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Chapter VIA - Deductions from gross total income: Section 80-P

In the last issue of Knowledgeware we dealt with deductions u/s 80-JJAA, 80-LA, 80-M, 80-PA, 80-QQB, 80-RRB. Since we are dealing with deductions under Chapter VI-A seriatim, logically, section 80-P should have figured in that issue. It was decided to defer discussion on this provision only because it deals with, and is intimately linked to, taxation of cooperative societies as a whole. Because of its importance, this subject needed a dedicated article dealing with the intricacies involved. We are therefore taking up the discussion on 80-P in this issue of Knowledgeware. →

Transfer Pricing Issue on Advertisement, Marketing and Promotion Expenditure: An Avoidable Litigation

Indian affiliates of overseas group companies have been facing transfer pricing issues related to incurrence of advertisement, marketing and promotion ('AMP') expenses especially in consumer durables, distribution and automotive sector. Transfer Pricing issues on the AMP front is indeed complex. Complexity of the issue can be gauged from the fact that even after a High Court ruling on the subject, the issue now finally rests before the Supreme Court of India, which will bring to rest the long-standing hotly debated issued on AMP expenditure. We have in our article attempted to take our readers through the evolving landscape around AMP expenditure including the jurisprudence. The debate on the AMP saga is far from over as Special Leave Petitions have been filed before the Supreme Court of India challenging the rulings from the lower authorities including the Delhi High Court. We hope you find this article insightful and a good read. →

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Chapter VIA - Deductions from gross total income: section 80-P

Introduction

In the last issue of *Knowledgeware* we dealt with deductions u/s 80-JJAA, 80—LA, 80-M, 80-PA, 80-QQB, 80-RRB. Since we are dealing with deductions under Chapter VI-A *seriatim*, logically, section 80-P should have figured in that issue. It was decided to defer discussion on this provision only because it deals with, and is intimately linked to, taxation of cooperative societies as a whole. Because of its importance, this subject needed a dedicated article, dealing with the intricacies involved. We are therefore taking it up now.

Definition of a cooperative society

A cooperative society is defined u/s 2(19) of the Act as a cooperative society, registered under the Cooperative Societies Act, 1912 or any other State law for the time being in force for the registration of cooperative societies.

Section 80-P - Deduction in respect of income of cooperative societies

Statutory provisions - brief summary

A society falling within the ambit of the aforesaid definition of a cooperative society can claim deduction under this section in respect of:

1) Profits or gains of business attributable to:

i. The business of banking or providing credit facilities to its members (from the assessment year 2007-08, cooperative banks are not eligible) [Section 80-P(2)(a)(i)];
ii. a cottage industry [section 80-P(2)(a)(ii)];
iii. the marketing of agricultural crops grown by the members of the society [section 80-P(2)(a)(iii)];
iv. the supply of agricultural implements, seeds, livestock or other articles meant for agriculture, to the members of the society [section 80-P(2)(a)(iv)];
v. processing the agricultural produce of the members, without the aid of power [section 80-P(2)(a)(v)];
vi. the collective disposal of labour of its members [section 80-P(2)(a)(vi)];
vii. fishing and other allied activities (catching, curing, processing, preserving etc. of fish, or supply of equipment to members in connection therewith) [section 80-P(2)(a)(vii)]

Deduction in respect of incomes indicated at vi and vii above are available only if the bye-laws and rules of the society limit membership to:

- persons who contribute their labour or as the case may be, carry on the business of fishing or other allied activities;
- cooperative credit societies that provide financial assistance to the cooperative society; or,
- the state government

2) the whole of the profits of a primary cooperative society supplying milk, oilseeds, fruits, vegetables, provided by its members to a federal cooperative society dealing in these

commodities, or to the Government, a local authority, a Government company or a statutory corporation engaged in supplying these aforesaid goods [section 80-P(2)(b)].

