MOOT PROPOSITION
DRAFT PROBLEM

The VSC India ("assessee") has filed an appeal before the Hon'ble High Court of Madras under Section 260A of the Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal, Chennai ("Tribunal") passed in the case of VSC India Vs DCIT for the Assessment Year 2008-09. The assessee raised the following substantial questions of law which has been admitted by the Hon'ble High Court of Madras and fixed for final hearing

> *"1. Whether on the facts and circumstances of the case, the Tribunal was right in holding that the advertising, marketing and promotional (AMP) expenditure incurred wholly and exclusively for its domestic business operation was within the realm "international transaction" under Section 92 B of the Act and whether the TPO had jurisdiction to take suo moto cognizance of said AMP expenditure for assessment under TP provisions?*
>
> *2. Whether the Tribunal was right in law in upholding the application of Bright Line Test (BLT) for determining the arm's length range of the AMP expenditure incurred by the assessee even though such method is not prescribed under the IT Act and IT Rules?*
>
> *3. Whether the Tribunal was right in holding that the excess AMP expenditure so calculated by TPO directly benefitted the 'brand' of the parent company and hence had to be reimbursed by the parent company?*
>
> *4. Whether the Tribunal was right in holding that the products/technical know-how developed in the Research & Development department of the assessee company will also benefit the parent company while arriving at a ratio of 50:50 sharing of expenditure without any basis?"*

In relation to the matter at hand, the following Annexures form part of the record of the case:
Annexure A: The impugned order of the Tribunal
Annexure B: Grounds of appeal filed before the Tribunal
Annexure C: Final Assessment Order
Annexure D: Directions of DRP
Annexure E: Objections before DRP
Annexure F: Draft Assessment Order
Annexure G: Transfer Pricing Officer's Order

Annexure A
IN THE **INCOME-TAX APPELLATE TRIBUNAL**, CHENNAI
BEFORE Mr.D.T.A.Senapati ., JUDICIAL MEMBER
AND Mr.T.P.Vardon,ACCOUNTANT MEMBER
ITA No. 007/Che/2013
Assessment Year 2008-2009

VSC India
Chennai,
India……….………………………………………………………………………………….Appellant

Vs.

Dy. Commissioner of Income-tax (DCIT),
Large Taxpayer Unit,
Chennai 101 …......……………………..…………………………………………….Respondent

Assessee represented by: Mr.P.Anthony.
Department represented by: Mr.F.Rebello

Per Bench:

This appeal emanates from the order of Assessing Officer (AO) under Section 143 (3) r.w.s 144C (13) of the Income Tax Act, 1961.

Background:

The assessee is a wholly owned subsidiary of VSC USA and had filed its return of income declaring an income of Rs.100 Crores for the impugned assessment year. The assessee engaged in the business of manufacturing and distribution of bikes and scooters. Since the assessee had international transactions with its Associated Enterprises (AE), the AO referred such transactions to the TPO.

The TPO during course of the proceedings found that all the referred transactions of the assessee with its AE are at arm's length range, but took cognisance of the transactions which were not referred to him and made the following disallowances:

1. Reduction in Royalty:

The TPO noted that there exist a Technical Collaboration Agreement i.e., a license agreement between the assessee company and its parent company where the parent company VSC USA being the LICENSOR licensed the assessee company VSC INDIA being the LICENSEE to manufacture motor bikes (i.e., two-wheelers) using the technical know-how of the parent company with a condition that the assessee company should use prefix the logo 'VSC' in all the finished products along with the particular model name.

The TPO also referred to particular clauses in that Technical Collaboration Agreement wherein it was mentioned that the assessee company shall pay a royalty of 2% in lieu of transfer of technical know-how, provision of technical assistance and technical information for manufacturing bikes and scooters and noted the clause wherein it mandates the assessee to use the logo of the parent company (i.e., VSC) in every finished/manufactured product.

The TPO also observed that it being mandatory for the assessee to use "VSC" Logo on its motorbikes, this only meant that VSC USA ensured that its brand name was being developed in India over a period of time. Therefore, in his (TPO) opinion, the assessee was popularizing the "VSC" brand, whereas, VSC USA was enjoying the benefits.

Relying on the decision of Hon'ble Delhi High Court in the case of ***Maruti Suzuki India Ltd. v. ACIT [2010] 328 ITR 210 (Del.)***, TPO put the assessee on notice as to why the licensor (VSC USA) was not compensating it (VSC India) and why an addition for arm's length price, commensurate with the circumstances should not be made.

In reply to the above, assessee submitted before the TPO that its primary business was manufacture and sale of motor vehicles (two wheelers) in India. As per the assessee, contract manufacturing of components and parts to VSC group companies outside India constituted negligible part of its turnover. Further, as per the assessee, VSC group was one of the world's largest producers of motor bikes with manufacturing and sales in more than 200 markets, spread over six continents. Assessee brought to the notice of the TPO, the directions given by Hon'ble Apex Court in the case of ***Maruti Suzuki India Ltd. v. ACIT*** to complete the transfer pricing assessment in the said case without being influenced by the judgment of Hon'ble Delhi High Court. Nevertheless, as per the assessee, exposure of the foreign brand name, on account of use the logo "VSC" on products manufactured by it, was only an incidental occurrence. Again, as per assessee, the use of logo "VSC" along with its bike model name, had helped the assessee immensely since it benefitted from the "VSC" brand name and hence, advantage was derived by the assessee and not by VSC USA through the use of brand name.

Furthermore, significant sales that assessee could do was only due to the use of "VSC" brand name and it could not be considered that VSC USA was deriving any advantage through promotion of "VSC" logo. Hence as per assessee, the observation that 'VSC' brand was popularized by the assessee, while the VSC USA had enjoyed all the benefits, was fundamentally wrong

However, the TPO did not accept any of the contentions of the assessee. As per TPO, though "VSC" was a global brand, its visibility in India was aided through various brand promotion exercises carried out by the assessee. TPO observed that VSC USA was getting ALL the benefits in the form of dividend by virtue of 100% shareholding as well as royalty based on the number of vehicles sold, in addition to lumpsum compensation from the assessee. The promotional efforts of the assessee generated economic value to "VSC" brand in India, for which, VSC USA was not compensating the assessee. In other words, as per TPO, assessee was only a contract manufacturer of M/s VSC USA. Agreement entered by assessee with VSC USA restricted assessee from manufacturing any other brand of bikes. Tangible marketing benefits were obtained by VSC USA through the efforts of the assessee. From a global study of the royalty rates on a range of products, TPO came to a conclusion that royalty payment in similar cases varied between 1% and 15%. Each bike produced by the assessee became the carrier of the brand of the holding company for which royalty was required to be paid by the holding company, namely, VSC. The TPO therefore considered 0.5% of the total sales effected by the assessee during the relevant previous year, as a reasonable estimate of the arm's length price for development of brand name and logo of VSC in India.

In conclusion on this ground, the TPO ruled based on the ***Maruti Suzuki decision (supra)*** that the royalty paid by the assessee should be reduced by one-fourth (i.e., Rs. 50 lakhs) on account of excess royalty paid for usage of the logo 'VSC' (which is net equivalent to the foreign AE being VSC USA bearing/paying 0.5% on the Indian sales to the assessee for the assessee's brand building activity on behalf of its AE i.e., VSC USA)

2. Excess AMP expenditure

The TPO has also held that once the parent company has preferred to pass on the brand building responsibility to the assessee company it must ALSO i.e., additionally compensate the assessee company for the advertising, marketing & promotional (AMP) expenditure it incurred to promote its brand. Therefore, the parent company by mandating the use of its brand name and logo has not only deprived the assessee company from developing its own brand but also burdened it with the financial costs which are in built in the entire structure of Assessee Company.

Assessee had strongly argued that the primary object of incurring AMP expenses, as per the assessee, was to promote sale of its bikes in India. Assessee also brought to the notice of TPO that the AMP expenses considered included in it sums which was remuneration paid to sales consultants for achieving targets and discounts given for various schemes of sales promotion. According to assessee, such amount could not be included in the AMP expenses. Assessee was of the opinion that there was no gain for VSC USA, which required any compensation to be paid by it to the assessee for the use of "VSC" logo.

TPO disagreed with the assessee and held that the AMP expenses incurred by the assessee, though wholly and exclusively for the purpose of its business, had helped promote the brand logo of M/s VSC USA, namely, "VSC". Expenditure incurred on AMP was beyond normal range. Relying on the decision of Hon'ble Delhi High Court in the case of ***Maruti Suzuki India Ltd. (supra)***, Ld. The TPO held that promotion of the brand was not an incidental activity and that the OECD guidelines had no relevance on such issues. VSC USA was trying to recoup part of brand development expenditure it had incurred during a period of more than hundred years, by promoting their brand in India at the expense of the assessee. As per TPO, if the assessee had benefited from the use of brand name "VSC", VSC USA had also immensely benefitted through heightened brand awareness of "VSC" in India. TPO also disagreed with the contention of the assessee that sales discounts and remuneration paid to sales consultants should be excluded from AMP expenses. As per TPO, such incentives were finally passed on to ultimate customers and were nothing but part of the AMP expenses. The TPO then went on to calculate the arm's length range of the total advertisement, marketing and promotion expenditure (AMP) incurred by the assessee for the relevant assessment year by selecting the following comparables:

- Strongarm Ltd.
- Garuda Ltd.
- Bikes India Ltd.

The TPO applied the **bright-line test** (BLT) wherein he compared the AMP expenses of comparables with the assessee and found that average of AMP spend by comparables was 5% of the total sales whereas the assessee company's AMP expenditure for the impugned assessment year is 15% of the total sales and hence the AMP spend of assessee was above the *bright-line* of the comparables by 10% and hence, disallowed a sum equivalent to 10% of the total sales of the assessee (i.e., 10 crores) by holding that those 10 crores was spent by the assessee to promote the brand of the parent company.

3. Research & Development Expenditure

The TPO also disallowed a sum of Rs.1.5 crores, which was spent by the assessee company in its R&D department to modify the products to suit the Indian road conditions, on the ground that the assessee is incurring expenditure and developing products for which the ownership lies elsewhere i.e., with the parent company and hence, the same cannot be allowed to the assessee as an allowable expenditure.

