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TAX FLASH NEWS

12 June 2018

AMP transaction does not exist in the absence of an agreement with the AE

Background

Recently, the Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Colgate Palmolive (India) Limited[1] (the taxpayer) held that in the absence of an arrangement or agreement with the Associated Enterprise (AE), the taxpayer is not obliged to undertake any brand building for its AE. Tribunal noted that the Revenue brought no tangible evidence to substantiate that Advertising, Marketing, and Promotion (AMP) expenses incurred by the taxpayer led to brand building, the creation of marketing intangible and benefited the taxpayer group. Tribunal stated no additions could be made merely on the basis of assumption of certain facts.

As regards the Revenue's appeal for reimbursement of AMP expenses by the AE, Tribunal noted that the nature of said expenses do not indicate brand building or creating marketing intangible for the taxpayer, and deleted the addition.

Tribunal also ruled on considering export benefits received from the government as operating income for calculation of margin for Research and Development Services (R&D Services) rendered to AE as the benefits received were interconnected to the R&D services rendered.

Facts of the case

- The taxpayer was 51 per cent subsidiary of Colgate Palmolive Inc., USA and was engaged in manufacturing and marketing of diversified pharmaceutical products.
- The TPO further noted taxpayer debited to financials AMP expenses amounting to INR136.83 crore which constituted approx. 13 per cent of the sales achieved by the taxpayer as against industry average rate of 6.39 per cent.
- The TPO also noted the royalty payment made by the taxpayer reflected steep growth from 0.15 per cent in AY 1999-2000 to 0.96 per cent in AY 2005-06 and in absolute term the increase was from INR1.50 crores in AY 1999-2000 to INR10.32 crores in AY 2005-06.
- Basis the aforesaid details, the TPO contended that the relevant sales on which royalty was being paid recorded a faster growth benefiting the AE. Therefore, AMP expenses should be shared by the AE as the same were the driving forces for enhancing the business.
- The Taxpayer contended that AMP expenses incurred were for the taxpayer's business and there was no agreement with AE for the promotion of brand and hence the provisions of Section 92(2)/92B of the Income-tax Act, 1961 (the Act) are not applicable.
- The TPO did not consider the taxpayer's contentions and apportioned the AMP expenses in the ration of royalty payment to total payment, i.e., 0.96 per cent and made an AMP addition.
- Aggrieved, the taxpayer filed an appeal before the Commissioner of Income-tax (Appeals) [CIT(A)]. The CIT(A), after considering taxpayer's submissions and the TPO's order, stated that the taxpayer is a full-fledged manufacturer and entrepreneur and retains

[1] Colgate Palmolive (India) Limited v. ACIT (ITA No. 6073/Mum/2014 and I.T.A. No. 2778/Mum/2011)

profit from the business. It manufactures, markets and distributes its product for which the taxpayer incurs advertisement expenses. Therefore there are no direct benefits from AMP expense to its AE.

- CIT(A) further affirmed incidental benefits to AE does not change the character of the expenses incurred and deleted the addition made by the TPO.

- Before the CIT(A), the taxpayer also argued on considering the export benefits received from the government for the R&D services rendered to AE as operating income while computing the margin. CIT(A) relying on Mumbai Tribunal decisionon Welspun Zucchi Textile Ltd[2] held it in favour of the taxpayer that the export benefits received were in connection to the R&D services rendered to AE and can be considered for margin calculation.

Tribunal's ruling

- On facts, the Tribunal noted that there was no arrangement or agreement between the taxpayer and its AE which obliged the taxpayer to undertake any brand building on behalf of its AE.

- Further, the Tribunal also held that nothing was brought on record to demonstrate that incurring of AMP expenses has resulted into a brand building or creating marketing intangibles for the AE.

- Tribunal affirmed that tax department has not produced any tangible evidence and has only argued that the brand value of the taxpayer group, as a whole, has reflected healthy growth during the period 2000 to 2006. Further, no co-relation has been explained between the AMP expenses incurred by the taxpayer and the growth of taxpayer Group's brand value.

- Tribunal stated that no addition could be made on the mere assumption of certain facts.

- The Tribunal also noted that the AMP expenses incurred are in the nature of meeting expenses, travelling expenses, hotel expenses which has been received as well as paid by the assessee to third parties, which in itself cannot be said to result in the creation of marketing intangibles.

- The Tribunal observed that TPO had computed the said adjustment by applying Bright Line Test which is not one of the prescribed methods under Rule 10B of the Income-tax Rules, 1962 (the Rules) as per settled legal positions. Further, TPO did not carry out any analysis of the impugned expenditure to corroborate his stand.

- The Tribunal referred to the Bombay High Court ruling in the case of Johnson & Johnson Ltd[3], wherein transfer pricing adjustment was done by disallowing the payment, on the basis of an assumption that it is excessive. The Tribunal held that such action is completely dehors the provisions of transfer pricing adjustment found in chapter X of the Act. Further, the Tribunal held that the determination of ALP has to be done only by following one of the methods prescribed under the Act.

- The Tribunal also referred to the Delhi High Court ruling in the case of Bausch & Lomb Eyecare (India) Private Limited[4], wherein the HC had held that the Revenue had been unable to demonstrate with tangible materials the existence of an international transaction involving AMP expenses between the taxpayer and foreign AE.

- Based on the aforementioned High Court decisions the Tribunal upheld CIT(A) order and dismissed tax department's appeal.

- Further, the Tribunal upheld the CIT(A)'s conclusion that export benefits received by the taxpayer are inter connected and are part and parcel of export of R&D services rendered by the taxpayer. Therefore the same can be considered as operating income for the purpose of computation of margins from R&D activities.

Our comments

The Tribunal has re-emphasised the importance of documentation to substantiate the presence of international transactions between AEs.

The Tribunal has rightly upheld that TPO cannot presume the existence of international transaction merely on the basis of AMP expenses incurred by the taxpayer and assumption of certain facts.

It is also important to note that the Tribunal has taken cognisance of the Hon'ble Supreme Court's admittance of the Special Leave Petition filed by the Revenue Authorities with respect to the AMP issue. The Tribunal, however, held that the Hon'ble Court has not stayed the operation of the judgement in any manner and therefore held it to be valid.

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[2] ACIT v. Welspun Zucchi Textile Ltd [2014] 44 taxmann.com 124 (Mum)
[3] Johnson & Johnson Ltd v. CIT [2014] 43 taxmann.com 15 (Mum)
[4] Bausch & Lomb Eyecare (India) P Ltd. v. ACIT [2016] 381 ITR 227 (Del)

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