Revenue cannot sit into the shoe of the assessee and decide what is prudent for the business. In this regard, we place reliance upon the decision of the Hon'ble Apex Court in the case of *CIT, Bombay Vs. Walchand and Co. Private Ltd.* in 65 ITR 381, wherein it was held that "*in applying the test of commercial expediency for determining whether an expenditure was wholly and exclusively for business, the expenditure has to be adjudged from the point of view of the businessman and not of revenue*".

14.13 We further note that it is on the basis of the same agreement the royalty was paid in earlier years. In earlier years the payment of royalty has not been held to be non-bonafide expenditure by the TPO. On these basis also the TPO's conclusion that there is no benefit to the assessee from the payment of royalty is unsustainable. In view of the foregoing discussions, we hold that payment of royalty in this case satisfies the benefit test. The benefit is undoubtedly tangible and it not passive as argued by the Ld. Departmental Representative.

14.14 Furthermore, assessee has duly submitted comparable instances to bench mark royalty as under:–

(i) Instances of royalty paid by third party licensees/ distributors

(ii) Agreement between Double D'Import S.A.R.I (France) with Adidas International for payment of royalty @ 12%

(iii) Agreement of sportsvision with Adidas international for payment of royalty @ 10%

(iv) Agreement of Molten Corporation Japan with Adidas International Marketing BV for payment of royalty @ 12%

14.15 Thus, the observation of the TPO that comparable instances were not given by the assessee does not hold water any more. We find that the case laws relied upon by the DR have been cogently rebutted in the assessee's submissions and rejoinder as above.

14.16 We further find that assessee has sought to justify the payment of the royalty on the basis that in the case of the assessee the concerned Ministry of Government Of India has scrutinized the payment of royalty and granted the approval, the payment cannot be regarded as non-bonafide so as to hold the arms length price thereof as NIL. In this regard, we agree that though it is not a conclusive proof, the above approval of the Government has to be given consideration while considering the arms length price of the transaction. Admittedly, in this case assessee has been granted due permission from the concerned Ministry of Government in this regard.

14.17 We are further in agreement with the ld. Counsel of the assessee that Rule 10B(1) states that for the purpose of section 92C(2) the arms length price shall be determined by one of the five methods which is found to be most appropriate method and goes on to lay down the manner of determination of the ALP under each method. The five methods recognized by the rule are (i) comparable uncontrolled price method (CUP), (ii) re-sale price method, (iii) cost plus method, (iv) profit split method and (v) transactional net marginal method (TNMM). The assessee has rightly considered the comparable uncontrolled price method for determining the arms length price. In this context, the conclusion of the TPO that the arms length price of the royalty payment should be NIL without specifying any cogent basis is not sustainable. The TPO's determination is on the basis of assumption and surmises. Hence, the adjustment made by the TPO is liable to be deleted.

15. In the background of the aforesaid discussion, we hold that the upward adjustment of Rs. 15,28,77,527/- on account of payment of royalty cannot be sustained. Accordingly, we hold that payment of royalty in this case was fully justified.

16. **III. Apropos issue of disallowance of a sum of Rs. 36,69,882/ 36,69,882/- u/s. 40(a)(ia).**

On this issue Assessing Officer noted that assessee company has debited various expenses on which TDS needs to be deducted as per provisions of Chapter XVII-B of the I.T. Act, 1961. Assessing Officer asked the assessee to make the reconciliation statement of expenses and TDS. Referring to the said reconciliation, Assessing Officer observed that there was a short deduction of Rs. 36,69,882/- In view of this non-deduction at source on the payment, Assessing Officer proposed to disallow the same u/s. 40(a)(ia) of the Act.

17. Before the DRP, assessee submitted that the payment in question was made to ICC and tax was deducted at source and paid to the Government. However, this entry was not reflected in the TDS return due to a dispute with ICC which had claimed that this tax was not deductible at source on the payment made to them. Accordingly, Assessee submitted that if the tax has been deducted at source and paid to the Government, then it cannot be a case of disallowance u/s. 40a(ia) merely on the ground that this amount was not shown in the TDS return filed by the assessee. Considering the above, DRP observed that in view of the factual position stated by the assessee that it was not a case on which disallowance was warranted. However, it directed the Assessing Officer to make the verification in this regard and if the assessee's submission were found correct, then the Assessing Officer was to allow the deduction of the amount in question.

18. Pursuant to the above directions of the DRP, Assessing Officer observed that the contention of the assessee was verified, in light of the directions of the DRP on the basis of material gathered and placed on record during the course of assessment proceedings by the then Assessing

Officer. It was observed that Assessing Officer has rightly made the addition. The Assessing Officer further observed that such amount is neither figuring in the TDS return of the company, nor is there available any proof of payment of the same in to government account. Hence, Assessing Officer held thata sum of Rs. 36,69,882/- was added back to the total income of the assessee.

19. Now the assessee is in appeal before us.

20. We have heard the rival contentions in light of the material produced and precedent relied upon.

20.1 Ld. Counsel of the assessee submitted that the assessee has duly deducted and paid tax at source from such payment to ICC which was duly deposited with the Government treasury on 28.9.2007. The payee, i.e. ICC, However, contended that tax was not liable to be deducted at source from such payment and that the assessee had wrongly deducted tax at source from the payment. Owing to dispute with ICC, the factum of deduction of tax at source was not reported in the TDS return.

20.2 Ld. Departmental Representative fairly agreed that if the tax had been deducted and paid to the Government account as claimed by the assessee, the disallowance in this regard, cannot be sustained.

20.3 Upon careful consideration, we find that DRP has duly directed the Assessing Officer to verify the assessee's submissions as to whether the payment in question was subject to the TDS and the TDS amount was paid to the government treasury or not. The Assessing Officer has not properly looked into the matter. Under the circumstances, we remit this issue to the files of the Assessing Officer. The Assessing Officer is directed to verify whether the assessee has deducted and paid tax at source from such payment to ICC which was claimed to be deposited with the Government treasury on 28.9.2007. If the aforesaid averments of the assessee are found correct, then there will be no case of disallowance in this regard. The contention of the Assessing Officer that the payment is not reflected in TDS return will not have any bearing on the allowability of the expenditure in this regard. Accordingly this issue stands remitted to the file of the Assessing Officer.

21. The last ground relating to interest u/s. 234B & 234C is consequential in nature.

22. In the result, this appeal filed by the assessee is allowed for statistical purposes.

Order pronounced in the Open Court on 14/6/2013.