INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH "I-2": NEW DELHI
BEFORE SHRI PRASHANT MAHARISHI, ACCOUNTANT MEMBER
AND
SHRI K.N.CHARY, JUDICIAL MEMBER

ITA No.6372/Del/2017
(Assessment Year: 2013-14)

M/s. Sony India Private Ltd, A-18, Mohan Cooperative Industrial Estate, Mathura Road, New Delhi PAN: AABCS1571Q	Vs.	Addl. CIT, Special Range-8, New Delhi
(Appellant)		(Respondent)

Assessee by :	Shri Nageswar Rao, Adv
Revenue by:	Shri H.K. Choudhary, CIT DR
Date of Hearing	09/01/2019
Date of pronouncement	08/03/2019

O R D E R

PER PRASHANT MAHARISHI, A. M.

1. This appeal is filed by the assessee against the order dated 15/09/2017 passed u/s 143 (3) read with section 144C of The Income Tax Act [The Act] by The Additional Commissioner Of Income Tax, Special Range – 8, New Delhi [The ld AO] . The only issue involved in this appeal is the transfer pricing adjustment in respect of international transactions for marketing and development of marketing services based on Bright line test approach on protective basis and transfer pricing adjustment in respect of import of finished goods on account of alleged additional advertisement, marketing and promotion related functions carried out by the appellant as per intensity method on substantive basis.

2. The assessee has raised the following grounds of appeal in ITA No. 6372/Del/2017 for the Assessment Year 2013-14:-

"1. That on the facts and circumstances of the case and in law, Ld. AO erred in assessing the income of the Appellant at INR 414,94,12,230/- as against the returned income of INR 183,50,33,230/-.

2. That on the facts and circumstances of the case and in law, the Final Assessment order passed under section 143(3) read with section 144C of the Income Tax Act, 1961 ("the Act") by the Ld. AO is bad in law as the same does not consider complete and relevant, facts, are not in accordance with provisions of law and principles of law as laid down by Hon'ble courts.

Transfer Pricing Adjustment in respect of Import of finished goods on account of alleged additional Advertisement, Marketing and Promotion related functions ("AMP functions") carried out by the Appellant

3. The Ld TPO/AO have erred in law and facts of the case by not analysing the transaction as entered into but re-writing the same on imaginary basis.

4. Without prejudice to all other grounds, the Ld. TPO/AO have erred in law and facts of the case by not considering Credit Note received by the Appellant against its purchases as an operating item and Hon'ble DRP has erred by giving ambiguous directions for the treatment, of Credit Note received by the Appellant.

5. Without prejudice to all other grounds, Hon'ble DRP has erred, in noting that two companies considered comparable by AO/TPO, i.e., Lava International Limited and Micromax Informatics Limited are not, brand owners and hence need to be deleted.

6. Without prejudice to all other grounds, the Ld. TPO/AO have erred in not giving complete effect to directions of the Hon'ble DRP thereby resulting in erroneous computation of demand arising from the substantive; adju.stment.

7. The Ld. TPO/AO and Hon'ble DRP have erred in law and circumstances of the case in concluding that Appellant is engaged in performing DEMPE function and such function alleged to be performed by the Appellant are adding value to the intangibles of ALL

8. *That on the facts and circumstances of the case and in law, the Ld. AO/ Ld. TPO/*

   Hon'ble DRP have erred in using intensity adjustment to adjust the net profit margin of comparable companies without appreciating that intensity adjustment in principle uses the same parameters which were being used for application of Bright Line Test ('BLT') which has already been held to be unlawful by the Delhi High Court in the case of multiple taxpayers.

