



Agreement between taxpayer and its AE and proof that the AMP expenditure is not for the taxpayers business in India are prerequisite for treating the AMP expenditure as an international transaction

Background

The Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of L’Oreal India Private Limited¹ (the taxpayer) held that it is incumbent on the tax officer to prove that real intention of the taxpayer in incurring Advertisement Marketing and Promotion (AMP) expenditure is to benefit its Associated Enterprise (AE) and not for promoting its own business. In the absence of an agreement between the taxpayer and its AE, provisions of Chapter X cannot be invoked for the AMP transaction². The Tribunal also stated that there was no proof that the AE has benefitted from such AMP spend or that the taxpayers business has not benefitted. On the tax department’s request to remand the matter to the tax officer, the Tribunal, strongly coming down on the tax department, held that if the tax officer has not brought on record an agreement, formal or informal, between the taxpayer and its AE for AMP expenditure incurred by the taxpayer in India then the first and primary condition of treating the AMP transaction as an international transaction remains unfulfilled. Since the AMP transaction is not an international transaction, the matter ought not to be remanded back to the taxpayer.

¹ L’Oreal India Private Limited v. DCIT [ITA Nos. 7714, 1119, 976/Mum-2014 and 518, 335/Mum-2015]

² Tribunal relied on the decision of the Delhi High Court in Bausch & Lomb Eyecare (India) Pvt. Ltd (ITA No. 643 of 2014) for coming to this conclusion

Facts of the case

- The taxpayer is engaged in the business of manufacturing and distribution of cosmetics. During the transfer pricing assessment proceedings, the tax officer found all international transactions of the taxpayer to be at arm’s length, except one i.e. AMP expenditure.
- The tax officer for benchmarking the international transaction of AMP expenditure adopted Profit Split Method (PSM). He held that profits could be attributed to three major activities of taxpayer viz. manufacturing – 50 per cent, research and development – 15 per cent and AMP – 35 per cent. The tax officer computed that AMP expenditure incurred by the taxpayer were 0.63 per cent of the global AMP expenditure. Thus out of 35 per cent of the global profits, he attributed 0.63 per cent of the profits to the taxpayer which was INR348.44 crore. The tax officer observed that the taxpayer had declared a profit of INR42.90 crore, hence he allowed a deduction of INR15.01 crore (35 per cent of INR42.90 crore) and arrived at an adjustment of INR333.43 crore.

- Alternatively, the tax officer had also determined the Arm's Length Price (ALP) of AMP expenditure based on Bright Line Test (BLT) for the manufacturing segment and the distribution segment of the taxpayer. He computed an adjustment of INR98.43 crore for the manufacturing segment and INR43.83 crore for distribution segment based on Cost Plus Method (CPM). A total adjustment of INR142.26 crore was proposed by the TPO.
- The Dispute Resolution Panel (DRP) concurred with the findings of tax officer and did not provide any relief to the taxpayer. Aggrieved, the taxpayer appealed before the Tribunal.

Taxpayer's contentions

- The taxpayer contended that AMP expenditure incurred by it was not an international transaction for the following reasons:
 - Payment for AMP expenditure was made to third parties in India
 - There was no agreement between the taxpayer and the AEs in respect of AMP expenditure
 - AMP expenditure were incurred in the course of carrying on its business in India for promotion of its products in the Indian market
 - Tax officer had not brought any evidence on record to prove that there was an arrangement between the taxpayer and the AE
 - More so since the taxpayer had furnished a certificate from its AE showing that there was no arrangement between them on AMP expenditure.

