

TRANSFER PRICING ADJUSTMENT - STATUS AND WAY FORWARD

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The issue of Advertising, Marketing and Promotion ("AMP") expenses is no longer res integra and has been dealt with by many high courts in India. The decisions of the high courts in various matters are now pending with the Supreme Court of India by way of Special Leave Petitions filed by Tax department as well as taxpayers.

At the core of these litigations, there are two principal issues under consideration:

(a) Whether there exists an international transaction of AMP when marketing expenses are being incurred by an Indian company?

(b) If the answer to the aforesaid question is in the affirmative, what is the method for benchmarking such international transaction and how?

In so far as the first issue is concerned, the Delhi High Court in the case of Sony Ericsson Mobile Communications vs. CIT dated 16.03.2015, reported in 374 ITR 118 (hereinafter referred to as the "Sony Ericsson") proceeded on the assumption that where the distributor incurs marketing expenses, there is bound to be an international transaction. This is the same analogy applied by the Tribunal in the Company's matter for the Assessment year 2010-11.

However, subsequent to the decision of the Delhi High Court in Sony Ericsson, the Delhi High Court, itself, in the cases of Maruti Suzuki India Ltd.,

reported in 381 ITR 117, Whirlpool of India Ltd vs. DCIT, reported in 381 ITR 154 and Bausch and Lomb Eyecare India Pvt. Ltd. vs. Addl. CIT, reported in 381 ITR 225 has categorically held that irrespective of marketing expenses being incurred by the Indian Company, the question whether there is an international transaction of AMP is a question of fact which needs to be specifically addressed by the Transfer Pricing Officer ("TPO") before proceeding with benchmarking any international transaction. The High Court has held that there should be some tangible evidence on record to demonstrate that there exists an international transaction in relation with incurring of AMP expenses for development of brand owned by foreign associated enterprises and in the absence of such transaction there is no question of undertaking any benchmarking of AMP expenses.

In so far as the second issue is concerned, at the threshold it must be stated that the Bright Line Test ("BLT") which has been proposed by the tax authorities has been unequivocally rejected by the High Court in successive judgments on the simple ground that BLT does not form part of the Indian Transfer Pricing Regulation, which are exhaustive and cannot be supplemented. This principle has not only been followed and applied in the cases relating to AMP, but otherwise also, the Delhi High Court in the case of Chryscapital Investment Advisors (India) Pvt. Ltd. vs. Dy. CIT reported in 376 ITR 183, held that the

Indian Transfer Pricing Regulation are exhaustive and cannot be supplemented by further OECD commentary or any other regulations.

The next aspect of this issue is the choice of method to be applied in case there does exist an international transaction of AMP. At the outset, it must be stated that choice of method is dependent on facts and circumstances of each case and this is the precise reason that why Delhi High Court in the case of Sony Ericsson held that it may not be proper to give authoritative ruling on what method to be applied in such cases. The High Court laid down various parameters for application of the Resale Price Method ("RPM"), the Transactional Net Margin Method ("TNMM") or the Comparable Uncontrolled Price ("CUP") method.

For distributors - without any value add, the proper method for benchmarking international transaction would be RPM, whereas TNMM might be a better option in practical sense due to lack of comparability options.

It is now to be seen how Supreme Court will deal with the aforesaid issues when the batch of matters come up for hearing. Either way - taxpayers will get some clarity and can plan their affairs accordingly. If the Supreme Court decides against taxpayers, there might be a surge in the Advance Pricing Agreements ("APA") between taxpayers and tax authorities.



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DMD Advocates is a leading full-service law firm with expertise in litigation, corporate, taxation, regulatory and intellectual property rights. The firm has a pan-India presence with principal offices in Delhi and Mumbai and associated offices in Bangalore, Chennai, Hyderabad, Cochin and Bhubaneswar.

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