The assessee then made an application to the Dispute Resolution Panel (DRP), Chennai objecting each of the disallowances made by the TPO as well as challenging the basis of the addition i.e., applicability of TP and jurisdiction of the TPO. but the DRP upheld the order of the TPO and directed the Assessing Officer to disallow the same.

Thus, the assessee is before this Tribunal against the order passed by the lower authorities.

In short, what is before us are three additions made by TPO and upheld by the DRP namely

- **Amount receivable for Brand-building services**,
- **Amount of excess advertising market & promotional** (AMP) **expenditure incurred by assessee to be reimbursed by foreign AE,**
- **R&D expenditure of assessee to be recouped from AE**

At the outset, it is to be noted that the Delhi Special Bench in the case of ***L.G. Electronics India Pvt. Ltd. Vs ACIT [(2013) 141 ITD 41 (Del.SB)]*** has covered most of the issues raised by the assessee in the similar set of facts and circumstances. However, the assessee distinguished its case with the ***L.G. Electronics' case (Supra)*** and ***Maruti Suzuki Ltd Vs DCIT [WP 6876/2008, Delhi HC]*** in the following manner

- L.G Korea was determining the strategy of advertisement to be followed by all the subsidiaries namely the 'blue sea strategy' whereas there is no such strategy is designed by the assessee's parent company and the assessee is entirely responsible for its AMP expenditure.
- Unlike ***L.G. Electronics***' case, the assessee never promoted its brand independently in the advertisements as such but only advertised the various models of bikes and scooters such as YUP 100, XZ 220, etc.

- LG India was obliged to advertise the products manufactured by the LG Korea apart from advertising its own product whereas there is no such restriction/obligation on the part of the assessee to promote/advertise the products manufactured.
- VSC was an established brand already and hence, the usage of the brand will only benefit the assessee and not the parent company.
- Unlike Maruti in the case of ***Maruti Suzuki Ltd. Vs DCIT (Supra)***, the assessee never piggy backed with brand of another company.

Now before us, learned Authorized Representative of the assessee tried to distinguish assessee's case with the facts in the case of Special Bench decision in ***LG Electronics India Pvt. Ltd. v. ACIT (140 ITD 41).*** As per learned A.R., assessee had not spent any amount for promotion of "VSC" brand as such. It was selling various models of bikes where the name "VSC" was mentioned along with the name of the particular model. It was not an independent exposition of the brand "VSC". In the case of ***LG Electronics India Pvt. Ltd. (supra)***, the Associated Enterprise was a company in Korea. The Korean entity was determining the strategy of advertisement to be followed by all LG subsidiaries all through various continents, in what is known as a "blue sea strategy". According to him, such blue sea strategy used by LG, for brand promotion throughout various continents, was absent here in assessee's case. Advertisement, marketing and promotion expenditure (AMP) incurred by the assessee were solely decided by the assessee here in India and there was no strategic or other controls or inputs of VSC USA on such expenditure. According to the learned A.R., "VSC" brand by itself having not been advertised, decision in the case of ***LG Electronics India Pvt. Ltd. (supra)***, had no applicability. Just because assessee had spent a higher amount on AMP, as compared to similarly placed independent entities, would not be a reason to infer that some part of such expenditure were incurred for brand promotion of VSC. Further, as per the learned A.R., in the case of ***LG Electronics India Pvt. Ltd. (supra)***, it was clearly held that it was left to the wisdom of an assessee to choose the amount he wanted to spend for advertisement. Here, the assessee had incurred expenditure on advertisement for selling products, which were having assessee's own bike name, and therefore, TPO should not have indulged in a transfer pricing analysis on such spends.

The Learned A.R. submitted that "VSC" had never piggybacked on the assessee. VSC USA was a pre-eminent name in the world of motor bikes. To say that, an international brand like "VSC", which had an aging close to hundred years before coming to India, derived any benefit by virtue of expenditure incurred by its Indian subsidiary for promoting such brand was a strange proposition. According to him, it was the assessee which had derived benefit by way of "VSC" brand name in India and had piggybacked on such brand name. Assessee got a head start when compared to an entity which was to develop its own brand. Thus, significant benefits were enjoyed by the assessee, by the use of "VSC" logo and not by VSC USA. Total sales of VSC India was < 1% of global sales. Assessee's endeavour here was only to promote its own bike brands and not promoting "VSC" as an umbrella brand in India. Further, as per learned A.R., it was under no obligation to use "VSC" brand name for all bikes manufactured by it. Mandatory use of "VSC" logo was required only for bikes manufactured by the assessee, based on the Technical Collaboration Agreement . So the assessee was not precluded from manufacturing or marketing any bikes other than the bikes which made use of VSC USA knowhow. Thus, the observation that there was a restriction placed on the assessee and assessee on account of such restriction lost out on promoting its own brand name, was not based on facts.

According to the Learned AR, in the ***LG Electronics case (supra)***, LG India was the provider and was to incur advertisement related expenses for LG products manufactured by LG India as well as by LG Korea. However, here in the case of the assessee, it was not obliged to incur any expenditure on advertisement for any VSC bikes sold by VSC USA or manufactured by VSC USA. According to him, the presumption that there was an international transaction relating to brand building itself was wrong. There was no such agreement between assessee and VSC USA. The use of "VSC" logo or trademark was not mandatory, but was only a consent given by VSC USA to the assessee. It was submitted that in ***L.G. Electronics case (supra)*** advertisement of LG India was for umbrella brand 'LG' and not for specific products. In assessee's case, according to learned A.R., there was no such standalone advertisement of VSC brand or logo. There was no implied agreement between assessee and VSC USA for promoting the brand "VSC" in India. LG was manufacturing different types of products, whereas, assessee was manufacturing only bikes and the name of "VSC" was also associated only with bikes. In other words, as per learned A.R., there was no primary obligation for the assessee to market "VSC" products in India, whereas, such an obligation was there in the case of ***L.G. Electronics India Pvt. Ltd. (supra)***.

Without prejudice it was submitted that the tests specified by the Special Bench in ***LG Electronics's case (supra),*** if applied in assessee's case, would clearly show that facts in the former case were entirely different. The tests which had to be applied and result of such test would be as under:-

S.No.	**Tests prescribed by Special Bench in LG Electronic's case**	**Result of the test vis-à-vis LG India**	**Result of the test vis-à-vis assessee**
1.	Whether the Indian AE is simply a distributor or is holding a manufacturing license from its foreign AE?	License from AE to manufacture and sell he products and also for distribution of products.	License from AE to manufacture and sell the products.
2.	Where the Indian AE is not a full-	LG India is	Assessee is

	fledged manufacturer, is it selling the goods purchased from the foreign AE as such or is it making some value addition to the goods purchased from its foreign AE before selling it to customers?	primarily a licensed manufacturer	predominantly a full-fledged Entrepreneur and markets and sells motor bikes in the Indian market. It purchases materials and components both from AEs and third parties that are used in manufacture of two-wheelers sold to dealers / customers.
3.	Whether the goods sold by the Indian AE bear the same brand name or logo which is that of its foreign AE?	Yes.	The products sold bear the "VSC" Brand along with the bike model and name styles registered in India.
4.	Whether the goods sold bear logo only of foreign AE or a logo which is only of the Indian AE or is it a joint logo of both the Indian entity and its foreign counterpart?	Generally, only the Logo of LG Korea	Respective bike brand name like "YUP 100", etc. is added along with the VSC logo. The bike and scooter models have brand recall specific to the product.
5.	Whether Indian AE, a manufacturer, is paying any royalty or any similar amount by whatever name called to is foreign	No Brand royalty is paid, but it has been specifically mentioned in the	There is no such agreement with AE and no brand royalty

	AE as a consideration for the use of the brand/logo of its foreign AE?	agreement that brand royalty when demanded by LG Korea needs to be paid by LG India after obtaining approval from Government of India.	is paid.
6.	Whether the payment made as royalty to the foreign AE is comparable with what other domestic entities pay to independent foreign parties in a similar situation?	No brand royalty paid for that year.	Not applicable as no brand royalty is paid.
7.	Where the Indian AE has got a manufacturing license from the foreign AE, is it also using any technology or technical input or technical knowhow acquired from its foreign AE for the purposes of manufacturing such goods?	Yes.	Yes.
8.	Where the Indian AE is using technical knowhow received from the foreign AE and is paying any amount to the foreign AE, whether the payment is only towards fees for technical services or includes	Royalty payment is only towards the technical license, but the agreement also allows use of brand. The parent	Royalty payment is towards technical license and not towards brand name or trademark or

	royalty part for the use of brand name or brand logo also?	company has a right to demand for Brand royalty later.	logo.
9.	Whether the foreign AE is compensating the Indian entity for promotion its brand in any form, such as subsidy on the goods sold to the Indian AE?	Details not available.	There is no such brand promotion, so no question of "subsidy" on goods sold to Indian AE to compensate brand promotion.
10.	Where such subsidy is allowed by the foreign AE, whether the amount of subsidy is commensurate with the expenses incurred by the Indian entity on the promotion of brand for the foreign AE?	Detail not available.	There is no such brand promotion and no subsidy.
11.	Whether the foreign AE has its presence in India only in one field or different fields? Where it is involved in different fields, then is there only one Indian entity looking after all the fields or there are different Indian AEs for different fields? If there are different entities in India, then what is the pattern of AMP expenses in other Indian entities?	The company operated in the consumer goods industry and telecom industry, and deals with several electronic products. There is only one entity in India.	The company operates in only one industry – two-wheeler industry. There is only one entity that manufactures and sells the products.

12.	Whether the year under consideration is the entry year for the foreign AE in India or is it a case of established brand in India?	LG India was in existence for more than a decade.	In existence for nearly a decade.
13.	Whether any new products are launched in India during the relevant period or are it continuation of the business with the existing range of products?	Information not available.	YUP 100 has been launched in November 2009.
14.	How the brand will be dealt with after the termination of agreement between AEs?	Information not available.	No express agreement on this matter.

With regard to the Bright Line test (BLT) applied by TPO learned A.R. submitted it was not an appropriate TP method at all under the Act. The learned A.R. submitted that no new procedure could be invented apart from the procedures in Rule 10B of Income-tax Rules, 1962 for determining ALP.