9. *That on the facts and circumstances of the case arid in law. the Ld. AC)/ Ld. TPO/ Hon'ble DRP have erred in using intensity adjustment to adjust the net profit margin of comparable companies without appreciating that intensity adjustment is not required within Transactional Net Margin Method (TNMM).*

10. *That on the facts and circumstances of the case and in law and without prejudice to our other grounds, the Ld. AO/ Ld. TPC)/ Hon'ble DRP have failed to appreciate that no reliable adjustment can be made for difference in intensity of functions if any, in absence of adequate and accurate data avail able in public domain.*

11. *That on the facts and circumstances of the case and in law and without prejudice to our other grounds, the Ld. AO/ Ld. TPO/ Hon'ble DRP have failed to appreciate that intensity of functions is dependent on the actual conduct of the Appellant vs the comparable arid not the quantum of spend.*

12. *That on the facts and circumstances of the case and in law, the Ld. AO/ Ld. TPO/ Hon'ble DRP have erred in using intensity adjustment to adjust the net profit margin of comparable companies without appreciating that intensity adjustment leads to the assumption that Appellant has not earned any benefit in terms of sales/profit out of AMP expenses and in arm's length situation, it would have earned a 8.5% return on every extra AMP spend. This assumption was negated by Hon'ble Delhi High Court while rejecting BLT test.*

13. *Without prejudice to all other grounds, Ld TPO/AO erred in performing the intensity adjustment on all indirect expenses instead of considering the quantum of marketing related function and Hon'ble DRP erroneously upheld the approach of the Ld. TPO/AO.*

14. *The Ld. TPO/ AO have erred in law and circumstances of the case in concl uding that FAR of the comparables is not similar to the FAR of the Appellant and thus, intensity adjustment is required for a fair analysis and Hon'ble DRP erroneously upheld the approach of the Ld. TPO/AO.*

15. *Without prejudice to all other grounds the Ld. AO/TPO erred in making inappropriate selection of comparables and rejected the comparables proposed by Appellant based on either factually incorrect reasons or by applying inappropriate filters, for the purpose of comparability analysis and Hon'ble DRP erroneously upheld the approach of the Ld. TPO/AO.*

16. *Without prejudice to all other grounds, the Ld. AO/TPO1 erred in making inappropriate selection of comparables providing marketing support services for benchmarking marketing function and Hon'ble DRP erroneously upheld the approach of the Ld. TPO/AO.*

Transfer Priding Adjustment in respect of inter-national transaction for Marketing and Development of Market Services ("MMDS") based on BLT approach (Protective adjustment)

17. *That on the facts and circumstances of present case, the Ld. AO/Ld. TPO and the Hon'ble DRP have erred in retaining protective assessment based on the BLT even though the same has been held to be unlawful by the Hon'ble Delhi High Court in multiple cases.*

18. *Without prejudice to other grounds, the Ld. AO/Ld. TPO and Hon'ble DRP while computing the protective adjustment have erred in quantifying excessive and/or non-routine MMDS expenses by considering rebates and discounts and selling and distribution expenses as brand building expenses while performing arm's length analysis contrary to the principles and findings laid down by the Hon'ble Delhi High Court in the case of Sony Ericson Mobile Communications India Private Limited.*

19. *Without prejudice to the above grounds, the Hon'ble DRP has erred in not giving directions for the grounds filed against the protective adjustment and gave an ambiguous direction for retaining the same as protective adjustment.*

20. *That on the facts and circumstances of present case and in law, Ld. AO/TPO and Hon'ble DRP have erred in holding*

that MMDS expenditure incurred by the Appellant, is an 'international transaction', thereby disregarding the findings of the Hon'ble Delhi High Court in the cases of Maruti Suzuki India Ltd., Whirlpool of India Ltd., Bausch & Lornb Eye Care India Pvt. Ltd and Honda. Siel Power Products Ltd

21. *That the Ld. AO/ Ld. TPO/ Hon'ble DRP have erred in not appreciating that MMDS expenses incurred by the Appellant iri the normal course of its business were not for the sole benefit of its associated enterprise and thus did not fall within the purview of an "international transaction" pertaining to rendition of service, as defined in section 92B of the Act, distinct from its functional profile and responsibility as a distributor.*