3) in the case of any cooperative society, profits up to Rs 50,000 attributable to other activities, either independently, or in addition to those mentioned above (in the case of a consumers' credit society deduction is available up to Rs 1,00,00) [section 80-P(2)(c)].

4) the whole of the income of a cooperative society from letting out of godowns, warehouses for storage or processing or marketing of commodities [section 80-P(2)(e)].

5) Interest from securities or house property of a cooperative society, other than a housing society, urban consumers' society, society carrying on transport business or a society manufacturing with the aid of power, provided the assessee's gross total income does not exceed Rs 20,000 [section 80-P(2)(f)].

6) Interest or dividend income from investments in other cooperative societies [section 80-P(2)(d)]

General principles - governing the aforesaid provisions

Section 80P(3) stipulates that the deduction referred in 1), 2) and 3) above, (i.e. deductions stipulated u/s 80-P (2)(a),(b) or (c)) will be allowed from the gross total income, only after allowing deductions u/s 80-HH, 80-HHA, 80-HHB, 80-HHC, 80-HHD, 80-I, 80-IA or 80-J. The deduction allowable under this section is from the gross total income. Hence the question of reducing other amounts – such as those indicated u/s 43B or 40A - does not arise [*PCIT v. U.P. Cooperative Federation Ltd. 398 ITR 630 (All)*].

The incomes indicated in section 80-P(2)(a) and (c), (indicated at 1) and 3) above) should be in reference to certain activities, since the word used is 'attributable' and not 'derived'. The legislature, apparently, intended to cover not merely the receipts arising directly from the activities indicated in the provisions but also those receipts which arise indirectly from the carrying on of the activities in question [*CCIT v. Kisan Sahakari Chini Mills Ltd. 273 ITR 42 (All)*].

In *Budhewal Cooperative Sugar Mills Ltd. V. CIT [315 ITR 351 (P&H*)], it was held that this section was enacted with a view to encourage and promote the growth of cooperative societies. Accordingly, the correct way to interpret section 80-P would be to treat each provision granting deduction as a distinct and separate head of deduction. If a particular income satisfies the test laid down by a clause, the assessee would be eligible to claim deduction, even if the conditions laid down under another clause are not fully satisfied. Thus, under clause (iii), agricultural produce, grown by members, processed with the aid of power and then marketed, would qualify for deduction. This would be so, even though under clause (v) it is mandatory that income from processing of produce of members should be carried on without the aid of power.

Section 80-P(2)(a)(i) stipulates that in order to obtain exemption under this provision the assessee must be a cooperative society engaged in carrying on the business of banking or providing credit facilities to its member. Insignificant transactions with non-members will not disentitle the assessee from claiming exemption [*Quepem Urban Cooperative Society Ltd. V. ACIT 377 ITR 272* (*Bom*)]. Cooperative banks however have been specifically excluded u/s 80-P(4).

Interest received by a cooperative banking society from its circulating capital qualifies for deduction u/s 80-P (2)(a) since it stems from its banking business [*Bihar State Cooperative Bank v. CIT 39 ITR 114 (SC)]*. Interest on advances made by a cooperative society to its members for the purchase of goods from itself is deductible under this section [*CIT v.Krishak Sahakari Ganna Samiti Ltd 258 ITR 594* (All)], so also is interest on securities held as stock in trade of its banking business [*UP Cooperative Bank v. CIT 61 ITR 563 (All); Behrampur Cooperative Central Bank v. CIT93 ITR 168 (Orissa)*].