In any case, according to learned AR, the AMP expenditure considered by the lower authorities included sums to sales consultants and direct sales expenditures which were not a part of AMP.

In defence, the learned D.R. at the outset submitted that AMP expenditure had added value to the brand name “VSC” in India and local subsidiary was not compensated by VSC USA. Not only had VSC USA not compensated, they were on the other hand getting considerable royalty on each and every vehicle sold by the assessee. Parent company had a free ride by getting their brand promoted in India without incurring any cost. Learned D.R. submitted that Hon'ble Delhi High Court in the case of ***Maruti Suzuki India Ltd. v. Addl. CIT/TPO (supra)*** had clearly observed that when there was compulsory use of a foreign trademark on products sold in India, benefit was derived by the owner of such foreign trademark.

Learned D.R. submitted that **"marketing intangibles"**, generated through market development, consists of two ingredients. One was to generate through market targeting and the second was through product targeting. They were separately considered and valued and according to him, it was not a case of double addition. A wholly owned subsidiary will always endeavour to maximize the profit its parent company. What was built by the excessive AMP spending in India was promotion of an international brand and not any indigenous brand. There was an opportunity cost to the assessee, which was foregone. Assessee could have developed its own brand but had instead ended up building foreign brand in India.

Justifying the dual methodology adopted by the TPO, learned D.R. submitted that value of intangibles like brand was made through perceptions of the products of the assessee, in the minds of the consumers. This created a **market capitalization value over and above the accounted value of AMP cost**. Assessee had employed market-targeted method and product-targeted method for enhancing the "VSC" brand. Market capitalization of brand value was considered at 0.5% of sales turnover, whereas, logo enhancement through product categorization was reflected in excess AMP spends.

According to the DR such separate valuation and aggregation done by TPO did not result in any double addition. The benefit derived by VSC USA through the excess spending done by assessee in India was creation of an intangible asset. Such intangible asset is the future benefit VSC USA will derive, if it directly marketed its product or entered into an agreement to sell its product through a concern other than the assessee.

The Learned D.R. submitted that all the business activities of the assessee were controlled by its parent company. Higher AMP expenditure resulted in lower profit margin and therefore assessee required to be tested under TNMM method. Marketing intangible in the nature of brand value add-on, was a benefit *over and above* sales generated and its value had to be captured. Marketing intangible of Type 1 created brand enhancement as a spin-off from normal sales. On the other hand, marketing intangible of Type 2 was created by higher than normal AMP expenditure, which resulted in additional sales, and brand enhancement from such additional sales.

The Learned DR arguments are summarized thusly:

a) Advertising (AMP) expenses incurred by the assessee were not for its own brand, but for its parent VSC USA, since assessee was a 100% subsidiary
b) Shareholder interest of the parent company was maximized through both tangible dividends as well as intangibles. International Accounting Standard 38 clearly recognized generation of international intangibles by a subsidiary for its parent company.
c) Royalty rate of 0.5% adopted by the TPO was based on reasonable industry accepted norms
d) Brand was one of the most important assets of an organization and valuation thereof was an essential element in taxation. "Royalty relief" approach considered by the Revenue was an accepted methods for such valuation.
e) Judgment of Hon'ble Delhi High Court in ***Maruti Suzuki's case (supra)*** which held that the comparables adopted by the TPO might not be appropriate comparables.

With respect to the Research & Development expenditure, the assessee submitted that the parent company cannot attain any benefit from the above expenditure as the R&D was carried out in manufacturing unit was to suit the products to the Indian road conditions. In other words, the products and IP rights developed in the assessee's R&D department cannot be made use by the parent company since the products developed are Indian centric. In any case, according to the assessee, the assessee became the economic owner of the products developed in its R&D department and hence, the parent company has no right over it. The TPO had held that ownership of the products developed by the assessee company was with the parent company and as per the Technical Collaboration Agreement expenditure incurred on development of product has to be attributed to parent company.

We have carefully perused the orders of the lower authorities and heard the rival submissions and pass the orders by analysing all the grounds raised by the assessee as under:

Ground #1 is a general ground and cannot be adjudicated here

<u>Ground #2: International Transactions & Jurisdiction:</u>

The summary of assessee's arguments in this regard is that the assessee never sold/advertised the brand 'VSC' in the promotions/advertisements but only the products such as YUP 100, XZ 220, etc. The assessee substantiated its argument by submitting that the Technical Collaboration Agreement between the assessee and its parent company never insisted on manufacturing the products licensed by the parent company alone and there was not a single clause in the agreement which mandates the assessee to use the technical know-how of the parent company. In other words, the assessee is free to manufacture the products and use a completely different technical know-how from that of its parent company and hence, penalising the assessee based on the Technical Collaboration Agreement is baseless. The assessee company also submitted that there is no "transaction" per se in this case with the parent company for the usage of logo 'VSC' and that royalty paid is only for the provision of technical know-how, technical assistance and expertise. Therefore, bifurcating a part of the Royalty payments and terming it as a fees paid for usage of the logo 'VSC' is absolutely erroneous as there is no "transaction" involved between the parties for usage of the logo.

Secondly, with regard to the excess AMP expenditure also, the assessee company submitted that there is no "transaction" involved between the assessee and the parent company. The substantiated its contention by stating that in order to take cognisance under Section 92 of the Act, there must be a "transaction" between the assessee and the parent company (i.e., an associated enterprise situated outside India) and in the instant case, the AMP expenditure incurred by the assessee was expended to the Indian TV channels/newspapers and the advertisements predominantly viewed by Indian viewers and the bikes/scooters are sold in India. Hence, the main prerequisite to cognisance under Section 92 is failed as there is no transaction between the assessee and the associated enterprise.

The assessee reiterated its ground by stating that the entire transactions related to the AMP expenditure took place between the domestic parties (assessee and Indian advertisers) and hence, the second prerequisite (i.e., presence of “international transaction” between the associated enterprises and the first prerequisite being presence of “transaction” between related parties) for taking cognisance under Section 92 of Act was also failed. Therefore, there is no question of transfer pricing additions.

With regard to the jurisdiction issue, the assessee contended that as per Section 92 of the Act the TPO can make ALP adjustments to the transactions which are referred to him by the AO and the TPO has grossly erred in this case to take cognizance of the case which was not referred to him by the assessee. Furthermore, the assessee submitted that the amendment of Section 92 which increased the scope of the TPO can be applied only prospectively and not retrospectively.

We have perused to the Technical Collaboration Agreement and agree with the point of the assessee that the agreement never mandated the assessee to manufacture the products licensed by the parent company and use the technical know-how of the parent company. However, we cannot forget the ground realities. The assessee is a 100% wholly owned subsidiary of the parent company VSC USA and it so far NOT manufactured any products or used the technical know-how other than the products/know-how licensed by the parent company under the agreement. Hence, the ground of the assessee that the VSC India is an Independent bikes and scooters manufacturer is summarily rejected.

Secondly, the Technical Collaboration Agreement mandates the assessee to prefix the logo ‘VSC’ to all the finished manufactured products. The assessee’s argument that it has never promoted the brand ‘VSC’ as such but only promoting products like YUP 100, XZ 220, etc. should also be rejected because the assessee never advertised/promoted the products with the product’s name alone but also prefixed the logo ‘VSC’ before it. We rely on the decision of Special Bench in the case of ***L.G.Electronics (Supra)*** in this regard.

The abovementioned Special Bench decision in the case of ***L.G.Electronics (Supra)*** also dealt with the issues of “transactions” and “international transactions” and decided it in favour of the revenue by holding that though there are is explicit contract between the assessee and the parent company (AE) there exist an implied contract between the parties (AEs) to promote the brand of the parent company. Therefore, this bench also decides the issue in favour of revenue by respectfully following the decision of Special Bench.

With respect to the jurisdiction issue raised by the assessee, we are of the view that this issue has also been squarely covered by the Special Bench decision. The assessee, in this instant case, also has not reported the brand building activity as international transaction under section 92E of the Act and when it is not reported by the assessee, it would be imprudent o expect the AO to refer the said transaction to the TPO and the TPO is totally justified in taking suo motu cognizance of the international transactions.

In view of the Special Bench decision, we therefore hold this issue in favour of Revenue.

Ground #5: Double Disallowance:

We decide Ground #5 before Grounds #3 and #4 as the proposition laid down in this ground will implication on the other grounds. Let us now analyse this issue

The assessee submitted that, the TPO in the instant case, in order to disallow the brand promotion expenditure of the assessee company had made a double disallowance and thus caused double burden to the assessee. The assessee further submitted that the TPO on one hand had reduced the percentage of Royalty paid by the assessee as per the Technical Collaboration Agreement by 0.5% owing to the fact that it is only the parent company which should compensate the assessee company for prefixing the logo 'VSC' (copyrighted by the parent company) to all the vehicles the assessee company manufactures instead of using its own brand and on the other hand, disallowed the excess Advertising, Marketing and Promotion (AMP) expenditure incurred by the assessee using the Bright Line Test. The assessee argued that both the disallowances have same characteristics and identical in nature (i.e., disallowance of brand promotion expenditure) and hence, disallowing the expenditure incurred under the very same head twice is illegal and unwarranted.

The revenue on the other hand strongly supported the order of the lower authorities by stating that disallowance of Royalty and disallowance of excess AMP expenditure are two separate distinct entries and does not have the character of the same. The revenue submitted that because of the Royalty rates (which is 2% as per the agreement) the assessee company's profit gets curtailed unnecessarily for bearing the logo of the parent company and hence, the reduction in Royalty rate by 0.5% would bring back the profit of the assessee company to its normal level; whereas the disallowance of excess AMP expenditure would denote the expenditure incurred by the assessee company on behalf of the parent company.

We have heard the rival submissions and we are in consensus with the argument of the assessee company that the TPO disallowed the brand promotion expenditure in two aspects. First one for enhancing the brand value through the sale of vehicles done by the assessee and for valuing the second one, the TPO worked out AMP expenditure which he considered excessive when compared to the similar expenses incurred by the similarly placed companies but not doing any brand building for associated enterprise.