22. *Without prejudice to other grounds, the Ld. TPO/AO and Hon'ble DRP erred in applying the BLT method to determine the excessive/non-routine MMDS expenses in complete disregard of the Transfer Pricing Regulations in India, commercial circumstances of the case and the principles and findings laid down by the Hon'ble Delhi High Court.*

23. *Without prejudice, even if MMDS expenses are held to be "non-routine" and "excessive", the Appellant was not required to be compensated by its AE, considering that the purported benefit caused to the AE on account of incurring of MMDS expenses incurred by the Appellant was only incidental.*

24. *Without prejudice, even if MMDS expenses are held to be "non-routine" and "excessive", the Ld. TPO/AO and Hon'ble DRP erred in not appreciating that the functions performed by the Appellant had already been adequately compensated by the AE since the Appellant's business model allows it to earn an arm 's length margin on all costs incurred including MMDS expenses.*

25. *That the Ld. AO/ Ld. TPO/ Hon'ble DRP failed to appreciate that once the net operating margins of the Appellant had met the arm's length test, no further adjustment was required for any non-routine function or non-routine MMDS expenditure*

26. *Without prejudice to all other grounds, the Ld. TPO/AO/Hon'ble DRP have erred in fact and in law by determining the arm's length level of routine MMDS expenses by considering inappropriate companies.*

27. *Without prejudice to other grounds, that the Ld. TPO/AO have erred in levying a further mark-up of service providers*

on MMDS expenses for determination of the arm's length price of the alleged brand-promotion services rendered by the Appellant to its AEs.

28. *Without prejudice to other grounds, that the Ld. TPO/AO erred in making inappropriate selection of comparables for the mark-up on alleged MMDS expenditure while computing adjustment in protective assessment.*

29. *Without prejudice to the other grounds, the Ld. TPO/AO have erred in facts and circumstances of the case and in law by ignoring the fact that even if the Appellant' s remuneration model is to be re-characterised to a service fee for MMDS activities, the profit earned by the Appellant over and above the return earned by a distributor undertaking no or limited MMDS activities should be considered as a remuneration for its MMDS activities as stipulated by the Hon'ble Delhi High Court in the in the case of Sony Ericson Mobile Communications India. Private Limited.*

Miscellaneous contentions

30. *Ld. AO has erred in initiating penalty proceedings under Section 271(1)(c) of the Act on account of an adjustment that was a result of a protective assessment."*

3. Assessee filed its return of income declaring income of INR 1 835033230/– on 30/11/2013. The assessee company is a wholly owned subsidiary of Sony Corp, Japan. During the year under consideration, the assessee company is engaged primarily in import and distribution of various Sony products, mainly including audio/visual entertainment products, in the Indian market.

4. During the assessment proceedings, the assessee has reported 14 types of international transactions [IT] with its Associated Enterprise [AE] . The assessee benchmarked all these transactions adopting the Transactional Net Margin Method [TNMM] as the Most Appropriate Method [MAM] adopting the profit level indicator [PLI] of operating profit divided by

operating revenue[OP/OR] . The assessee compared its 2 segments (1) consumer electronics (2) and advisory segments. In the consumer electronics segment the operating profit by operating revenue was found at 2% and in advisory services it was 14.72%. To determine the Arms length price of ITs the assessee has undertaken with its associated enterprise, The ld AO referred the matter was referred to the learned transfer pricing officer [TPO] . The learned TPO passed order u/s 92CA (3) of the income tax act, 1961 on 24/10/2016, wherein 2 adjustments were made under Chapter X of The Act to returned income

(1) intensity as the comparability adjustment as substantive adjustment to the international transaction of distribution and

(2) adjustment on account of advertisement marketing and publicity expenditure by applying the bright line test as a protective adjustment.