Interest earned from surplus funds lying in bank deposits [*Bihar State Cooperative Federation Ltd. v. CIT 315 ITR 286 (Patna)*] and investments made from the society's reserve fund in compliance with statutory provisions to carry on the business of banking would again form part of deductible profits under this provision [*CIT v. Karnataka State Coop 251 ITR 194 (SC)*]. This would be equally applicable to interest on income tax refund [*CIT v. Haryana State Cooperative Apex Bank 322 ITR 404 (P&H)*], unutilized funds [*CIT v. Iqbalpur Cooperative Cane Development Union Ltd 315 ITR 441 (Utt HC)*], rental income [*CIT v. Grain Merchants Cooperative Bank Ltd 267 ITR 742 (Kar.)*], locker rent [*Mehsana District v. ITO 251 ITR 522 (SC)*], underwriting commission [*CIT v. Nawanshahr Central Coop Bank Ltd 349 ITR 689 (SC)*] etc. However, since a loan advanced to an employee does not form part of the society's banking business, interest on the same will not qualify for deduction [*CIT v. Sirohi S.B.V. Bank Ltd 321 ITR 533 (Raj); SLP dismissed 320 ITR (St) 19*].

A subsidy received by the cooperative banking society from the Government for opening new branches for giving loans to the poor, being part of its receipts attributable to its banking business, is deductible under this provision [*CIT v. Madurai District Central Cooperative Bank Ltd 148 ITR 196(Mad)].* Quite to the contrary, a subsidy received by a sugar cooperative for repayment of a loan for expansion of business or setting up new units, being capital in nature, is not deductible [*CIT v. Ponni Sugars and Chemicals Ltd. 306 ITR 392(SC*)].

The deduction is *inter alia* "for providing credit facilities". This means that the society must engage in the activity of providing credit facilities to its members, and not selling goods on credit to them [*CIT v. Coral Stores 106 ITR 868 (Madras)*]. It would include guaranteeing payments; but would not include buying auto rickshaws for members and selling them to members on hire purchase agreements [*Madras Auto Rickshaw Drivers v. CIT 249 ITR 330 (SC)*]. The deduction is available only to profits attributable to extending credit facilities to its own members and not to members of its member societies [*UP Cooperative Cane Union v. CIT 237 ITR 574 (SC)*].

Under section 80-P(2)(ii) deduction is available to profits of a cooperative society attributable to running a cottage industry. The provision includes *inter alia* an apex society that provides raw materials and machinery to weavers through primary cooperative societies; and then purchases the goods made by the weavers, through primary cooperative societies, for sale in the market [*CIT v. MP State Handlooms 231 ITR 243* (M.P.)]. Basically, the word "industry" implies that some manufacture or processing should take place; mere buying and selling is not enough [*Addl. CIT v. Indian Cooperative Ltd 134 ITR 108 (Delhi)*]

Section 80-P(2)(iii) extends the deduction to marketing of agricultural produce grown by its members. The term "marketing" includes not merely buying and selling but all other intermediate processes connected with marketing the produce of its members [*CIT v. Haryana State Cooperative Supply and Marketing Federation 182 ITR 53 (P&H)*]. This is so, even if such processing involves the use of power, as in the case of sugarcane [*Budhewal Cooperative Sugar Mills Sugar Mills Ltd. V. CIT 315 ITR 351 (P&H*)]. Thus, profits from ginning and pressing would be eligible for deduction under this provision if such activity is ancillary to the society main activity of marketing the cotton produced by its members [*Broach Society v. CIT 177 ITR 418 (SC*)]. The same is equally true of profits of a society attributable to hulling of paddy grown by its members before sale [*CIT v. Ryots Agricultural Produce Cooperative Society 115 ITR 709 (Kar.)*] or from hiring of lorries for the purpose of transporting agricultural produce of its members [*CIT v. Ryots Agricultural Produce Cooperative Society 115 ITR 709 (Kar.)]*.

The benefit of sub clause (iv) extends also to cooperative societies (including apex cooperative societies], provided they supply agricultural implements seeds, livestock, (basically, all articles required for agricultural operations) to member societies [*CIT v. Tamil Nadu Marketing Federation 144 ITR 74* (Mad.)]. For the purposes of this provision the word 'article' covers water as well [*CIT v. Shetkari Sahakari Sakhar Karkhana 283 ITR 983 (Bom)*]. The supply of the aforesaid goods to non–members in addition to members would not disqualify an assessee from claiming deduction under this clause; however, such deduction would be limited only to the profits arising from the supply to members *[CIT v. Guntur District Cooperative Marketing Society 154 ITR 799* (A.P.)].