We are of the view that the findings of the TPO are mere surmises and are not backed by empirical data. Unless, the revenue is able to prove substantially that the Royalty rate of encompasses the payment for usage of logo 'VSC' it would be imprudent to hold it so. In this instant case, the revenue failed to prove substantially that the Royalty payment made by the parent company includes the payment for usage of logo 'VSC'. Also, in our opinion, the only objective criteria that could be applied is the disallowance of excess AMP expenditure incurred by the assessee when compared to its competitors not having a foreign brand or logo. The Special Bench also in the case of ***L.G. Electronics (Supra)*** had held that Bright Line Test is nothing but a method falling under the ambit of 92 C of the Act and that the amount on one side of the Bright Line was the amount of expenses incurred on normal course of business whereas the amount on the other side of the Bright Line indicates the excess AMP expenditure incurred on behalf of the parent which ought to be disallowed in the hands of the assessee company.

Hence, this question is answered in favour of the assessee and consequently, Ground #3 and Ground #5 are answered in favour of the assessee.

Ground #4: Disallowance of excess AMP expenditure

The assessee supported its grounds of appeal in this regard by stating that it was not engaged in the brand building activity of its parent company. The assessee asserted that the usage of logo 'VSC' has only benefitted the assessee in boosting its sales in India and not otherwise and hence, no disallowance/addition could be made to the assessee. Alternatively, the assessee argued that Bright Line Test adopted by the TPO is not one of the prescribed five methods in the then Section 92 of the Act and that the amendment which included the sixth method called "any other method" is only applicable prospectively from AY 2012-13. The assessee has also raised a ground that the decision of Delhi High Court in the case of ***Maruti Suzuki Ltd. (Supra)*** is no more good in law as that decision has been overruled by the Supreme Court.

Without prejudice to the above grounds, the assessee also raised the following grounds:

- The TPO did not give suitable adjustments to the comparables adopted by it to account for the differences in the comparable companies.
- Out of the total 15 crores of AMP expenditure, 2 crores related to direct selling expenditure which should be allowed as per Special Bench decision.

Whereas the learned DR supported the orders of the lower authorities and relied on the decision of Delhi Special Bench in the case of ***L.G. Electronics (Supra)*** in support of its argument that the assessee was indeed promoting the brand of the assessee and the Bright Line Test will fall well within the ambit of the prescribed five methods.

We have considered the rival submissions and we are of the considered view that the main ground of the assessee in this regard is liable to be rejected since the Special Bench in the case of ***L.G. Electronics (Supra)*** has very clearly held that the Bright Line Test was nothing but a method falling within the scope of Section 92C of the Act. It also held that BLT is only a line drawn in between an overall AMP expenditure and that amount on one side of the BLT represents the AMP expenditure incurred during the normal course of the business whereas balance amount represents expenses incurred for and on behalf VSC USA for creating and maintaining its marketing intangible which was the 'VSC' logo. When both the expenses are in-built some mechanism needs to be devised for ascertaining the cost of the international transaction. Furthermore, the assessee also had neither declared the expenditure incurred for brand building activity as international transaction nor found out the arm's length range of the AMP expenditure by employing any one of the prescribed methods and hence, it is up to the TPO to choose a method which he/she feels is appropriate. Secondly, the issue of whether the decision of Delhi High Court in the case of ***Maruti Suzuki Ltd. (Supra)*** still holds good or not has also been answered by the Special Bench in the case of ***L. G. Electronics (supra)*** in favour of revenue. Accordingly, we also decide this issue in favour of revenue.

With regard to the other two grounds raised by the assessee, we are in agreement with the first two contentions of the assessee i.e., TPO should give proper adjustments to the comparables selected by him to account for the differences in functional profile of the comparables when compared it with the functional profile of the assessee company and also as held by Special Bench in the case of ***L.G. Electronics (Supra)*** that the Direct Selling expenditure should be allowed as an allowable expenditure in the hands of the assessee. We, therefore, remit the matter back to the file of AO to recompute the ALP of the AMP expenditure of the assessee after making suitable adjustments to the comparables selected by the TPO and also to deduct the direct selling expenditure from the ambit of its AMP expenditure as that is an allowable expenditure.

Therefore, this issue is allowed partially in favour of the assessee and partially in favour of the revenue.

Ground #6: Research & Development Expenditure:

The TPO has held that the ownership of the products developed by the assessee company was with the parent company and as per the Technical Collaboration Agreement entered in to between the assessee and the parent company and therefore, expenditure incurred on development of product has to be attributed to the parent company. On the other hand, it was the submission of the assessee that it has only been remodelling the products of the parent company to suit the Indian road conditions and that the assessee had become the economic owner of the products developed and moreover the products developed cannot be used by the parent company situated in USA as products/remodelling done in R&D department of the assessee is Indian centric and will not be of any use to the parent company.

We have considered the rival submissions and of the view that although the products developed in the R&D department are Indian centric and will not be of any use to the parent company situated in USA, the parent company ultimately holds the ownership (legal) of the products developed and it could sell/transfer/license the products developed by the assessee to the other companies situated outside India but has similar road conditions. At the same time, we cannot say that the R&D department solely benefitted the parent company alone as the assessee had used the technology/product it developed on the vehicles it manufactured and attained economic benefit. Hence, in our view, both the parent company of the assessee as well as the assessee company has benefitted from the expenditure incurred by R&D department of the assessee company.

In such circumstances, we are of the opinion that 50% of the total R&D expenditure should be attributed to the assessee company and the remaining 50% of the R&D expenditure should be attributed to the parent company. Hence, we decide this issue partly in favour of the assessee and partly in favour of the revenue.

Summary

- Ground No. 1 & 7 – These are general grounds and hence require no adjudication.
- Ground No.2 (International transaction & Jurisdiction) – This issue is decided in favour

of Revenue.

- Ground No. 3 & 5 (Reduction of royalty rate by 0.5% and Double disallowance): These issues are decided in favour of assessee.

- Ground No. 4 (Disallowance of excess AMP expenditure): The main ground of the assessee is answered in favour of the revenue and two out of the total three alternate grounds (i.e., suitable adjustments to be made to account for differences in functional profile of the comparable companies and that the direct selling expenditure such as commission, brokerage, etc. should be considered as an allowable expenditure) are answered in favour of assessee for stastical purpose.

- Ground No. 6 (disallowance of R&D expenditure): This ground is decided partially in favour of assessee and partially in favour of revenue.

In the result, the appeal of the assessee is partly allowed.

Order was pronounced in the court on 16th December, 2013.

Sd/-
(T.P.Vardon)
Accountant Member

Sd/-
(D.T.A. Senapati)
Judicial Member

Chennai: Dated 16-12-2013
Copy to:

1. Parties
2. The AO
3. The TPO
4. The DRP

(True Copy)

By Order
Asst. Registrar, ITAT Chennai

Annexure B

Form No. 36B
Form of appeal to the Appellate Tribunal

In the Income Tax Appellate Tribunal, Chennai Bench
ITA No. 007/Che/2013
AY: 2008-09

VSC India …… Appellant

Vs

DCIT (LTU) ….. Respondent

Grounds of Appeal

1. The DRP/AO erred in law by confirming the addition made by the TPO to the tune of Rs. 12 crores based on Chapter X of the Income Tax Act.

2. International Transaction & Jurisdiction

2.1 The DRP/TPO erred in law and in facts in considering the expenditure wholly and exclusively for its domestic business operations within the realm of 'International Transactions' based purely on conjectures and surmises.

2.2 The DRP/TPO erred on facts and in law in taking cognisance suo moto of the alleged international transaction which had not been specifically referred to the TPO by the AO under Section 92 CA of the Act.

2.3 The DRP erred in upholding the action of TPO in not satisfying any of the conditions prescribed under Section 92C(3) of the Act before making an adjustment to the income of the appellant.

3. Reduction in Royalty

3.1 The DRP/TPO erred in facts and in law in holding that the amount of royalty paid by the assessee to its parent company should be reduced by 0.5 percent.

3.2 The DRP/TPO erred in law and in facts in holding that the 0.5% out of the total two percent of the royalty paid is for the usage of logo in the products manufactured.

3.3 The DRP/TPO erred in holding that the usage of logo 'VSC' in the manufactured products leads to brand building of the parent company.

3.4 The DRP/TPO erred in ignoring the fact that the usage of logo 'VSC' in the assessee's manufactured products only boosts the sales of the assessee company.

4. Disallowance of Excess AMP expenditure

4.1. **Advertising, Marketing and Promotional (AMP) expenditure**

4.1.1 The DRP/TPO erred in law and in facts by alleging that VSC India (Appellant) has popularised and taken efforts to build the 'VSC' brand by incurring excess AMP expenditure whereas the VSC USA (AE) enjoyed all benefits accrued from AMP expenditure incurred by the Appellant for its domestic business operations.

4.1.2 The DRP/TPO erred in holding that the AMP expenditure incurred by the assessee promotes the brand of the parent company.

4.1.3 The DRP/TPO erred in not appreciating the fact that Bright Line Test (BLT) is not one of the prescribed methods for finding out the arm's length range of the international transactions.

4.1.4 The DRP/TPO erred in making transfer pricing adjustments without making suitable adjustments to the comparables adopted to account for the differences in functional profile and economic circumstances.

4.1.5 The DRP/TPO erred in ignoring fact that in the total AMP expenditure of Rs. 15 Crores, Rs. 2 crores amounts to direct selling expenditure in the form of commission, brokerage, etc. which in no way promotes the brand of the assessee.

4.1.6 The DRP/TPO erred in ignoring the fact that the assessee is only in its initial years of its business and hence, it needs to spend more on AMP expenditure to gain visibility in India.

4.2. **Maruti Suzuki Ltd. Vs ACIT (328 ITR 210 Del) overruled**

4.2.1 The DRP/TPO erred in ignoring the fact that the Delhi High Court's decision in the case of ***Maruti Suzuki Ltd. Vs ACIT (328 ITR 210 Del. HC)*** was overruled by the Supreme Court in ***Maruti Suzuki vs. ACIT*** **(335 ITR 121 SC)**.

4.2.2 The DRP erred in holding that the Supreme Court did not overrule the decision of Delhi High Court entirely and hence, the principle laid down by the Supreme Court still holds good.