Consequently draft assessment order was passed on 23/11/2016 wherein the transfer pricing adjustment was incorporated amounting o Rs. 2562145000/– and total income of the assessee was assessed at Rs. 4402665254/–.

5. Assessee filed objection before the learned Dispute Resolution Panel – 2, New Delhi [DRP] . The learned DRP issued direction u/s 144C (5) of the act on 18/8/2017. Consequently the assessment order u/s 143 (3) read with section 144C of The Act was passed on 15/9/2017 wherein the adjustment INR 2 314379000 was made on substantive basis and INR 4 813200000 on a protective basis. Therefore the net addition of

INR 2 314379000 was made to the total income of the assessee and assessment was made at Rs. 4149412230/–.

6. Meanwhile assessee filed rectification application before the learned DRP as well as application for rectification under section 154 of the Act before the learned Deputy Commissioner Of Income Tax, transfer pricing, New Delhi. On the rectification application of the assessee before the learned dispute resolution panel – 2, New Delhi, directions were passed under rule 13 of the DRP rules on 22/11/2017. Further, learned AO passed an order u/s 154 of the Act and effect of DRP directions dated 22/11/2017 stating that correct workings were made. He selected 13 comparables, whose intensity and working capital adjusted operating profit/operating revenue PLI were 3.56 percentage, compared it with PLI of assessee and the difference was computed at INR 507843000/–, therefore substantive addition on account of AMP was computed at INR 5 07843000/– on intensity basis The learned AO further computed the protective adjustment after considering the correct advertisement expenses at the same amount.

7. Assessee being aggrieved with the order of the learned assessing officer has preferred this appeal before us raising above grounds of appeal.

8. The ld AR submitted that as can be seen from page 203 of Appeal set order (dated 11.9.2017) giving effect to DRP directions margin earned by Appellant is computed by recasting Profit & loss account at page 37 of paper book and comparing the same with net profit OP/OR earned by set of 14 comparable companies an adjustment of Rs. 2,19,04,95,000/- is determined. Pursuant to request of Appellant, Ld. TPO provided reconciliation of total

operating cost of Rs. 821862 lacs considered in this working . It was noticed from above reconciliation that Rs. 5338 lacs and Rs. 7372 lacs of Reimbursement received were added to operating costs. Such amounts were taken suo moto by TPO from schedule showing 'Transactions and balances with related parties in ordinary course of business and on arm's length basis" and forming part of audited financials of appellant from ultimate holding company and fellow subsidiaries at page 58 of Paper book and added to operating costs reported in audited profit & loss account. Such reimbursement received if grossed up in expenditure account will need to be considered as part of Income reported in Profit and loss account to arrive at correct margin. If corresponding amount is not grossed up in income, it would lead to an absurd and incorrect results. He submitted that TPO failed to make this corresponding adjustment in his computation. This error resulted in artificially and incorrectly suppressing the margin earned by appellant. Vide rectification application dated 18th January 2018, Appellant requested rectification of above error and poin ed out that by correcting this error, intensity adjustment would be deleted. However, Ld. TPO denied benefit of correction. He stated that l TPO has erred in holding that operating cost of the assesse is to be adjusted to that extent so as to facilitate comparability. None of the comparables received the same kind of financial assistance in their business. This approach of making suo moto adjustment only to expenditure portion of audited Profit & loss account would lead to absurd and incorrect results, in case correspondent amount is not grossed up to Income, because amount of Rs. 12710 lacs credited to expenditure account cannot be altogether be ignored from

consideration while computing margin earned. Refusal by Ld. TPO to correct this error on the pretext that "this is neither an arithmetical error or mistake apparent from record" leads to incorrect, unjust and absurd results. These circumstances necessitated request for correction of this error.