Under sub-clause (vi) income from the collective disposal from the labour of members qualifies for deduction provided voting rights in the society are restricted to individuals, the state government and other cooperative societies that provide financial assistance to the society. "Collective disposal from the labour of members" means actual labour and not merely supervision by members of paid labour [*Nilagiri Engineering v. CIT 208 ITR 326* (Orissa)].

Cooperative societies carrying on other activity, either independently or in addition to the activities listed in this section, are **under section 80-P(2)(c)** entitled to a further deduction of Rs. 50,000 (Rs. 1,00,000 in the case of a consumers' cooperative society). Rent received from non-members has been held to be covered by this clause [*CIT V. Ratanabad Coop 215 ITR 549* (*Bom*)], although a view to the contrary, also exists [*Kottayam Bank v. CIT 172 ITR 443 (Ker)]*. Dividends from shares or interest earned from bank deposits, raised out of funds, raised through sale of assets, when the cooperative society's sugar factory was under construction, has been held to be attributable to the activities of the society and hence eligible for deduction under this provision [*CCIT v. Kisan Sahakari Chinni Mills Ltd. 273 ITR 42 (All*)].

Section 80-P(2)(d) allows for deduction of interest and dividend income from investments with any other cooperative society. Thus, interest received by an apex cooperative society from amounts advanced to a member society may amount to investments in the latter; and may thus be entitled to deduction under this section [*CIT v. UP Cooperative Fed 176 ITR 435 (SC)*]. Interest on short term call deposits with a cooperative bank would also qualify [*CIT v. Haryana Coop 180 ITR 631 (P&H)*]. The Allahabad High Court has held that this provision is subject to section 80AB; accordingly, this deduction is only available in respect of net interest and not gross [*CIT v. Duggh Utpadak Sahakari Sangh Ltd. 277 ITR 35;* for contrary view please see *CIT v. Doaba Cooperative 230 ITR 774 (P&H)*].

For the purposes of this provision, a cooperative society includes a cooperative bank [*PCIT v. Totagars Cooperative Sale Society 392 ITR 74 (Kar)*].

Section 80-P(2)(e) allows a deduction for letting out of godowns or warehouses for storage, processing or facilitation of marketing of commodities. Income from such activity unconnected with any of the above purposes would not be eligible for deduction [*Udaipur Sahakari Upbhokta Thok Bhandar Ltd V. CIT 182 ITR 287 (SC)]*. Letting out here has been used in a broad sense so as to include cases where the society stores goods of its members and outsiders and renders incidental services [*CIT v. South Arcot 92 ITR 371 (Mad); affirmed in 176 ITR 117 (SC)*]. Where apart from rendering this service, the society also renders other services not covered by this provision, the onus would be on the assessee to separate the income from all such services, and claim only the income which is deductible [*CIT v. J&K Cooperative* Bank *248 ITR 289* (*J&K*)].

Exclusion of cooperative banks:

Section 80-P(4) debars cooperative banks, except primary agricultural credit societies and primary cooperative agricultural and rural development banks, from claiming the benefit of this section. The Explanation below this section stipulates that "cooperative banks" and "primary agricultural credit societies" shall have the same meaning as under the Banking Regulation Act, 1949. Thus, merely because it provides credit, a credit cooperative society is not a cooperative bank [*CIT v. Surat Vankar Sahakari Sangh 225 Taxman 162* (Guj.); *PCIT v. Ekta Coop Credit Society 402 ITR 85 (Guj*)].

