



Payment of marketing survey expenses made directly by AE on behalf of Indian taxpayer held to be at ALP

Background

The Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of BMW India Private Limited¹ (the taxpayer) has pronounced its ruling on the Transfer Pricing (TP) dispute in favour of the taxpayer by holding that, the expenditure incurred towards conducting marketing survey specifically for the Indian market (wherein the AE does not make direct sales in India), cannot be construed to benefit the AE. It is pertinent to note here that the AE had directly made such payments to a third party and subsequently recovered (at costs) from the taxpayer.

The Tribunal, in relation to the International Transaction of 'payment of technical support cost', upheld the ALP determined by the taxpayer by application of the Comparable Uncontrolled Price (CUP) method, thereby, rejecting the Transfer Pricing Officer's (TPO) approach based on a random search on the Internet. The Tribunal endorsed the view that comparables should not be rejected merely due to the geographical difference, unless the impact of differences in the market conditions is demonstrated.

Facts of the case

- The taxpayer is engaged in the import of completely built units (CBUs) of BMW's motor vehicles, related spare parts and accessories from its Associated Enterprises (AEs), and resale in the Indian market. The taxpayer is also engaged in assembling of completely knocked down (CKD) kits of certain products imported from its AEs, for further resale in the Indian market.
- During this relevant Assessment Year, the AE of the taxpayer (BMW AG) arranged for a market survey report for the Indian market to be prepared by a third party. For these services, BMW AG made direct payment to the third party on behalf of the taxpayer and subsequently recovered it from the taxpayer, at cost (i.e. without any mark-up). The transaction was reported as 'payment of market survey expenses' in the taxpayer's TP documentation. The taxpayer justified the arm's length nature of the transaction by application of CUP method wherein the third party payment by the AE was referred to as CUP and thus, justified to be at ALP.
- The TPO however challenged this payment, stating that the market survey activity was performed at the request of, behest of, and to the ultimate benefit of the AE. Further, adding that the survey would have been conducted even in the absence of the taxpayer since India was a strategic market for the group, the TPO determined the arm's length price (ALP) of the said transaction as nil.
- Upon appeal, the Commissioner of Income-tax (Appeals) [CIT(A)], while upholding the adjustment, held that the taxpayer has not been able to substantiate the rationale for the involvement of the AE in the survey.
- For the international transaction of 'payment of technical support cost', the taxpayer had entered into a 'service level agreement' with its AE for availing of technical training pertaining to setting and operating the taxpayer's production facility in Chennai, against which payments were made based on specified hourly rates. This transaction was substantiated to be at arm's length by

¹ BMW India Pvt Ltd v. ACIT (ITA No. 6160/Del./2014)

application of CUP wherein the taxpayer relied on the data for hourly rates from comparable agreements sourced from the RoyaltyStat database. The TPO however, noted the differences in the geography of the comparable agreements vis-à-vis the taxpayer and rejected the same. The TPO then carried out his own search on the Internet for such hourly rates in the AE's geography and imputed the TP adjustment.

- On appeal, the CIT(A) upheld the approach of the TPO while only allowing the travel and lodging expenses included in such payments.
- Aggrieved, the taxpayer filed the appeal before the Tribunal.

Tax department's contentions

Payment of market survey expenses

- The TPO rejected the taxpayer's claim that the market survey report was an India specific report, and hence could be used only for the benefit of the taxpayer.
- It was held that the very involvement of the AE satisfied the presumption that the activity ultimately benefitted the AE.
- The TPO stated that India was a very important market for the group and accordingly, such market survey would have been conducted even in the absence of reimbursement of the same by the taxpayer.
- The CIT (A) upheld this approach of the TPO holding that the taxpayer could not demonstrate the rationale of the AE's involvement if it did not obtain any benefit.

Payment of technical support cost

- The TPO rejected the taxpayer's comparability analysis on the ground that the selected agreements did not relate to the same geography i.e. Germany (country of AE).
- The TPO then proceeded to carry out a search on the Internet for hourly rates of automotive engineers in Germany. Accordingly, the TPO computed the adjustment for the difference in hourly rates so arrived vis-à-vis the actual payment by the taxpayer.
- The CIT (A) upheld the action of the TPO, except for deleting the adjustment in respect of the expenditure of travel, lodging, etc. which were charged back to the taxpayer at cost.

Taxpayer's contentions

Payment of market survey expenses

- The taxpayer submitted that the aforesaid transaction did not fall under the ambit of 'shareholder/ stewardship activity' as defined under the OECD's guidelines.
- As the market survey was an India-specific report, the sole benefit of the expenditure, thus incurred, accrues to the taxpayer. Further, the invoices substantiating the 'at cost' nature of the transaction along with a written confirmation from the AE were also submitted to substantiate the taxpayer's claim.
- The taxpayer argued that since the AE was not directly making any sales in India, hence, any benefit arising in the form of incremental revenue/sales, from the expenditure so incurred, can only accrue to the taxpayer.
- Placing reliance on various judgements of the Tribunal benches and the High Court, it was contended that the commercial rationale of a business decision is the taxpayer's prerogative and cannot thus be questioned.

Payment of technical support cost

- The taxpayer submitted that the technical trainings provided by the automotive engineers of the AE were critical to the production processes in the taxpayer's Chennai unit.
- With regards to the comparable agreements, it was submitted that the agreements pertaining to the U.S. and Japan are comparable to the taxpayer's case i.e. Germany as all the three countries i.e. Germany, US and Japan are developed countries having similar cost/pricing structures.
- It was also argued that a random search on the internet is incapable of being verified and cannot form basis of a comparability analysis.
- The taxpayer also placed reliance on the decision of Bharti Airtel Limited² to support its argument that comparables should not be rejected merely due to the geographical difference.

² Bharti Airtel Limited v. ACIT (ITA No. 5636/Del/2011)

Tribunal's ruling

Payment of market survey expenses

- The Tribunal found merit in the distinction drawn by the taxpayer vis-à-vis a shareholder activity in the taxpayer's case.
- Further, the Tribunal acknowledged that the taxpayer had demonstrated that the AE had no direct sales to customers in India.
- The Tribunal also clearly laid out the facts that (i) the market survey report was clearly very specific to the Indian market, and (ii) the sole benefit arising from such expenditure accrued to the taxpayer, cannot be disputed.
- Thereby, the ITAT directed the aforesaid adjustment to be deleted.

Payment of technical support cost

- The Tribunal acknowledged that the search carried out by the taxpayer was comprehensive and appropriate. Further, the Tribunal found merit in the taxpayer's argument that the hourly rates mentioned on random websites were not reliable and could not be accepted as CUPS.
- Accordingly, the Tribunal upheld the taxpayers' comparability analysis to be correct and decided the issue in favour of the taxpayer.

Our comments

This Tribunal ruling, though very specific to the facts of the given case, lays down that the expenditure specifically incurred for Indian taxpayers' market (and to solely benefit the Indian taxpayer) cannot be construed to benefit the AE.

Further, the case sets good precedence to demonstrate the importance of supporting documents and analysis in respect of various claims made by the taxpayer in its TP documentation.



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