5. Double Disallowance:

5.1 Without prejudice to the above grounds, it is submitted that DRP/TPO grossly erred in making double disallowance of the assessee for the same expenditure (i.e., Brand Promotion Expenditure).

5.2 The DRP/TRP cannot make additions for the same transaction twice. In other words, the DRP/TPO could either reduce one percent of the royalty paid by the assessee (or) could disallow the excess AMP expenditure incurred by the assessee for building the brand of the parent company, but cannot make additions on both accounts.

6. Research & Development Expenditure

6.1 The DRP/TPO erred in ignoring the fact that the assessee is the legal owner of the product developed in its R&D department and the parent company of the assessee has no right to use the products developed by the assessee without assessee company's permission.

6.2 The DRP erred in relying on a general clause in the Technical Collaboration Agreement which only states that any improvement and modification in the products will belong to the parent company.

6.3 The DRP/TPO erred in not considering the fact that the products developed in the R&D department are not merely improvements and modifications in the product, but include remodelling to suit the Indian road conditions.

7. The appellant seeks leave to add to, amend or withdraw any of the aforesaid grounds of appeal.

For VSC India
Location: Chennai
Date: 31.03.2013
Director

Annexure C

INCOME TAX DEPARTMENT
No. 121, M.G.Road, Nungambakkam, Chennai - 34

FINAL ASSESSMENT ORDER
U/S 143(3) r/w 144C (13) OF THE INCOME TAX ACT, 1961

Present : Sri. Arvind Hazare,
Deputy Commissioner of Income Tax

A.Y/ 2008-09 **Date: 31.01.2013**

1	Name and address of the company	:	VSC India Ltd. No. 105A, Dr. Radhakrishnan Salai, Mylapore, Chennai
2	Assessment Year	:	2008-09
3	Permanent Account Number	:	RRRR AB 1234
4	Status	:	Company
5	Whether Resident/ Non-Resident/ Resident but not ordinarily resident	:	Resident
6	Method of Accounting	:	Mercantile
7	Previous year ending	:	31.03.2008
8	Nature of Business	:	Manufacturing and dealing of bikes, automobile accessories, spares, etc.
9	Dates of Order	:	31.01.2013
10	Section & Sub-section under which the order is made	:	143(3) r.w.s 144C(13) of the Income Tax Act

FINAL ASSESSMENT ORDER

The assessee has filed its return of income for the AY 2008-09 declaring a total income of Rs.100 Crores. The return was processed under Section 143(1)and subsequently, the return was selected for scrutiny and notice u/s 143(2) was issued to the assessee.

Based on the details submitted by the assessee, draft assessment u/s 143(3) read with 144C was forwarded to the assessee company as a proposed order. The assessee filed an application before the Dispute Resolution Panel (DRP), Chennai and the Hon'ble DRP passed an order dated 31.12.2012 and made the following additions and directed me to follow the same.

Adjustment towards transfer pricing u/s 92 CA:

The DRP determined the arm's length price of the international transaction carried out by the assessee company with its associated enterprises during the financial year 2007-08 as under.

1. International transaction & jurisdictional issues:

The Learned DRP has held that the additions made by the TPO were as per Provisions of the Act and hence this Ground of the assessee is rejected.

2. Reduction of Royalty paid:

The Royalty paid by the assessee to its parent company is reduced to one percent from two percent for the following reasons:

a) VSC India is mandatorily required to use the brand VSC which is owned by an overseas parent company.

b) VSC USA charges royalty of one-fourth of the total two percent from VSC India for using the logo of VSC.

c) Hence, that one-fourth percent of royalty paid is deleted from the allowable expenditure and liable to be taxed.

Therefore, a sum of Rs. 50 lakhs out of the total Rs. 2 Crores paid should be reimbursed by the parent company VSC USA to VSC India.

3. Reimbursement of AMP expenditure incurred on behalf of the parent company

The DRP has concluded that the assessee has incurred Advertising, Marketing and Promotional (AMP) expenditure over and above the arm's length range on behalf of the parent company and hence, the same has to be disallowed in the hands of the assessee /reimbursed by the parent company. The DRP culled out the following reasons for disallowing the same.

a) The Indian assessee company has been brand building the image of the overseas parent company at the cost of developing its own brand.

b) There is no infirmity in the order of TPO while bench marking certain AMP expenditure and holding that the bench marked expenditure lead to the promotion of the brand of the overseas parent company.

c) The comparables identified by the TPO are proper comparables, though they are not identical to that of the assessee, they are in the same line of business as that of the assessee.

d) In our considered view, the TPO has relied on the principles laid down by the Hon'ble High Court of Delhi in the case of ***Maruti Suzuki Ltd. Vs ACIT (Supra)*** which still holds good as the Supreme Court has not overruled the entire concept of brand promotion but has only sent it back to the file of AO to decide the matter afresh.

For the foregoing reasons, it was directed by the DRP to disallow a sum of Rs.10 Crores for incurring AMP expenditure over and above the arm's length range.

4. Research & Development Expenditure:

The DRP has also concluded that the assessee has an incurred expenditure of Rs.1.5 Crores on Research & Development and developed products to which the ultimate ownership lies with the parent company. The DRP relied on a clause in the agreement which clearly stated that the improvement, modification of products and parts shall be treated as licensed information whose ownership lies with VSC USA and dismissed the assessee's objection that the ownership lies with VSC India (i.e., the assessee).

Hence, the DRP has confirmed the disallowance made by the TPO and directed the AO disallow a sum of Rs. 1.5 Crores towards the product development expenditure.

Thus, the DRP has directed this AO to make an addition to the tune of ~ Rs. 12.00 Crores with respect to assessee's international transactions with its associated enterprises.

Accordingly, the above amount of Rs. 12.00 Crores is added to the total income of the current year. Penalty u/s 271(1)(C) of the Act will be initiated separately for this purpose.

ADD: Rs. 12,00,00,000/-

Based on the above facts and circumstances of the case, the assessment is completed as under:

Computation under Normal Provisions:

Business income	:		Rs.100,00,00,000/-
Add: Additions u/s 92 CA	:	Rs.12,00,00,000/-	
Total Taxable Income	:		Rs.112,00,00,000/-

Copy to:
1. The Parties
2. The AO
3. The TPO
4. The DRP
5. The Guard

Annexure D

Income Tax Department
DISPUTE RESOLUTION PANEL (DRP)
No. 121, M.G.Road, Nungambakkam, Chennai - 34

DIRECTIONS U/S 143(5) r.w.s 144C (8) OF THE INCOME TAX ACT, 1961

Present:
1. Sri.John D'Souza, Member
2. Smt. Indira Rani, Member
3. Sri. V.Vijayaraghavan, Member

F. No. DRP/ Chennai/A.Y/ 2008-09 **Date: 31.12.2012**

1	Name and address of the company	:	VSC India Private Ltd. No. 105A, Dr. Radhakrishnan Salai, Mylapore, Chennai
2	Assessment Year	:	2008-09
3	Permanent Account Number	:	RRRR AB 1234
4	Total Income as per Draft Order	:	Rs. 112.00 Crores
5	Date of Forwarding of Draft Order	:	09.04.2012
6	Date of Filing of Objections by the Assessee before the DRp	:	23.04.2012
7	Dates of Hearing	:	20.09.2012, 21.10.2012 and 22.12.2012
8	Dates of Direction	:	31.12.2012
9	Section & Sub-section under which the directions are given	:	144C(5) r.w.s 144C(8) of the Income Tax Act

VSC USA Inc. (hereinafter VSC USA) is one of the world leaders in the area of manufacturing bikes and scooters. During the year 2000, VSC USA purchased 10% of RPAS India Ltd. and in February 2003 they jointly started to manufacture and distribute products in the name of "VSC India". In December 2003, the equity pattern changed to 50:50 between VSC USA and RPAS India Ltd. and the Indian company was renamed to VSC India Ltd (hereinafter called "VSC India"). In March 2004, VSC USA purchased the remaining 50% from RPAS, India.

The assessee filed its return of income for the assessment year 2008-09 declaring an income of 100 crores. The return was processed under Section143(1) and later selected for scrutiny. The assessing officer (AO) referred the case to Transfer Pricing Officer (TPO) for computation of Arm's Length Price in relation to international transactions. The TPO finalised the order which was communicated to the assessee by way of draft assessment order u/s 144C r.w.s. 143(3) of the IT Act, 1961. In response to the same, the assessee filed its objection in Form 35A in terms of Section 144C. The objection filed before this Dispute Resolution Panel was within the time prescribed.

In response to the notice u/s 144C(11), the learned authorised representatives for the assessee company appeared. Explanations filed by them were taken on record and the case was discussed.

The assessee has raised three grounds of objections in Form 35A which are analysed and adjudicated as follows:
Objection #1: The TPO order was erroneous as the instant case did not involve any international transaction and the order was passed without jurisdiction

With regard to the assessee's AMP expenditure not being "international transaction" and hence not under purview of Transfer Pricing assessment and the with regards to the fact that the TPO should not have taken suo moto cognizance of the advertising, marketing & promotional (AMP) transactions of assessee when they were not reported in the Form 3CEB and hence not referred by the AO are BOTH squarely covered by the Special Bench decision in ***L.G. Electronics India Pvt. Ltd. Vs ACIT [(2013) 141 ITD 41 (Del.SB)]***. In short, the assessee in this case has not reported the brand building activity as international transaction under section 92E of the Act and when it is not reported by the assessee, we cannot expect the AO to refer the said transaction to the TPO and the TPO is totally justified in taking suo motu cognizance of the international transactions as per the provisions of the Act. Therefore in view of the L.G. Special Bench decision (supra), we therefore hold this issue in favour of Revenue.

Objection #2: The TPO erred in concluding that the amount of royalty paid by the assessee should be reduced by one percent owing to the fact that the Technical Collaboration Agreement mandates the assessee to use the logo/trademark of the foreign parent company.

It is the contention of the assessee that the usage of logo on the finished products only benefits the assessee as VSC is a 100 year old established global player in the field of bikes and scooters. It is also the contention of the assessee that the sales from Indian market constitute only 2.5% of global sales of VSC and hence it would be imprudent to state that the usage of logo benefits the parent company.