9. Adverting to ground no 5 he submitted that Companies owning brands were not includible in set of comparable companies for making intensity adjustment. Reference to internal pages 21 and 22 of DRP order would show that in case of Micromax informatics and Lava international, DRP incorrectly attempted ascertaining by reference to financial statements of those companies, completely failing to appreciate that self-generated assets like brand may not be accounted for in audited accounts. Consequently, margins earned by these 2 companies were part of the average margin used for intensity adjustment. He stated that as the entire comparability exercise under Chapter X of Income Tax Act, 1961 is with reference to information available in public domain, by inviting attention to information available on website of Government of India, Ministry of commerce & industry, Department of Industrial policy & promotion, Controller General of Patents Design & Trade Marks palced at pages 68 to 82 of paperbook . Appellant filed request for rectification before Ld. DRP seeking direction to exclude these 2 companies as they own the brand unlike in case of Appellant where the overseas AE owns the brand. It was submitted that Ld. DRP conclusions on ownership of brand by looking into financials of respective companies was not justified or correct. However, under pretext of technical difficulties, Ld. DRP refused to issue directions for exclusion of these 2 companies . he refeered to the order of ld

DRP where it is observed " It would amount to review of previous decision, which is not permitted Rule 13 of DRP Rules". If these 2 companies are excluded from the set of companies used for making so called intensity adjustment the average margin of the set would come down.

10. In the end he submitted that above 2 reliefs if granted viz., correction of reimbursement wrongly grossed up only total operation cost for working out tested party margin and exclusion of 2 companies owning brands would result in NIL adjustment even under the so called intensity method (though unknown to law) as adopted by TPO and approved by DRP.

11. The learned CIT DR submitted that the prayer of the assessee that the learned transfer pricing officer has recast the profit and loss account of the assessee is incorrect. He submitted that the learned transfer pricing officer has extracted the figure from the audited annual accounts of the assessee. He therefore stated that INR 5338/- lakhs and INR 7372 lakhs of reimbursement received were correctly added to the operating cost. He submitted that the reimbursements are part of the cost and revenue of the assessee and therefore they cannot be excluded. With respect to the 2 comparables he submitted that the learned dispute resolution panel has given a tribulation of both this comparable is and therefore to be functionally comparable with the assessee. Therefore it is proved that these 2 companies do not on any brand value and hence the argument of the learned authorised representative is incorrect that both these companies on huge brand value and therefore they should be excluded.

12. We have carefully considered the rival contentions and perused the orders of the learned transfer pricing officer and the learned

dispute resolution panel which were later on rectified. There are only 2 disputes left in this appeal. The 1st dispute is regarding the correct computation of the margin of the assessee and the 2nd dispute is with respect to the 2 comparables namely Micromax informatics and Lava international whether they can be included in the comparability analysis.

13. Coming to the 1st dispute, looking at the order passed by the learned transfer pricing officer on 27/12/2017 while working out the operating cost which is tabulated at page number 8 of the paper book on 3rd page of the order, he has made an addition of reimbursement received on account of advertisement of INR 5 338 and warranty of INR 7 37 2,00,000 to the ' Other operating expenses" of the assessee. The above figure have been extracted by the learned transfer pricing officer from note number 13 pertaining to the 'related party disclosure as per accounting standard 18' wherein the reimbursement of expenses received credited to respective expenses of INR 5 33 8,00,000 in case of advertisement and INR 7 37 2,00,000 in case of warranty was mentioned. The contention of the learned authorised representative is that that should also been included in the part of income reported in profit and loss account is rejected as these are not the operating revenue of the assessee. However when the learned transfer pricing officer has included the direct cost of INR 96820/– lakhs, (77619+801+18400), he has included the advertisement expenses of INR 5 33 8,00,00 and Rs 7 37 2,00,000 of warranty in the above cost, therefore there is no requirement of further making an addition on this account. On looking at para number 33 of the balance sheet it is apparent that reimbursement of expenses received were credited to the

respective expenses account. By that it means that when the original expenses were incurred they were also included by debiting those expenditure to those expenditure accounts. Once those expenditure have been debited whenever they were incurred and at the time of reimbursement they were credited to the same expenditure account, both should have been excluded. Therefore addition of INR 12710/– lakhs to the operating expenses of assessee amounts to double addition to the operating cost by the sum. Therefore it is apparent that the adjustment made by the learned transfer pricing officer by increasing the operating expenses by this amount is erroneous and incorrect. Therefore the learned TPO is directed to remove the addition made of INR 1 2710/– lakhs to the other operating expenses of the assessee.