Under the Banking Regulation Act, 1949, a primary agricultural credit society is not permitted to admit any other cooperative society as a member. A cooperative society whose statute violates this condition cannot be a primary agricultural credit society [*Kerala State Cooperative Agricultural and Rural Development Bank Ltd v. CIT 383 ITR 610 (Ker)*]. A society claiming to be a primary agricultural cooperative society must obtain a certificate to that effect from the registrar of cooperative societies, and prove that it is eligible for deduction in the relevant assessment year. [*PCIT v Poonjar Service Cooperative Bank Ltd. 414 ITR 67 (Ker)*].

Section 80-P in the overall context of taxation of cooperative societies

Currently, for cooperative societies the rate of 30% kicks in, when total income exceeds Rs. 20,000 [Finance Act, First Schedule, Part I, Para B]. Section 115-BAD, effective from 1st April 2021, however confers an option to a cooperative society to opt for an alternative tax regime. Under this regime, in order to be taxed at a flat rate of 22%, the cooperative society would *inter alia* have to forego the exemption under section 10AA (available to new units situated in special economic zones), section 32(1)(iia) (additional depreciation), section 32AD (Investment in new plant and machinery in a backward area), section 33AB (tea, coffee and rubber development allowances), section 33ABA (section 35(1)(ii),(iia) and (iii) and (2AA))(expenditure on scientific research), section 35AD (capital expenditure on specified business), section 35CCC (agriculture extension project), section 35CCD (skill development project) and all deductions under Chapter VI- except, section 80JJAA (employment of new employees). The assessee also has to forego the right to set off losses and depreciation of earlier years which shall be deemed to have been given effect to. Alternate minimum tax u/s 115-JC will not be applicable if the assessee opts for the new tax regime.

Accordingly, every taxpayer will have to reassess its options after working out its tax liability under this existing tax regime as well as the new regime outlined above. It may thereafter choose the regime more advantageous to it in its individual circumstance.

Conclusion

In the next issue of *Knowledgeware* we shall cover the remaining provisions of chapter VI-A.

Transfer Pricing Issues on Advertisement, Marketing and Promotion Expenses: An Avoidable Litigation

Indian affiliates of overseas group companies have been facing transfer pricing issues related to incurrence of advertisement, marketing and promotion (AMP) expenses especially in consumer durables, distribution and automotive sectors. Given the complexity and the amount of tax involved, a three-member special bench of the Income Tax Appellate Tribunal was constituted to address the issues raised by the Indian revenue authorities (IRAs) and the Indian taxpayers. Complexity of the issue can be gauged from the fact that even after the HC ruling on the subject, the issue now ultimately rests with the Indian Supreme Court which, in all likelihood, will bring a closure to the long-standing vexed issue around AMP expense.

Indian licensee distributors or manufacturers of branded goods generally incur AMP expenses in order to spread awareness of the products and increase/maintain the market share of the products manufactured or distributed by them in India.

IRA have taken a position that incurrence of AMP expenses by the Indian taxpayers beyond the level of comparable companies, termed as bright line, measured in terms of AMP expenses as a percentage of sales, is an international transaction as the same tantamounts to provision of services in the nature of enhancing/creating the value of brand legally owned by the AE. IRA have been making transfer pricing additions by imputing an income in the hands of Indian taxpayers on the premise that the Indian taxpayers, licensed manufacturers and distributors alike, should have recovered such excess AMP expenses (non-routine AMP expense) incurred, from its AE along with a suitable mark-up.