Let us first analyse the facts in the light of Technical Collaboration Agreement and decide on merits whether the assessee company uses the brand of VSC or propagates the brand VSC.

The agreement between VSC India Pvt. Ltd. and VSC, USA makes it very clear that the parent company owns the brand/trademark/logo. The Indian subsidiary only gets the permission to use the brand. In fact, the parent company mandates the use of logo on all the products manufactured by the Indian subsidiary. The Technical Collaboration Agreement stipulates a consideration for transfer of technical know-how, grant of license, etc. However, the mandate to use the logo has been left unvalued.

Also, from the analysis of the financials of VSC for the year 2007-08, it seen that the value of 'trademark' of the parent company, which is shown as an intangible asset in its financials, has gained from USD 435 million to USD 495 million between April 2007 and March 2008 but the sales of the bikes and scooters has gone down by 4% globally and 11% in Asia-pacific region. As against this, sales of bikes and scooters in India have gone up by 51% compared to the previous financial year.

Is VSC India using the brand of the parent company or propagating it

Use of brand could either be mandatory or discretionary. If it is discretionary, VSC India will have an option to use the brand of the parent company or the brand of its choice. In the instant case, use of the brand of parent company is a mandatory requirement. The entire agreement depends on that mandatory condition.

It would be a puerile to say that VSC condescended to allow VSC India to use its brand. There was no overt or covert benefit to VSC India as far as the brand goes. Also, when VSC is charging for every right granted, including the right to service the products manufactured, it would be futile argument to say that they have not charged for usage of the brand. VSC has charged for the usage of the brand when, in fact, it should have compensated the assessee for using the logo on the products it manufactures.

As VSC has acknowledged, India and China are the emerging markets for VSC. Considering the tremendous growth VSC has achieved in India and the huge market potential available, India is bound to substantially add the volume base of VSC.

By mandating the use of brand in each and every vehicle, VSC India is forced to perform substantial development efforts for the brand, whose owner is VSC USA. Hence, VSC India makes substantial effort in enhancing the value of the brand.

In the background of the aforesaid discussion, the applicability of the Transfer Pricing provisions to the issue under consideration is confirmed as under:

a) VSC India is mandatorily required to use the brand VSC which is owned by an overseas parent company.

b) VSC USA charges royalty one-fourth of the total two percent from VSC India for using the logo of VSC.

c) Hence, that one-fourth percent of royalty (i.e., 50 lakhs) paid is deleted from the allowable expenditure and liable to be taxed.

<u>Objection #3:</u> The TPO erred in holding that the excess AMP expenditure incurred by the assessee results in brand promotion of the parent company in India.

<u>Assessee's Contention:</u>

It is the contention of the assessee that the TPO has made a blatant error by relying upon extraneous legal and factual references in identifying excess AMP expenditure and alleging creation of marketing intangibles by VSC India for its AEs.

Furthermore, in the absence of any specific arrangements between the parties to develop the brand of another it would be imprudent on the part of the TPO to state that the assessee is developing the brand of the assessee.

The TPO has made a gross allegation while stating that the expenses incurred over and above the bright line be treated as in creation of marketing intangible for VSC in India and the benefits of which accrue to the AEs thereby entitling the assessee for a compensation.

The assessee submitted that advertisement is a functional concept. It is a direct function of an organisation to attract people to become its customers, which involve direct cost to the company. This functional aspect of advertisement will get compensated once the product is sold to the ultimate customer. Secondly, the contention of the TPO that the advertisements amount to brand building may not be entirely true because several products have become a failure inspite of spending a fortune on advertisements. Therefore, the concept of brand building goes much beyond advertisement expenditure. Advertisement focuses on short term benefit whereas brand value focuses on long term benefit. The effect of advertisement will be realised in its sales whereas the effect of brand value will be reflected in the image of the organisation in the future prospective. Advertisement leads to education among the people about the product but the brand value emerges from the loyalty people have on the company.

To put it in a nut shell, among various values a customer gets in buying a product, functional value and economical values are achieved through advertisement whereas psychological and social values are achieved through brand. Hence, the AMP expenditure incurred by the assessee does not play any active role in developing the brand of the assessee or even if it does, it is only up to the negligible extent.

Without prejudice to the above submissions, the assessee also submitted that the TPO has not followed the mandate of the Act. Bright-line method applied by the TPO for computing adjustment on account of the alleged arm's length price of domestic advertisement and promotion expenses does not fall within the five prescribed methods provided under the Transfer Pricing Regulation in India.

Also, it is reiterated that the total AMP expenditure of the assessee also constitutes some of the direct selling expenditure such as commission paid on sale of products, brokerage paid, etc. which can never result in brand promotion as it is paid subsequent to the sale and according to the volume of sale.

DRP's stand:

The TPO has contended that the assessee company has incurred certain AMP expenditure for the purpose of developing the brand of its overseas parent company and when the expenditure is incurred by the assessee company, the benefits are being enjoyed by the parent company because the IP rights of the brand belongs to the assessee and not of the assessee company. The assessee submitted that the expenditure incurred by the assessee company is limited to Indian market and whatever benefit accrue from the expenditure will go only to the Indian entity and that the parent company does not get benefitted by the expenditure incurred by the assessee company.

It is to be mentioned that the era of globalisation has made the world in to a global village. It is genuine to say that the assessee company has incurred all the expenditure for promotion of brand within the territory of India but the promotion of does not end at the first hand and the brand building activity is a chain reaction which is fed in one mind and spreads across through several minds. Hence, it is not acceptable view that when expenditure is incurred in India, then the benefits are limited to India only.

Further the assessee company though has the capacity to build its own brand had not done so but indulged in promoting the brand of the parent company because of the mandatory provision in the agreement. It is not necessary to have a separate agreement governing the brand building activity but a clause (mandatory) in an agreement is suffice. In this case, the Technical collaboration Agreement between the assessee and its parent company to affix the logo 'VSC' in all the products manufactured in India by the assessee.

At that same time, due to the Technical Collaboration Agreement, the assessee company has to wear mask of the parent company and also tolls to develop the masked identity and withered out without anything in the end. Once the mask is removed, there is no value for the assessee company. The assessee company lost its identity and promotes the brand of the parent company as its brand. This deprivation has led the parent company to enjoy all the benefits incurred due to the promotion of the brand.

The TPO has given a finding that the expenses incurred by the assessee towards advertisement and sales promotion are not wholly for the purpose of the assessee company but certain expenses should be attributed to the AE also. The assessee company while doing sales and business promotion not only sells and promotes the products manufactured by it but also the brand name of the AE which is wholly owned by the AE. Through the sales and promotion activities done by the assessee company, the AE is also getting benefitted as its brand is popularised. The benefit has been received by the AE while the cost is incurred by the assessee company. Hence, the TPO has arrived at a finding that a proportion of the AMP expenditure should be attributed to the AE also.

In this regard, the TPO relied on the decision of Delhi High Court in the case of ***Maruti Suzuki Ltd Vs ACIT (supra)*** and has adopted the 'Bright-line method' as a method to segregate the extra ordinary AMP expenditure and identified three comparable companies to find out the arm's length range of AMP expenditure.

The above discussions lead us to the following conclusions:

a) The Indian assessee company has been brand building the image of the overseas parent company at the cost of developing its own brand.

b) There is no infirmity in the order of TPO while bench marking certain AMP expenditure and holding that the bench marked expenditure lead to the promotion of the brand of the overseas parent company.

c) The comparables identified by the TPO are proper comparables, though they are not identical to that of the assessee, they are in the same line of business as that of the assessee.

d) In our considered view, the TPO has relied on the principles laid down by the Hon'ble High Court of Delhi in the case of ***Maruti Suzuki Ltd. Vs ACIT (Supra)*** which still holds good as the Supreme Court has not overruled the entire concept of brand promotion but has only sent it back to the file of AO to decide the matter afresh.

In view of the same, the objections raised by the assessee company vide Objection #2 are rejected.

Objection #4: The TPO erred in holding that the assessee's expenditure on Research & Development has benefitted only the parent company and not the assessee.

Assessee's contention:

It is the contention of the assessee that the TPO has incorrectly characterised assessee's business as contract manufacturer and that the assessee is an entrepreneur manufacturer which bears most of the risks with respect to sales and market conditions. The assessee further submits that R&D activities undertaken by it are for product development, localisation and customisation of technology (which includes expenses primarily incurred for homologation to meet Indian road conditions and safety requirements of the bikes looking to the temperature, terrain and climate) and that the assessee has the full right to enjoy the product developed by its R&D department.

The assessee further submits that the business of manufacturing and distributions needs a continuous process of implementing new features and facilities in the products and offering to the customers improved versions of the product on a regular basis.

DRP stand:

Economic ownership is not the sole criteria for deciding who is benefitted from an activity. It is only the legal owner who has access to research and development undertaken by the assessee. Legal ownership has an enduring benefit and can sell it off to a third party as per its wish whereas economic owner can only enjoy the benefits arising from it and cannot sell the developed product on its own. The assessee has tried to bring under the ambit of hypothetical asset but a real tangible tradable asset for which the ownership lies elsewhere.

Furthermore, the agreement between the assessee and its parent company clearly states that the improvement, modification of products and parts shall be treated as licensed information whose ownership lies with VSC USA. No independent party would have spent money on products, only to give ownership right to the other party.

SUMMARY

Objection # 1 to Objection #3 of assessee are REJECTED. Hence, the three additions made by the TPO shown below are sustained

Sl.No	Nature of Adjustments	Amount
1	**<u>Brand-building services:</u> Amount receivable by the assessee from the parent company for building the brand of the parent company** (AE) by affixing its logo (VSC) on all the products developed by the assessee = Disallowance of ~ 0.5% of Total Sales being Reduction of Royalty paid to AE	Rs. 50 lakhs
2	**<u>Excess AMP:</u> Amount of excess AMP expenditure incurred on behalf of the parent company** with a purpose to develop the business of the parent company ~ 10% on total sales	Rs.10 Crores
3	**<u>R&D spend:</u> Research & Development expenditure** to be recouped from the Parent Company	Rs.1.5 Crores
	TOTAL	**Rs. 12.00 Crores**

Sd/- Sd/- Sd/-

Sri. John D’Souza (Member) Smt. Indira Rani (Member) Sri. V.Vijayaraghavan (Member)

Copy to:-

1. DCIT, LTU
2. TPO, Chennai
3. The Assessee
4. The Guard File

Annexure E
VSC, INDIA
Assessment Year 2008-2009
Summary of Objections before the DRP

1. The TPO order was erroneous as the instant case did not involve any international transaction and the order was passed without jurisdiction

1.1 The TPO erred in law and in facts in considering the expenditure wholly and exclusively for its domestic business operations within the realm of 'International Transactions' based purely on conjectures and surmises.