14. Coming to the acceptability of 2 comparable companies being Micromax informatics Ltd and Lava international Ltd where the assessee has claimed that both these companies have the brand available to them have been shown to be correct by producing the extracts from the website of controller general of patents, designs and trademarks, government of India. Such evidences are placed at page number 77 – 82 of the paper book. On perusal of page number 77 of the paper book it is apparent that Micromax informatics Ltd have certain brand available to it. However the status of such brand in some of them are mentioned as “abandon”in 2 cases and registered in case of one registration. Further on perusal of page number 79 of the paper book in case of Lava international Ltd, several brands are found to be registered. Therefore, apparently it cannot be said that both these company does not have any brand. The learned dispute

resolution panel has also given a finding that on the basis of the annual report of these companies there does not exist any brand in the annual accounts. Naturally if the brands are self generated then they do not find any mention in the annual accounts. However even self generated brands may also impact the profitability of the brand owner. The learned dispute resolution panel has rejected the contention of the assessee only because of the reason that these 2 companies do not have any brand recorded as its fixed assets in its annual accounts. But on verification of the website extract provided by the assessee shows that both these companies have certain intangible assets. Further the website extract produced before us is based on search dated 29/08/2017. The report itself shows that certain brands or intangible assets are also abandoned. The impugned assessment year before us is 2013 – 14. Therefore it is not known whether the above companies were having these brands registered in their name for assessment year 2013 – 14 or not. In view of this, we set aside the issue with respect to the selection of comparable companies with respect to these 2 companies back to the file of the learned transfer pricing officer to determine whether there is any brand registered in the name of this companies for assessment year 2013 – 14 or not and then to find ut whether such brands have made any impact on their profitability. Such information may be obtained by the learned transfer pricing officer by exercising powers u/s 133 (6) of the income tax act. On receipt of such information, it should be provided to the assessee to submit its contention, and then decide about whether such companies can be selected as a comparable companies are not.

15. Hence for the 2 issues raised by the assessee before us we direct the learned transfer pricing officer accordingly.

16. As assessee has raised only 2 issues before us and submitted that if those 2 issues are decided it would result in Nil adjustment even under the so-called intensity method.

17. With respect to the protective adjustment made by the learned transfer pricing officer by bright line test method it was submitted by the learned authorised representative that it is contrary to the decision of the honourable Delhi High Court in Sony Ericsson 374 ITR 118. Therefore respectfully following the decision of the honourable Delhi High Court we hold that bright line test cannot be used for making an adjustment of excessive advertisement marketing promotion expenditure.

18. In view of above facts, we direct the learned assessing officer/transfer pricing officer to not to make adjustment by addition of reimbursement received of INR 1 2710/– lakhs to the operating expenses of the assessee and also to examine the 2 comparable companies afresh discussed above.

19. Therefore, leaving all other issues open to be adjudicated, we dispose of the appeal of the assessee with above directions.

Order pronounced in the open court on 08/03/2019.

-Sd/-	-Sd/-
(K.N.CHARY)	(PRASHANT MAHARISHI)
JUDICIAL MEMBER	ACCOUNTANT MEMBER

Dated: 08/03/2019
A K Keot

Copy forwarded to

1. Applicant
2. Respondent
3. CIT

4. CIT (A)
5. DR:ITAT

ASSISTANT REGISTRAR
ITAT, New Delhi