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TAX FLASH NEWS

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Transfer pricing adjustment on account of marketing intangibles by factoring AMP Intensity in the profit rates of comparables upheld

Background

Recently, the Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal), in the case of Luxottica India Eyewear Pvt. Ltd.[1] (the taxpayer), for Assessment Year (AY) 2010-11 and AY 2011-12, followed the taxpayer's own ruling for preceding AY 2009-10 and remitted Advertisement and Marketing Promotion (AMP) issue to the files of the Assessing Officer (AO)/Transfer Pricing Officer (TPO) for fresh determination by applying principles laid down by Jurisdictional Delhi High Court (High Court) in the case of Sony Ericsson[2].

For AY 2012-13, however, Tribunal upheld the TPO's action of treating the taxpayer's marketing activity as a 'function' (and not as a separate 'transaction') and factoring AMP intensity adjustment in the profit rates of comparables while making Transfer Pricing (TP) adjustment, with respect to international transaction of import of finished goods.

Facts of the case

- Luxottica was incorporated in India on 15 November 2007 and commenced its actual operations from February 2008. The taxpayer is a part of Luxottica group, a leader in design, manufacture and distribution of sun glasses and prescription frames in mid and premium price categories.

AY 2010-11 and 2011-12

- TPO proposed TP adjustment amounting to INR3,13,20,369 and INR13,40,31,274 for AY 2010-11 and AY 2011-12 in respect of AMP expenses incurred by the taxpayer by applying Bright Line Test (BLT), which was largely approved by the Dispute Resolution Panel (DRP). Aggrieved thereof the taxpayer filed an appeal before Tribunal for both the subject years.

AY 2012-13

- TPO proposed TP adjustment amounting to INR4,25,51,845 in respect of AMP expenses incurred by the taxpayer by carrying out AMP Intensity Adjustment (AIA) in profit margins of comparable companies.

Taxpayer's contentions

AY 2010-11 and 2011-12

- Luxottica took a position that AMP does not fall within the purview of 'international transaction' relying on High Court decisions in the case of in Maruti Suzuki[3] and Whirlpool of India[4] and, hence, there can be no question of determining the arm's length price of this transaction or making any addition thereon.

[1] Luxottica India Eyewear Pvt. Ltd. vs ACIT (ITA No.1492/Del/2015, ITA No.1205/Del/2016 and ITA No.344/Del/2017) – Taxsutra.com
[2] Sony Ericson Mobile Communications (India) Pvt. Ltd v. CIT [2015] 374 ITR 118 (Del)

[3] Maruti Suzuki India Ltd. [ITA No. 110/2014 and 710/2015]
[4] CIT v. Whirlpool of India Ltd. [2015] 381 ITR 154 (Del)

- As an alternate proposition, the taxpayer contended that the AIA as applied by the TPO in its case for AY 2012-13 should be applied in subject years as well.

AY 2012-13

- In respect of AIA carried out by the TPO, the taxpayer confined its objection only to the manner of computation of said TP adjustment whereby the TPO determined proportionate adjustment based on percentage of 'cost of material purchased from overseas affiliate' to 'total cost of material purchased'. The taxpayer advanced a proposition regarding use of denominator as 'total operating cost' instead of 'total cost of material purchased'. The taxpayer did not raise any objection on TPO carrying out AIA in the first place.

- The taxpayer also stressed on the application of Resale Price Method (RPM) over Transactional Net Margin Method (TNMM) as Most Appropriate Method (MAM), stating that the same was blessed by the Tribunal as well as High Court in the taxpayer's own case for preceding AY 2009-10.

Tax department's contentions

AY 2010-11 and 2011-12

- In oppugnation, tax department contended that AMP expenses have been held to be an international transaction and the matter of determination of its ALP has been restored, in High Court decision of Sony Ericson and few other decisions[5]. Stating that there is no Blanket Rule of AMP expenses as a non-international transaction, tax department pleaded that the matter be restored to the files of AO/TPO for fresh determination.

AY 2012-13

- TPO had treated the taxpayer's marketing activity as a 'function' (and not as a separate 'transaction') performed by the taxpayer as part of its role as a distributor. This was done considering a similar view taken by High Court in the case of Bausch & Lomb[6] as also supported by Sony Ericsson's decision. On that premise, the TPO went on to undertake AIA while making TP adjustment with respect to international transaction of import of finished goods.

Tribunal's ruling

AY 2010-11 and AY 2011-12

- Noting that the TPO treated AMP as a separate transaction and benchmarked the same using BLT, Tribunal followed the taxpayer's own case for preceding AY 2009-10 and remitted the issue to the files of AO/TPO for fresh determination by applying principles laid down in the case of Sony Ericsson.

- For subject years, Tribunal also struck down the taxpayer's alternate proposition to carry out AIA (similar to TPO's action in AY 2012-13) instead of restoring the matter to the AO/TPO. In this context, Tribunal cited that if the taxpayer's alternate proposition was accepted, it would amount to setting up of an altogether different case.

AY 2012-13

- Tribunal sanctioned the TPO's action of undertaking AIA and also rejected the taxpayer's proposition regarding use of denominator as 'total operating cost' instead of 'total cost of material purchased' stating that there cannot be any item wise difference between composition of numerator and denominator and that in case the taxpayer's contention to expand the denominator to 'total operating cost' was accepted, it would only lead to distorted results.

- However, Tribunal approved the taxpayer's application of RPM over TNMM. As part of this adjudication, the Tribunal strongly stressed on carrying out AIA and held that if such an adjustment cannot be done due to any reason, a different suitable method may be adopted to encompass AIA. In this context, Tribunal observed that application of RPM as MAM was sanctioned by Tribunal and High Court in the taxpayer's own case for preceding AY 2009-10 and this view is also fortified in the case of Sony Ericsson.

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[5] Yum Restaurants (India) P. Ltd. v. ITO [2016] 380 ITR 637 (Del)
Rayban Sun Optics India Ltd. [ITA No. 942/2016]
Toshiba India Pvt. Ltd [ITA No. 418/2016]
Bose Corporation (India) Pvt. Ltd. [ITA No. 462/2016 and 635/2016]

[6] Bausch & Lomb Eyecare India Pvt. Ltd. [ITA Nos. 643,675-77/2014 and 165, 166/2015]

Our comments

With the above ruling it appears that the concept of 'bright-line test' has been relaunched as 'AMP intensity adjustment', even though it is fairly established that there are no explicit provisions of 'bright-line' under the Indian law and its use has been rendered redundant by various recent court decisions. Whether 'AMP intensity adjustment' can be referred to as re-labelled bright-line test and whether an adjusted RPM formula encompassing 'AMP intensity adjustment' is executable remains to be seen. There are a lot of open issues with no conclusive answers on AMP being an international transaction as there is no final dictum on the subject. The Revenue should at least have a qualitative probe into the taxpayer's business model and true functional profile while evaluating any arm's length return attributable to marketing activities undertaken by them.

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