- The taxpayer had relied on the decision of the Delhi High Court in Maruti Suzuki India Ltd.³, Honda Ciel Power Products⁴, and Whirlpool of India Ltd.⁵ for the proposition that AMP expenditure could not be termed as an international transaction in the absence of an agreement between the taxpayer and the AE.
- The taxpayer further contended that advertisements were for its own products and not for the brand of its AE. Such products were developed specifically for Indian markets as per the requirements and preferences of Indian people.
- The taxpayer also contended that it was an independent risk bearing entity, thus, it alone enjoyed the increased product sales as a result of AMP expenditure. Even if some benefits were derived by the AE, they were only incidental and ancillary.
- The taxpayer had also contended that the methods adopted by the tax officer were not correct. More so, the approach of the tax officer in arriving at two alternate ALP by adopting two different methods (PSM and CPM) was bad in law.

Tax department's contentions

- The tax department argued that Delhi High Court in the case of Sony Ericsson Mobile Communication India Private Limited⁶ had laid down certain broad principles on the issue of AMP. It referred to eight cases decided by the Delhi Tribunal wherein the issue of AMP expenditure was restored back to the file of the tax officer argued that in light of the judgment of Sony Ericsson.

³ Maruti Suzuki India Ltd. v. CIT [2015] 64 Taxmann.com 150 (Del)

⁴ Honda Ciel Power Products Ltd v. DCIT [2016] 64 Taxmann.com 328 (Del)

⁵ CIT v. Whirlpool of India Ltd.[2015] 64 Taxmann.com 324 (Del)

⁶ Sony Ericsson Mobile Communication India Private Limited v. CIT [2015] 231 Taxman 113 (Del)

- The tax department contended that the decision of the Delhi High Court in the case of Maruti Suzuki was dated 11 December 2015, thus available to tax officers only after that date. Prior to Maruti Suzuki's case tax officers used to compute ALP of AMP expenditure based on Tribunal's Special Bench decision in the case of LG Electronics⁷, which was partly upheld by the Delhi High Court in the case of Sony Ericsson. Thus, it was contended that the matter ought to be set aside to the file of the tax officer for a fresh examination of this issue.

Tribunal's ruling

- The Tribunal appreciated the argument of the taxpayer that AMP expenditure incurred by it was for products launched especially for the Indian market and that the brand of the AEs was not promoted. In coming to this conclusion, the Tribunal had taken cognisance of the taxpayer's growth in sales of 19 times since the year 1999. It held that AMP expenditure incurred by the taxpayer had played an important role in the rapid progress made by the taxpayer in Indian market.
- The Tribunal held that the tax officer's assumption that AMP expenditure incurred by the taxpayer would have benefitted AE who owned the brands used by the taxpayer, suffered from a basic flaw since it presumed that taxpayer would not incur AMP to promote its own business.
- The Tribunal held that the moot question that had to be answered in this case was whether in the absence of any agreement for payment of AMP expenditure it could be held that there was an international transaction. The answer was an emphatic 'no' in view of the decision of the Delhi High Court in the case of Maruti Suzuki, Whirlpool India, and Bausch & Lomb Eyecare (India) Pvt. Ltd.⁸.

- On the tax department's contention that the matter ought to be remanded to the file of the tax officer the Tribunal held that non-availability of a particular decision of the higher forum cannot justify the restoration of issues in each and every case. Unnecessary litigation has to be avoided, and issues have to be settled for once and all.
- The Tribunal held that in the absence of an agreement between the taxpayer and the AE on AMP expenditure, the first and primary precondition of treating the transaction in question an international transaction remained unsatisfied. Without crossing the first threshold, the second threshold of application of principles of Sony Ericsson could not be approached. Hence, when AMP expenditure itself was not an international transaction, the matter was not required to be restored to the file of the tax officer.

Our comments

This ruling is certainly an important step in transfer pricing jurisprudence especially when the concept of AMP adjustment has taken so many twists and turns. With the department not willing to relent on this issue even after the decision in Maruti Suzuki, this judgment is expected to provide further relief to the taxpayers from the second round of proceedings before the tax department.

⁷ LG Electronics v. ACIT [2013] 140 ITD 41 (Del)(SB)

⁸ Bausch & Lomb Eyecare (India) Pvt. Ltd (ITA No. 643 of 2014 of Delhi High Court)

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