1.2 The TPO erred on facts and in law in taking cognisance suo moto of the alleged international transaction which had not been specifically referred to the TPO by the AO under Section 92 CA of the Act.

1.3 The TPO erred in passing on order while not satisfying any of the conditions prescribed under Section 92C(3) of the Act before making an adjustment to the income of the appellant.

2. The TPO erred in disallowing Royalty to the tune of 0.5 % of sales paid by the assessee holding that it represented an amount the assessee's AE has to have paid the assessee for assesse's brand building services of the 'VSC' logo based on the Technical Collaboration Agreement which mandates use of the 'VSC' logo/trademark of the foreign parent company by assessee in its products

2.1 The TPO erred in holding that the use of logo in the finished products leads to brand building of the parent company of the assessee.

2.2 The TPO erred in ignoring the fact that the Royalty amount paid by the assessee is also for the usage of logo 'VSC' since the brand VSC is an established global player of over 100 years and it helps the assessee to enhance its Indian market sales.

2.3 The TPO erred in ignoring the ground reality that the assesse ought to pay VSC USA for the use of 'VSC' logo and not the other way around (i.e., 0.5% of sales to be recouped from VSC USA), especially keeping in mind the Indian and global turnovers of the VSC group

2.4 The AO erred in ignoring the decision of the Hon'ble High Court of Delhi in ***Maruti Suzuki India Ltd Vs ACIT [328 ITR 210 (Del.HC)] has been overruled by the Supreme Court***.

3. The TPO erred in holding that the excess AMP expenditure incurred by the assessee results in brand promotion of the parent company in India.

3.1 The TPO erred in ignoring the fact that the assessee company had not spent AMP expenditure to develop the “marketing intangibles” of the parent company but solely to boost its own sales in India.

3.2 The TPO erred in ignoring the fact that the assessee has had to spend more AMP expenditure than competitors only to gain the foot hold in the Indian market.

3.3 The TPO erred in holding that the assessee has spent AMP expenditure for developing the brand of another company instead of developing its own brand.

3.4 The TPO erred in ignoring the fact that the assessee company had not developed its parent company’s brand but in fact used it to penetrate the Indian market.

3.5 The TPO erred in adopting the ‘Bright-Line Method’ to find out the arm’s length price of the AMP expenditure and the BLT was not one of the allowed TP methods under the Act.

3.6 The TPO erred in choosing the comparables which are not similar to that of the assessee.

3.7 The TPO erred in ignoring the fact that the part of the AMP expenditure incurred by the assessee company involves direct selling expenditure such as commissions, brokerage paid, etc.

3.8 The TPO erred in ignoring the fact that the decision of Delhi High Court in the case of ***Maruti Suzuki Ltd. Vs ACIT*** **in 328 ITR 210 (Del.HC)** has been overruled by the Supreme Court.

3.9 The TPO erred in coming up with and adopting incorrect and erroneous concepts such as creation of “marketing intangibles” while the issue was purely of revenue expenditure incurred in India towards advertisement, marketing and promotion (AMP) to boost the Indian sales

4. The TPO erred in holding that the assessee’s expenditure on Research & Development has benefitted only the parent company and not the assessee.

4.1 The TPO erred in ignoring the fact that the product developed through assessee’s R&D department entirely belongs to the assessee and that the assessee is the legal owner (IP Rights) of those products.

4.2 The TPO erred in ignoring the fact that the parent company of the assessee does not have any right to use the property developed by the assessee’s R&D department and that the parent company has to pay royalty to the assessee company if at all it wants to use products developed by assessee R&D department.

4.3 The TPO erred in ignoring the nature of the R&D expenses were primarily incurred towards for homologation to meet Indian road conditions and other engineering expenses, travel and testing charges.

5. The appellant seeks leave to add to, amend or withdraw any of the aforesaid grounds of appeal.

The appellant seeks leave to substantiate the above grounds at the time of hearing.

Chennai
For VSC India
Dated: 23rd April, 2012
Authorised Signatory
M/s SAPR Advocates
Assessment Year 2008-09

Annexure-F

INCOME TAX DEPARTMENT

No. 121, M.G.Road, Nungambakkam, Chennai - 34

DRAFT ASSESSMENT ORDER

U/S 143(3) r.w.s. 144C OF THE INCOME TAX ACT, 1961

Present : Sri. Arvind Hazare,

Additional Commissioner of Income Tax

A.Y/ 2008-09 **Date: 31.03.2012**

1	Name of the Assessee	:	VSC India Ltd. No. 105A, Dr. Radhakrishnan Salai, Mylapore, Chennai
2	Assessment Year	:	2008-09
3	Permanent Account Number	:	RRRR AB 1234
4	Status	:	Company
5	Whether Resident/ Non-Resident/ Resident but not ordinarily Resident	:	Resident
6	Method of Accounting	:	Mercantile
7	Previous Year Ending	:	31.03.2008
8	Nature of Business	:	Manufacturing and dealing in bikes, scooters, spares, etc.
9	Date of Order	:	31.03.2012
10	Section & Sub-section under which the order is made	:	143(3) r.w.s 144C of IT Act

The assessee had filed a return of income for the AY:2008-09 declaring a total income of Rs. 100 Crores. The return was processed under Section 143(1) and subsequently the return was processed under CASS and notice u/s 143(2) was duly served on the assessee.

In response to the above notice issued, assessee's representatives Mr. Tim Botham, Taxation Department of the assessee company has appeared and produced the details called for.

Based on the details submitted by the assessee, the draft assessment is being completed as under:

Adjustments towards Transfer Pricing u/s 92CA:

The case was referred to the Transfer Pricing Officer, Chennai for the purpose of determining the arm's length price with reference to the international transaction carried out by the assessee company with its associated enterprises during the financial year 2007-08 as per the provisions of Section 92 CA of the Act.

In response to the same, the Transfer Pricing Officer-I, Chennai, has passed order u/s 92CA of the income-tax Act wherein the TPO has proposed an adjustment towards the reduction of royalty paid by the assessee to the parent company for building the brand and logo of the parent company to compensate the assessee for depriving it from developing a brand and logo legally and economically owned by the assessee to the tune of Rs. 50 lakhs.

Further Transfer Pricing Officer has proposed an adjustment towards the AMP expenditure incurred on behalf of the parent company with a purpose to promote the brand business of the parent company. Hence, the parent company has to reimburse the assessee company to the tune of ~ Rs.10 Crores.

The TPO has also proposed an adjustment towards the research and development expenditure to be recouped by the VSC, USA to the tune of ~ Rs. 1.5 Crores.

Thus, the TPO has proposed an adjustment to the tune of ~ Rs. 12.00 Crores for its international transactions with its associated enterprises.

Accordingly, the above amount of Rs. 12.00 Crores is added to the total income of the current year. Penalty u/s 271(1)(C) of the Act will be initiated separately for this purpose.

Based on the above facts and circumstances of the case, the draft assessment order is completed as under:

Computation under normal provisions:

Business income	:	Rs. 100 Crores
Add: Disallowance u/s 92CA	:	Rs. 12.00 Crores
Total Taxable Income:		**Rs. 112.00 Crores**

In view of the provisions of 144C, this draft order is being forwarded to the assessee as a proposed assessment for order for assessment year 2008-09.

In view of the provisions of Section 144C, the assessee is required to file its acceptance or file objections to the Dispute Resolution Panel and the Assessing Officer within 30 days after the receipt of this order. If no reply received within the prescribed time limit as per Section 144C, the Draft Assessment Order will be final.

Draft Assessment Order is being issued u/s 143(3) r.w.s 144C of Income Tax Act, 1961.

(Mr.Arvind Hazare)
Dy. Commissioner of Income Tax
Large Tax Payer Unit, Chennai

Copy to: 1. The assessee, 2. The TPO

Annexure-G
INCOME TAX DEPARTMENT
Proceedings of the Transfer Pricing Officer – I
Room No. 420, IV Floor, Main Building,
No. 121, M.G.Road, Nungambakkam, Chennai - 34

ORDER U/S 92 CA OF THE INCOME TAX ACT, 1961

Present : Sri. John Galt,
Additional Commissioner of Income Tax

F.No. F -282/TPO-I/ A.Y/ 2008-09 **Date: 31.12.2011**

1	Name and address of the company	:	VSC India Ltd. No. 105A, Dr. Radhakrishnan Salai, Mylapore, Chennai
2	Assessment Year	:	2008-09
3	Permanent Account Number	:	RRRR AB 1234
4	Reference from	:	ACIT (LTU), Chennai
5	Date of Reference	:	27.07.2010
6	Total Income Returned	:	Rs. 100 Crores
7	Nature of Business	:	Producers of manufacturing bikes and scooters with manufacturing assembly, and sales operations
8	Name and address of AE and the country in which it is resident	:	VSC USA Inc., Delaware
9	Nature of Association as per Section 92A	:	Companies under common control & management
10	Method adopted by the assessee	:	TNMM Method
11	Section & Sub-section under which the order is made	:	92 CA(3)

A reference u/s 92CA(1) of the Income Tax Act in the case of VSC India Limited (hereinafter referred to as the assessee) was received from ACIT (LTU), Chennai. The assessing officer has made the reference for determination of arm's length price with reference to all the transactions reported in Form 3CEB filed by the assessee for the AY: 2008-09

Accordingly, a notice u/s 92 CA(2) was issued to the assessee on 19.08.2009 to furnish all the relevant details with regard to the international transactions entered in to by the assessee with its associated enterprises. The authorised representative, Mr. Tim Botham, Deputy Manager- Taxation appeared and presented the case.