The Indian taxpayers have been contesting such AMP related TP addition on following substantive grounds:

- Incurring of non-routine AMP expenses is on its own volition and for its own benefit and therefore not an "international transaction";
- Bright line method is not a method specified under Indian TP regulations;
- There is no need to separately benchmark the AMP expenses as the same is subsumed in the taxpayers' over-all profit margin;
- Selling expenses and expenses in connection with sales like travelling and commission/incentive paid to dealers or agents are not part of AMP expenses qualifying for brand promotion

Evolution of Indian transfer pricing jurisprudence on AMP

The issue of AMP can be traced back to the year 2010 when the Delhi HC pronounced a ruling in the case of Maruti Suzuki[1] wherein the Hon'ble HC remarked that if the intensity of AMP expenses, defined by a ratio of AMP expense to sales, by the Indian taxpayers are more than what a comparable company would incur (bright line test), the Indian taxpayer should be remunerated at arm's length particularly when use of the trade mark or logo of the foreign affiliate is obligatory on the part of Indian taxpayer. Since then there was no looking back for the IRA and Indian taxpayers, distributors or licensed manufacturer or service provider. They were all painted with the same broad brush and subjected to transfer pricing adjustment for

[1] Maruti Suzuki India Limited Vs Addl. CIT TPO [W.P.(C) 6876/2008] [2010] 328 ITR 210

incurring so called non-routine AMP expenses without appreciating the significant difference in characterisations of the Indian taxpayers. Although IRA started agitating this issue in 2010, as is evident from the Delhi HC ruling in the case of Maruti Suzuki, (*supra*), the IRA seemed to have taken inspiration from the US Tax Court ruling in the year 1998 in the case of DHL[2] which was subsequently reversed by the Ninth Circuit US Court of appeal[3]. Tax Court in DHL case did require DHL to prove that it incurred more than routine AMP expenses outside US in order to substantiate that DHL was the developer of the non-US rights of trademark/brand although the Ninth Circuit court of appeal rejected the approach of the Tax court as there was no such requirement under 1968 regulation of comparing AMP expenses incurred by the taxpayer with comparable companies. A snapshot of the evolution of Indian transfer pricing jurisprudence relating to AMP expenses is given below:

Jurisprudence prior to amendment in Section 92C by Finance Act 2012:

Prior to amendment in Section 92CA of the Income-Tax Act, 1961 (the Act) through Finance Act 2012, the Income Tax Appellate Tribunals (ITAT) deleted AMP related TP additions made by the IRA on the technical ground of IRA's lack of jurisdiction over transactions which were not specifically referred by the assessing officer to the transfer pricing officer (TPO). Finance Act 2012 amended section 92CA of the Act w.e.f. 1 April, 2012 bestowing a right on the TPO to determine the ALP even when any international transaction was not specifically referred by the AO. Post the said amendment, the ITATs started adjudicating the AMP issues on merits but there were varying judgements from ITAT which created uncertainty around the transfer pricing implications of AMP expenses.

[2] DHL Corporation & Subsidiaries Vs. Commissioner of Internal Revenue (T.C. Memo.1998-461, December 30, 1998)
[3] DHL Corporation & Subsidiaries Vs. Commissioner of Internal Revenue (Ninth Circuit Court ruling, April 11, 2002)

Jurisprudence evolved through Special Bench Ruling in the case of LG Electronics India[4]:

Considering the importance and complexity of the issue, a three-member special bench of the Tribunal was constituted in the case of L.G. Electronics India, a licensed manufacturer of consumer electronics, to adjudicate the transfer pricing issues related to AMP expenses. Several other Indian taxpayers[5], affected by the AMP issue, also appeared in the matter as interveners. The special bench heard the rival submissions of the taxpayer, interveners and the IRA and held, with a majority view, that incurrence of non-routine AMP expenses should be treated as an international transaction. The Special Bench also held that the International transactions may not necessarily be expressed in black and white but may be inferred from the conduct of the parties. The Special Bench further upheld the application of Bright Line Test to compute the value of international transactions in relation to AMP expenses and also remarked that the arm's length value of non-routine AMP expenses needed to be computed separately and could not be subsumed under entity level Transactional Net Margin Method. The Special Bench also granted relief to the taxpayers by stating that Sales Expenses which do not lead to brand promotion should be excluded for the purpose of determining the intensity of AMP expenses.

