IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH "I-1" NEW DELHI

BEFORE SHRI S.V. MEHROTRA : ACCOUNTANT MEMBER
AND
SHRI KULDIP SINGH : JUDICIAL MEMBER

ITA no. 1515/Del/2014
Asstt. Yr. 2009-10

Haier Appliances India Ltd., B-1/A-14, Mohan Co-op. Indl. Estate, Mathura Road, New Delhi. PAN: AABCH 3162 L	Vs.	DCIT Circle 12(1), New Delhi.

AND

ITA no. 1582/Del/2014
Asstt. Yr. 2009-10

DCIT Circle 12(1), New Delhi.	Vs.	Haier Appliances India Ltd., B-1/A-14, Mohan Co-op. Indl. Estate, Mathura Road, New Delhi.
(Appellant)		(Respondent)

Assessee by :	Shri Ajay Vohra Shri Neeraj Jain Adv. Shri Abhishek Agarwal CA
Revenue by:	Shri Manish Kumar CIT(DR)

Date of hearing	:	09/08/2016.
Date of order	:	08/09/2016.

O R D E R

PER S.V. MEHROTRA, A.M:

The captioned appeals, preferred by the assessee as well as the department, are directed against the assessment order dated 16.01.2014 passed by the Assessing Officer u/s 143(3) read with section 144C(5),

pursuant to directions of ld. DRP. Both the appeals were heard together and are being disposed of by this composite order for the sake of convenience.

ITA no. 1515/Del/2014 (Assessee's appeal):

2. The assessee has raised so many grounds in its grounds of appeal. However, the sole controversy is regarding adjustment made by the TPO on account of AMP expenses incurred by the assessee, as partly confirmed by ld. DRP.

3. Brief facts of the case are that the assessee, a wholly owned subsidiary of Haier Electrical Appliances Corp. Ltd. ("Haier Group), started its business operations in December 2003 in India. It deals with consumer products across six product categories- refrigerators, colour television/ DVDs, washing machines, microwave ovens and dishwashers. The assessee had reported 8 international transactions, as noted by ld. TPO in para 1.1 of his order, but he noted from the TP study, submitted by assessee that the TP study was silent about marketing intangibles developed by the assessee in India for the products of its AE by incurring huge AMP expenditure, on the ground of assessee not having any significant intangible and no research and development of non-routine intangibles being undertaken. He noted that assessee had entered into an agreement with Haier Electrical Appliances Corp. Ltd. ("in short Haier China"). He further noted that as per the agreement Haier China was the owner of trade name/ mark and was the owner of registered trade mark in India. The assessee had been allowed to use the trademarks for the first 5 years free of charge. After reproducing relevant parts of the agreement, ld. TPO noticed that following important facts emerged from the same:

(i) Under the agreement the assessee was authorized to use trade mark and sale of products.

(ii) The assessee was also assigned license to assemble and/ or manufacture product as per specification of the AE.

(iii) The assessee was required to keep business records of sale of product and shall furnish the same to the AE as quarterly report.

(iv) All the functions relating to protection of trade mark and risk were assigned to the assessee.

(v) In case the assessee acquires or develops any intangible the same shall be transferred to the AE without any compensation.

(vi) No royalty was charged from the assessee for the first five years.

(vii) In pursuance to the above extracted terms and conditions of the agreement, the assessee had launched, promoted and protected "Haier" Brand in India and had developed marketing under heads advertisement, marketing and promotional expenditure in the year under consideration and in earlier year."

3.1. He, accordingly, issued show cause notice to assessee, inter alia, pointing out that assessee was making significant efforts to promote the brand of the AE. He pointed out that advertisement expenses over and above the normal AMP expenses incurred by comparable companies was towards brand building. He compared the AMP/ sales ratio with Vivek Ltd. and observed that assessee had incurred 16.04% of AMP to gross sales as compared to 3.87% of the AMP to gross sales incurred by Vivek Ltd. He, inter alia, show caused the assessee as under:

> *"This segment is proposed to be benchmarked using CUP with a markup to the calculated over costs. It must be kept in mind that this process of providing AMP services involves deploying your funds. It is considered prudent that a mark-up of at least equal to the prime lending rate of the State Bank of India be applied on this account The PLR of SBI was 12.75% for the FY 2008-09. In the whole process, you have not only deployed your funds but also engaged your trained manpower towards this task. You have also spent on staff salaries, office expenses, Travelling and conveyance, rent, electricity, communication costs etc. etc. Therefore, because of these indirect expenses made by you, a further mark up of at least 2.25% on the above AMP spend amount is considered appropriate. Therefore, a total of 15% markup on AMP spend is considered to be appropriate."*

3.2. The TPO after considering the assessee's submissions directed for adjustment of Rs. 13,59,01,632/- as under:

Arm's Length Mean Margin (%)	15
Total revenue of the assessee	2,916,711,067
Arm's Length price of AMP expenses (%)	3.87
Arm's Length AMP Expenses (A)	112,876,718
AMP expenses incurred by the assessee (B)	467,874,750
Expenditure incurred on creation of intangibles (B-A)	354,998,032
Mark up @ 15%	53,249,705
Arm's Length value of capital grant	408,247,736
Actual Grant Received	272,346,104
Difference	135,901,632

3.3. Ld. DRP confirmed the TPO's action but varied the markup applied by TPO from 15% to 9% and, thus, reduced the difference to be adjusted at Rs. 114,601,751/-.