Background of the company

VSC USA Inc. (hereinafter VSC USA) is one of the world leaders in the area of manufacturing bikes and scooters. During the year 2000, VSC USA purchased 10% of RPAS

India Ltd. and in February 2003 they jointly started to manufacture and distribute products in the name of "VSC India". In December 2003, the equity pattern changed to 50:50 between VSC USA and RPAS India Ltd. and the Indian company was renamed to VSC India Ltd (hereinafter called "VSC India"). In March 2004, VSC USA purchased the remaining 50% from RPAS, India.

4. Profile of the Associated Enterprises:

VSC India is a wholly owned subsidiary of VSC USA. VSC USA is one of the world's largest producers of bikes and scooters in more than 200 markets in six continents with sales by more than 24,000 dealers.

5. International Transaction Entered in to by the Assessee:

Name and Address of the AE	Description	Amount
VSC, Mexico	Export of Bikes and Scooters	73,436,196/-
VSC, South Africa	Service Parts Export of Bikes and Scooters	5,633,890/- 8,115,029/-
VSC, Brazil	Export of Bikes and Scooters	3,448,702/-
VSC, Indonesia	Export of Bikes and Scooters	15,584,989/-

6. Nature of Business of the Assessee:

The assessee company has two distinct activities.

1. Contract manufacturing activity and
2. Distribution activity.

Contract manufacturing involves a company that produces products to sell to its customers, the essence of contract manufacturing is that the assessee earns a service fee and bears no primary financial risks and market risks associated with the company. The assessee imports from its AE as well as other sources and carries out manufacturing activity in India of motorbikes and scooters of whose finished products are sold in India and exported abroad.

In the instant case the assessee adopted TNMM as the "most appropriate method" (MAM) for the purpose of Transfer Pricing analysis of manufacturing activity and its distribution activity. The arm's length range for this analysis is based on the financial results for the year 2005-06 to 2007-08. The Return on Capital employed was chosen as the PLI.

7. Comments issued by the TPO:

As per the Technical Collaboration Agreement between VSC USA and the then RPAS India (now VSC India), the assessee has manufactured bikes and scooters using the technical know-how supplied by VSC USA. The assessee has also been paying Royalty in consideration of this grant of license, technical information and for the technical assistance provided by VSC USA.

One of the clauses of the Technical Collaboration Agreement clearly stipulates that the assessee should use the logo 'VSC' in every finished article. It is implied that the brand 'VSC' forms an inseparable part of the various bikes and scooters manufactured by the VSC India. The trademark for logo 'VSC' is owned by VSC USA.

It could be seen from the financials that assessee has paid 2% of the total sales as 'Royalty' to VSC USA for the relevant financial year. In other words, the assessee paid Royalty to VSC USA to the tune of Rs. 2,00,00,000/- in the relevant Assessment Year. Apart from that, the assessee has also incurred Advertising, Marketing and Promotional (AMP) expenditure to the tune of Rs. 15.00 Crores. From these expenditures, it could be ascertained that the assessee is building the brand of its parent company in India at its own cost.

VSC India has incurred substantial expenditure on account of advertisement, marketing and distribution activity which had held helped in creation of the brand to the logo 'VSC' and due to which VSC India had become the leading bikes and scooter manufacturer in India. No compensation in this regard was made by the VSC USA to assessee for the mandatory use of trademark logo in the products manufactured in India. On the basis of terms and conditions of the agreement between the assessee and VSC, USA, it is clear the assessee had developed "marketing intangibles" for VSC in India.

VSC is a global brand and VSC USA has NOT compensated VSC India for developing its global brand logo 'VSC' in India. However, VSC USA enjoyed all the benefits of the expenditure incurred by the assessee in form of its dividend income of its share holding in India which is 100%, as well as Royalty which was payable on the basis of sale of finished products and spare parts.

Therefore, the TPO proceeds to make following disallowances.

Reduction of Royalty:

Compulsory use of the trademark even when the domestic entity does not require it indicates that the benefit is being accrued to the Non-resident entity in the form of brand promotion in the domestic market by its display on the products as well as on its packages. Since the sale of the products of the assessee are steadily increasing over the years and in consequence the Royalty paid by the assessee based on the Technical Collaboration Agreement, in which a clause mandates the assessee to use the logo of the parent company, also has been steadily increasing.

In other words, VSC India not only has been promoting the brand "VSC" owned by VSC USA by affixing 'VSC' in all its manufactured products free of cost, but also pays towards it in the form of Royalty which has increased considerably year after year. Therefore, it would be appropriate to hold that the rate of royalty paid by the assessee to VSC USA shall be reduced to 0.5% of total sales amount.

Addition made towards AMP expenditure incurred on behalf of foreign entity:

There is no justification in insisting upon the use of the trade mark of the foreign entity unless the owner of the brand feels that he stands to gain by such compulsory use of its name in the Indian entity. Development of brand carries a cost which the assessee has incurred. In other words, it is an arrangement in which the benefit accrues to the parent company and the expenditure has been incurred by the Indian entity i.e., the assessee. Will such arrangement take place if the two were unrelated parties? The answer is NO. What are the costs which the assessee has suffered in this arrangement? The costs are varied. First and foremost is the cost of sacrificing the right of developing its own brand name. Secondly, brand name and logo are intangible assets which are developed by incurring lot of costs, but once developed it could be a successful revenue generation tool in future. Therefore, the Parent company by mandating the use of its brand name and logo has not only deprived the assessee company from developing its own brand but also burdened it with the financial costs which are in built in the entire financial structure of the company. Hence, once the parent company has preferred to pass on the brand building responsibility to the assessee company then the parent company must compensate the assessee company suitably.

The total advertisement expenditure incurred by the assessee for the relevant assessment year is 15 Crores. This is 15% of the total sales of the assessee company. The assessee had spent this amount for marketing the licensed products under Technical Collaboration Agreement and not for any other products.

The Delhi High Court vide in the case of ***Maruti Suzuki P. Ltd. Vs ACIT [328 ITR 210 (Del.HC)]*** had held that if a domestic company is an AE of the foreign entity within the meaning of Section 92A of the IT Act and if that foreign entity mandates the Indian AE to use it logo/ foreign trademark on its products, packaging, etc. appropriate payment in this regard should be made by the foreign entity to its Indian AE on account of the benefit it derives from "marketing intangibles" obtained from it from such mandatory use of foreign trademark or logo. The court further held that if the expenses incurred by the domestic entity which is the AE of the foreign entity on account advertising, marketing and promotion activities are more than what a similarly situated comparable independent domestic entity would have incurred then the domestic entity needs to be suitable compensated by the foreign entity for that excess expenditure incurred by the domestic entity.

Therefore, in the light of the conclusions drawn by the Delhi High Court in the above mentioned writ petition, the amount of compensation/reimbursement from the foreign entity (i.e., VSC, USA) for the brand building activity done by the domestic entity (VSC, India) needs to be determined in the light of T.P. Provisions of Indian IT Act, 1961.

In this regard, I found three comparable independent domestic companies which do not use any foreign logo/ trademark. They are:

Company Name	**Total AMP Expenditure for the AY 2008-09**	**Total Sales for the AY: 2008-09**	**% of AMP expenditure on total sales**

Strongarm Ltd.	3 Crores	70 crores	4.2%
Garuda Ltd.	4 Crores	75 Crores	5.3%
Bikes India Ltd.	3 Crores	55 Crores	5.5%
Total	10 crores	200 Crores	
Average			**5% of total sales**
VSC India	15 Crores	100 Crores	15% of Total sales

Difference between arm's length range and margin of controlled transactions ~ 10 Crores

The difference between arm's length range and the assessee's margin will represent the value of "marketing intangibles" created for the foreign entity in India. Hence, VSC USA needs to compensate the assessee to an extent of 10 Crores for the brand building activity carried out by the assessee on behalf of its parent company.

Research & Development Expenditure:

It could be seen from the financials of the assessee company that it has incurred expenditure to the tune of Rs.1.5 crores towards product development expenditure. The assessee states in order to offer its customers best possible product, VSC India incurs various expenditure towards Research and Development (R&D) viz., engineering expenses, travel, testing charges, expenses primarily incurred for homologation to meet Indian road conditions and safety requirements of the bikes looking to temperature, terrain and the climate.

It is an established fact that VSC USA is the absolute owner of all the patents, trademarks and other IP rights with respect to the products developed in VSC India and therefore, it would be prudent to state that any improvements made in the product to enhance the performance of the product by VSC, India will belong only to VSC, USA irrespective who has developed and researched on it. It is not a hypothetical but a real asset whose ownership lies elsewhere and any expenditure spent to develop the product of other company will not be allowed as expenditure in the hands of the assessee. Hence, this amount ought to be disallowed.

Conclusion:

After perusing the written submissions, TP documents and discussions with the assessee's authorised representative, I in the authority of TPO reject the assessee's arguments on reduction of royalty, brand promotion expenses over and above the bright line and product development expenditure and as per Section Section 92C(3) the information or data used in computation of Arm's length price is not reliable or correct and hence, the TPO proposes following adjustments:

Sl.No	Nature of Adjustments	Amount
1	**Brand-building services: Amount receivable by the assessee from the parent company for building the brand of the parent company** (AE) by affixing its logo (VSC) on all the products developed by the assessee = Disallowance of ~ 0.5% of Total Sales being Reduction of Royalty paid to AE	Rs. 50 Lakhs

2	**Excess AMP: Amount of excess AMP expenditure incurred on behalf of the parent company** with a purpose to develop the business of the parent company ~ 10% on total sales	Rs.10 Crores
3	**R&D spend: Research & Development expenditure** to be recouped from the Parent Company	Rs.1.5 Crores
	TOTAL	**Rs. 12.00 Crores**

The assessing officer is requested to compute the total income of the assessee in accordance with sub-section (4) of Section 92C of the Income-tax Act, after giving an opportunity to the assessee. The adjustment proposed is Rs. 12.00 Crores.

It is hereby classified that the findings and discussions made in this order are applicable only in respect of reference received for the AY 2008-09 and not for subsequent years.

(Mr. John Galt)
Addl. Commissioner of Income Tax
Transfer Pricing Officer – III, Chennai

Copy to:
VSC India Ltd.
Assessing Officer