The impact of the above-mentioned special bench ruling was that most of the AMP related cases pending before various tax tribunals got remitted to the file of the TPO with specific direction to follow the principles laid down by the special bench in the L.G. Electronics resulting in significant TP adjustment in many cases.

[4] L.G. Electronics India Private Limited Vs. Asstt. Commissioner of Income Tax (ITA No. 5140/Del/2011)

[5] Haier Telecom Pvt. Ltd; Goodyear India; Glaxo Smithkline Consumer India; Maruti Suzuki India; Sony India; Bausch & Lomb; Fujifilm Corporation; Canon India; Diakin India; Amadeus India; Star India; Pepsi Foods India

Jurisprudence evolved through Delhi HC ruling in the case of Sony Ericsson[6] & Maruti Suzuki India[7]

Aggrieved by the order of the ITATs following the special bench ruling, several tax payers, mostly consumer electronics and consumer durables giants like Daikin, Haier, Reebok, Canon and Sony appealed before the Delhi HC. The HC in Sony Ericsson's case laid out the following broad principles in respect of AMP expenses:

- The HC agreed with the revenue that incurrence of AMP expenses may be treated as international transaction under Indian TP regulation.
- The HC rejected the bright line test approach followed by the ITATs for computing the compensation for AMP expenses;
- Distribution function and marketing functions are inter-twined functions and should be analysed in a bundled manner from an arm's length remuneration perspective unless good and sufficient reasons are demonstrated for de-bundling the same;
- If the gross margin or net margin of the Indian taxpayers are sufficient to cover the excess AMP expenses then a separate remuneration for such excess from the foreign affiliate is not required if the bundled approach is found appropriate under the facts of a particular case;
- The HC also ruled that if the distribution and marketing functions are to be de-bundled then the taxpayer should be allowed a set-off for additional remuneration in one function with a short fall in the other function;

[6] Sony Ericsson Mobile Communication India Pvt. Ltd Vs. Commissioner of Income Tax (ITA No. 16/2014)
[7] Maruti Suzuki India Limited Vs CIT (ITA No. 110/2014 & ITA No. 710/2015)

Although the Delhi HC in Sony Ericsson case laid down broad principles and guidelines for computation of ALP of distribution and AMP function, the ambiguity on applicability of the HC ruling for licensed manufacturers still persisted. Transfer pricing issues in respect of AMP expenses for a licensed manufacturer were adjudicated by the Delhi HC in the case Maruti Suzuki India Limited (MSIL). The central issues required to be adjudicated in this case was whether incurrence of AMP expenses by MSIL was an "international transaction".

The HC in MSIL's case held that incurrence of AMP expenditure could not be considered as an international transaction. The HC based its decision on its earlier ruling in the Sony Ericsson's decision whereby bright line test, the very basis of determining the existence of the international transaction, had been rejected. Further, the HC also reasoned that there was no agreement and or arrangement, express or implied, between MSIL and its AE obliging MSIL to incur AMP expenses. The HC also reconciled the decision in Sony Ericsson's case with the decision in MSIL's case, in so far as it related to existence of an international transaction on account of AMP, by highlighting the fact that the MSIL's appeal and Sony's case were delinked and heard separately and also, other assessees in Sony Ericsson's case never questioned the existence of international transaction on account of incurrence of AMP expenses.

Essence of Current Jurisprudence

A combined reading of both the above rulings of the Delhi HC suggest that incurrence of AMP expenses by Indian taxpayers, distributor or manufacturer alike, by itself, does not tantamount to an international transaction. Revenue will have to establish that the Indian taxpayer was under an obligation, express or implied, to incur AMP expenses on behalf of the AE and AMP expenses had, in fact, increased the value of brand owned by the AE. Furthermore, wherever AMP is characterized as an international transaction, bundled approach, in appropriate cases as suggested by HC in Sony Ericsson case and affirmed in Maruti Suzuki case, may be followed to justify the arm's length characteristics of AMP expenses.