4. At the time of hearing both the parties agreed that in view of the decision of Hon'ble Delhi High Court in the case of Sony Ericsson Mobile Communications Vs. CIT (2015) 374 ITR 118 (Del), the matter needs to be restored back to the file of ld. AO/TPO for de novo consideration.

5. We have considered the submissions of both the parties and have perused the record of the case. The assessee is a distributor of various products of its AE. The Hon'ble Delhi High Court the case of Sony Ericsson Mobile Communications (supra), has, inter alia, observed as under:

> *"The test of allowability of expenditure under section 37(1) is whether the expenditure is incurred wholly or exclusively for the business consideration. The issue of arm's length price per se does not arise when deduction under section 37(1) is claimed. Chapter X of the Act relates to arm's length pricing adjustment- Chapter X is not concerned with disallowance of expenditure but relates to determination of arm's length price or cost of an international transaction between two associated enterprises. It relates to income or receipts, and also expenses and interest but in a different context. Thus, section 37(1) and Chapter X provisions pertain to different fields. The arm's length procedure prescribed in Chapter X, once applicable has to be given full application. The impact of Chapter X of the Act cannot be controlled or curtailed by reference to the allowability of expenditure under section 37(1) of the Act The purpose of determination of arm's length price is to find out the fair and true market value of the transaction and accordingly the adjustment, if required, is made. The exercise has its own object and purpose. Advertising, marketing and sales promotion expenses incurred by the assessee in India can be treated and categorised as an international transaction under section 92B of the Income-tax Act, 1961.*

LG. ELECTRONICS INDIA P. LTD. v. ASST. CIT [2013] 22 ITR (Trib) 1 (Delhi) [5B] approved on this point".

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"*It would be incorrect to treat advertisement as equivalent or synonymous with "brand building" for the latter in a commercial sense refers to several facets and components, the primary being the quality and reputation of the product or name, which is acquired gradually and silently over a passage of time.*

The following factors would govern the determination of arm's length price in relation to advertising, marketing and promotion expenses:

(i) In the case of a distributor and a marketing associated enterprise, the first step in transfer pricing is to ascertain and conduct a detailed functional analysis, which would include the advertising, marketing and promotion functions/expenses.

(ii) The second step mandates ascertainment of comparables or comparable analysis. This would have reference to the method adopted which matches the functions and obligation performed by the tested party including the advertising, marketing and promotion expenses.

(iii) A comparable is acceptable, if based upon comparison of conditions a controlled transaction is similar with the conditions in the transactions between independent enterprises. In other words, the economically relevant characteristics of the two transactions being compared must be sufficiently comparable. This entails and implies that the difference, if any between controlled and uncontrolled transactions, should not materially affect the conditions being examined given the methodology being adopted for determining the price or the

margin. When this is not possible, it should be ascertained whether reasonably accurate adjustments can be made to eliminate the effect of such differences on the price or margin. Thus, identification of potential comparables is the key to the transfer pricing analysis. As a sequitur, it follows that the choice of the most appropriate method would be dependent upon availability of potential comparables keeping in mind the comparability analysis including fitting adjustments which may be required. As the degree of the comparability increases, the extent of potential differences which would render the analysis inaccurate necessarily decreases.

(iv) The assessee, i.e., the domestic associated enterprise must be compensated for the advertising, marketing and promotion expenses by the foreign associated enterprise. Such compensation may be included or subsumed in a low purchase price or by not charging or charging a lower royalty. Direct compensation can also be paid. The method selected and comparability analysis should be appropriate and reliable so as to include the advertising, marketing and promotion functions and costs

(v) Where the Assessing Officer/Transfer Pricing Officer accepts the comparables adopted by the assessee, with or without making adjustments, as a bundled transaction, it would be illogical and improper to treat the advertising, marketing and promotion expenses as a separate international transaction, for the simple reason that if the functions performed by the tested parties and the comparables match, with or without adjustments, the advertising, marketing and promotion expenses are duly accounted for. It would be incongruous to accept the comparables and determine or accept the transfer price and still segregate the advertising, marketing and promotion expenses as an international transaction.