Our comments and Way Forward

The central issue that needs answer for addressing the AMP issue is whether the Indian taxpayers have incurred the AMP expenses as a service provider or as an entrepreneur on their own account. This can be verified from the functional analysis between the Indian tax payer and the foreign affiliate group owning the trade mark/brand and conduct of the parties. Based on the functional analysis and conduct of the parties, if it is concluded that the Indian taxpayer is incurring AMP expenses in the capacity of a service provider only, then the question arises whether the Indian taxpayer is remunerated at arm's length or not, for such service. However, if the FAR and conduct suggest that Indian taxpayer has long-term exclusive distribution rights and thereafter incurs AMP expenses and performs all the relevant strategic functions related to AMP expenses and assumes all the risks as an entrepreneur then the Indian taxpayer can be considered as the economic owner of the marketing intangible which should be subsumed under over all FAR analysis of the transacting entities. Economic ownership of the intangible attributable to the Indian licensee will in turn place it at a higher pedestal in terms of its characterisation which, in turn, may impact selection of the transfer pricing method. Insisting on a separate reimbursement for the AMP expenses by an entrepreneurial licensed manufacturer or entrepreneurial distributor from the legal owner of the marketing intangible will tantamount to notching down the characterisation of entrepreneurial licensee manufacturer/distributor to a service provider which may neither be in sync with the FAR of the entity incurring AMP expenses nor in the interests of the revenue in the longer run. An entrepreneurial distributor/licenced manufacturer should be entitled for a return associated with marketing intangibles in the form of premium pricing and increase in the market share.

IRAs have been pushing for upfront remuneration for AMP expenses for all types of Indian taxpayers on the logic that there would be no scope and opportunity for Indian taxpayers to earn for the excess AMP expenses in the eventuality of termination of license agreement or transfer of brand/trademark by the overseas affiliate to another company. Such an argument can very well be countered by adequately incorporating long term exclusive license clause and termination clause where the interest of Indian taxpayer can be safeguarded in the eventuality of early termination. Further, the Indian tax system does not force the characterization of an enterprise merely on speculation that the entity would behave in a certain manner in future.

While the result of the decision of the Hon'ble HC in the Maruti Suzuki's case in respect of AMP issue may have achieved the desired result for the assessee in question, the approach of reaching to the conclusion seems to be focussed on legal interpretation of the definition of an international transaction. The interpretation by the HC in Maruti Suzuki case may lead to a conclusion that had the Sony Ericsson questioned the existence of international transaction on account of AMP then the result of the Sony Ericsson's case might have been different. Therefore, will it be within the arm's length principle to conclude that AMP expenditure cannot be considered as international transaction in any situation?

The AMP saga is still not over in India as a few of the Indian taxpayers, viz, Sony Ericsson, Canon India and Daikin India have filed a special leave petition (SLP) before the SC challenging the Delhi HC ruling. These taxpayers have filed the SLP mainly on the ground that the incurrence of AMP by the Indian Taxpayers cannot be considered as an international transaction. Further, the SC has also admitted IRA's SLP against the Delhi HC ruling in the case of Honda Siel[8]

[8] Honda Siel Power Products Limited Vs.DCIT (ITA No. 346/2015)

wherein the HC deleted the TP adjustment made by the IRA in respect of AMP following Delhi HC ruling in the case MSIL.

In our view, the answer to the issues discussed should be addressed based on the facts of each specific case instead of trying to make it a legal question whether the AMP expenditure is an international transaction or not. As with most transfer pricing issues, this is a mixed question of fact and law. While it may be easy for the Supreme Court to lay down the legal principles, application of those principles by the tax department would be the nub of the issue and could result in another round of litigation unless of course, the Supreme Court rules altogether in favour of the tax department or the tax payer.