(vi) The Assessing Officer/Transfer Pricing Officer can reject a method selected by the assessee for several reasons including want of reliability in the actual matrix or lack/non-availability of comparables (section 92C(3) of the Act).

(vii) When the Assessing Officer/Transfer Pricing Officer rejects the method adopted by the assessee, he is entitled to select the most appropriate method, and undertake a comparability analysis. Selection of the method and comparables should be as per the command and directive of the Act and Rules and justified by giving reasons.

(viii) Distribution and marketing are interconnected and intertwined functions. Bunching of interconnected and continuous transactions is permissible, provided the transactions can be evaluated and adequately compared on aggregate basis. This would depend on the method adopted and comparability analysis and the most reliable means of determining the arm's length price.

(ix) To assert and profess that brand building is an equivalent or substantial attribute of advertisement and sales promotion would be largely incorrect. It represents a coordinated synergetic impact created by assortment largely representing reputation and quality. "Brand" has reference to name, trade mark or trade name and like goodwill is a value of attraction to customers arising from name and a reputation for skill, integrity, efficient business management or efficient service. Brand creation and value, therefore, depends upon a great number of facts relevant for a particular business. It reflects the reputation which the proprietor of the brand has gathered over a passage or period of time in the form of widespread popularity and universal approval and acceptance in the eyes of the customer. Brand value depends upon the nature and quality of goods and services sold or dealt with. Quality control

is the most important element, which can mar or enhance the value

(x) The bright line test has no statutory mandate and a broad-brush approach is not mandated or prescribed. The exercise to separate "routine and "non-routine" advertising, marketing and promotion or brand building exercise by applying the bright line test of non-comparables should not be sanctioned. It would be conspicuously wrong and incorrect to treat the segregated transactional value as "nil" when in fact the two associated enterprises had treated the international transactions as a package or a single and contributions are attributed to the aggregate package. In a specific case this criteria and even zero attribution could be possible but the facts should so reveal and require. This would be necessary when the arm's length price of the controlled transaction cannot be adequately or reliably determined without segmentation of advertising, marketing and promotion expenses.

(xi) The Assessing Officer/Transfer Pricing Officer for good and sufficient reasons can de-bundle interconnected transactions, i.e., segregate distribution, marketing or advertising, marketing and promotion transactions. This may be necessary when bundled transactions cannot be adequately compared on aggregate basis.

(xii) When segmentation or segregation of a bundled transaction is required, the question of set off and apportionment must be examined realistically and with a pragmatic approach. Transfer pricing is an income all allocating exercise to prevent artificial shifting of net incomes of controlled taxpayers and to place them on parity with uncontrolled, unrelated tax-payers. The exercise undertaken should not result in over or double taxation. Thus, the Assessing Officer/Transfer Pricing Officer can segregate the advertising, marketing and promotion expenses as an

independent international transaction but only after elucidating grounds and reasons for not accepting the bunching adopted by the assessee and examining and giving the benefit of set off. Section 92(3) does not bar or prohibit set-off.

(xiii) The cost plus method is a recognised and accepted method under lie Indian transfer pricing regulation. It can be applied by the Assessing Officer/Transfer Pricing Officer in case the advertising, marketing and promotion expenses are treated as a separate international transaction, provided the cost plus method is the most appropriate and reliable method. Adoption of the cost plus method and computation of cost and gross profit margin comparable must be justified.

(xiv) The object and purpose of transfer pricing adjustment is to ensure that the controlled taxpayers are given tax parity with uncontrolled taxpayers by determining their true taxable income. Costs or expenses incurred for services provided or in respect of property transferred, when made a subject matter of the arm's length price by applying tile cost plus method, cannot be again factored or included as a part of interconnected international transaction and subjected to the arm's length pricing. [Matter remanded.]"

5.1. Respectfully following the decision of Hon'ble Delhi High Court, the matter is restored to the file of AO with the direction to examine all the functions carried out by comparables vis a vis the tested party and thereafter select the comparables as per the guidelines laid down by Hon'ble Delhi High Court noted above.

6. Assessee's appeal is allowed for statistical purposes.

ITA no. 1582/Del/2014 (Revenue's appeal):

7. Sole effective ground raised by the revenue in its appeal is as under:

> "*Whether DRP-1, New Delhi was correct on facts and circumstances of the case and in law in directing the AO to delete the addition of Rs. 2,93,89,615/- made on account of disallowance of market to market loss of restatement of assets and liabilities as on balance sheet date*?

8. In course of assessment proceedings the AO required the assessee to furnish details of loss on foreign exchange fluctuations. He required the assessee to explain as to why the unrealized loss should not be disallowed as the same was notional. The assessee relied on the decision of Apex Court in the case of CIT Vs. Woodward Governor India P. Ltd. (2009) 312 ITR 254 (SC), wherein it has been held that the loss incurred by the assessee on the date of balance-sheet is an allowable loss u/s 37(1). The AO, however, following the CBDT Instruction no. 3/2010 dated 23.3.2010, disallowed the assessee's claim. However, ld. DRP allowed the assessee's claim observing that the same was fully covered by AS-11 and the Hon'ble Supreme Court's decision in the case of Woodward Governor India P. Ltd. (supra).

9. Ld. DR submitted that the matter may be restored as assessee's appeal is being restored for AMP issue.

10. We have heard both the parties. We find that ld. DRP has elaborately considered this issue and has noted from para 6.4.1 to 6.4.3 as under:

> "*6.4.1 The Panel has examined the matter. It is noticed that the taxpayer has claimed the said loss of Rs.2,93,89,615/- on account of the unrealized exchange loss on 31.3.2009 by making MTM bench marking of the outstanding payments on*

account of import of goods from Overseas Vendors. According to the information submitted before the Panel, such out standings are with the following break up:

S. NO.	*Name of the Vendor*	*MTM Loss/Gain*
1	*HAH Hongkong Company*	*-28,947,584.41*
2	*Haier America Refrigerators Company*	*-296,667.80*
3.	*Zhongshan Changhong Electric Co Ltd.*	*-145,636.56*
4	*Hefei Rongshida Washing Equipment*	*273.34*
	Total	*-29,389,615.43*

The said claim is made pursuant to the provisions of AS-11 issued by the ICAI. The taxpayer has placed strong reliance upon the decision on Hon'ble Supreme Court in the case of Woodward Governor India P. Ltd (supra). Thus, it is to be considered if the case of the taxpayer is covered by it or not? The reported decision was rendered in the context of loan liability in the books of account of the taxpayer. The said loan was on revenue account as a monetary transaction appearing in the balance sheet and was raised in the foreign exchange. The taxpayer debited the unrealized loss due to foreign exchange fluctuation as on the 31st March of the accounting year and the matter was about the determination of the said loss, which was directly in correlation with the liability appearing in the balance sheet. The basis of the decision can be understood from the hypothetical example given by the Court, reproduced as under:

"A company imports raw material worth US $ 250000 in January 15, 2002, when the exchange rate was Rs.46 per US $. The company records the transaction at that rate. The payment for the imports is made on April 15, 2002, when the exchange rate is RS.49 per US $. However, on the balance-sheet date, March 31, 2002, the rate of exchange is RS.50 per US $. In such a case, in terms of AS- 11, the effect of the exchange difference has to be taken into the profit and loss account.

Sundry creditors is a monetary item and hence such item has to be valued at the closing rate, i.e. Rs.50 at March 31, 2002, irrespective of the payment for the sale subsequently at a lower rate. The difference of Rs. 4 (50- 46) per US $ is to be shown as an exchange loss in the profit and loss account and is not to be adjusted against the cost of raw materials". (emphasis supplied)

6.4.2 There are two broad categories of foreign exchange losses:

1. Transaction Losses: These losses arise on settlement of foreign exchange transactions. The exchange difference between the date on which the transaction is entered into and the date of settlement of foreign exchange transaction is a foreign exchange loss or gain as the case may be.

2. Translation Losses: These losses are a provision for restatement of unpaid foreign exchange liabilities as on the Balance Sheet date. The foreign exchange liabilities are converted into Indian Rupees as on the balance sheet date and the difference in the value of the liabilities appearing in the books of accounts vis a vis the restated liabilities is booked as a foreign exchange loss or a gain as the case may be.

Accounting Standard 11 states that al\ unpaid monetary liabilities should be restated at closing value as on the balance sheet date. Any exchange gain or loss arising thereon is considered as an income or an expenditure as the case might be

10.1. Thereafter ld. DRP considered the CBDT Instruction relied upon by AO and observed that MTM loss claimed by the tax payer was on actual monetary items appearing in the balance-sheet due to their reinstatement and not on forex derivatives. The department has not brought any material to

controvert these factual aspects noted by ld. DRP. We, therefore, sustain the order of ld. CIT(A) following the decision of Hon'ble Supreme Court in the case of Woodward Governor India P. Ltd. (supra).

11. Revenue's appeal is dismissed.

12. In the result, assessee's appeal is allowed for statistical purposes and the revenue's appeal is dismissed.

Order pronouncement in open court on 08/09/2016.

Sd/-	Sd/-
(KULDIP SINGH)	(S.V. MEHROTRA)
JUDICIAL MEMBER	ACCOUNTANT MEMBER

Dated: 08/09/2016.

MP

Copy of order to:

1. Assessee
2. AO
3. CIT
4. CIT(A)
5. DR, ITAT, New Delhi.