Mumbai ITAT deletes TP disallowance on advertising, marketing and promotion expenses

Summary

The Mumbai bench of Income Tax Appellate Tribunal (ITAT), in a recent[1] decision, dismissed the Revenue's appeal on the issue of excessive Advertising, Marketing and Promotion (AMP) expenditure incurred towards brand building activities for its Group. The ITAT held that in the absence of an agreement or any facts supporting that the taxpayer actually engaged in brand building activities, the Revenue cannot act on an assumption and make an addition to the taxable income.

Facts of the case

- The taxpayer, a subsidiary of a foreign company, is engaged in manufacturing and trading of diversified products in the oral health sector.
- During the year under consideration, the taxpayer had various sale/purchase transactions with many of its Associated Enterprises (AE).
- The taxpayer incurred AMP expenditure amounting to INR 136.83 cr which constituted about 13 per cent of sales (as against 6.39 per cent computed by the Transfer Pricing Officer (TPO) to represent the average for the FMCG industry).
- The taxpayer also paid royalty of INR 10.32 cr (the royalties were on account of technology license and not on account of license of brands). On percentage terms, the royalty payouts worked out to 0.96 per cent of sales.

[11] ACIT vs. Colgate Palmolive (India) Limited [ITA No. 6073/Mum/2014 and 243/Mum/2014]

Chronology of proceedings

- The TPO contended that such Royalty payouts had increased significantly over the last few years. The TPO held that the sales on which royalty has been paid recorded faster growth, and this has benefitted the AEs. The TPO concluded that AMP expenses incurred by the taxpayer drove such growth.
- The TPO contended that the AMP expenses were to be shared by the taxpayer and its overseas AEs. Consequentially, the TPO applied the royalty ratio of 0.96 per cent to the total AMP expense to determine the amount of AMP to be disallowed, resulting in an addition of INR 131.36 lakhs for AY 2005-06.
- The Commissioner of Income-tax (Appeals) (CIT(A) deleted the TP adjustment on the premise that the taxpayer was a full-fledged manufacturer incurring AMP for its own business and there were no direct benefits flowing to the AE from such AMP expenses.
- The CIT(A) accepted that the taxpayer has not made any brand royalty payments to the AEs during the relevant assessment year.

Arguments before the ITAT

- Revenue submitted that the steep increase in brand value of taxpayer's Group from year 2000 to 2006 was on account of AMP incurred by the taxpayer.
- The taxpayer challenged the presence of an international transaction, on the basis that there existed no agreement between the taxpayer and its AE for any brand building activities.
- In this regard, the taxpayer relied on the rulings of Hon'ble Delhi High Court ('HC') in case of *Maruti Suzuki*[2] and the Mumbai ITAT in the cases of *Johnson & Johnson*[3] wherein the very existence of an international transaction on account of incurrence of AMP expenses, has been discussed.

Held by the ITAT

- The ITAT noted that:
  - The only argument of the Revenue was that the brand value of the taxpayers Group had increased significantly over the years. However, no evidence was furnished to show any correlation between the same and AMP expense incurred by the Assessee.

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[2] Maruti Suzuki India Ltd. Vs. CIT *[381 ITR 117]*
[3] Johnson & Johnson Ltd. Vs. CIT *[ITA 83/Mum/2011]*

- Nature of AMP expenses incurred included travel and meeting expenses paid to third parties. There was no basis on which it could be concluded that such expenditure could result in brand building activities.
- TPO applied Bright Line Test without any analysis of the expenditure incurred, which is not an accepted methodology.

- Relying on the ruling of the jurisdictional ITAT in the case of Johnson & Johnson (supra), which is also upheld by the Bombay HC, the ITAT held that in the absence of an agreement obliging the taxpayer to undertake brand building activities, no international transaction can be presumed.
- The ITAT also distinguished the Delhi HC ruling in the case of *Sony Ericsson* on facts, as the same was rendered where the taxpayer was not a manufacturer, unlike the instance case.
- The ITAT also placed reliance on rulings of Maruti Suzuki (supra), *Bausch and Lomb*[4] and several others, which upheld the same rationale.

Our comments

The issue of AMP expenses of the Indian entity being attributed to the overseas group company's brand building activity has been the subject matter of litigation. The ITAT's decision is in line with past rulings and emphasises that in the absence of an international transaction, transfer pricing provisions would be infructuous.

The Delhi HC's favorable decision in case of Maruti Suzuki (supra) on a similar AMP issue, which was relied upon by the taxpayer and ITAT in the present case, has been challenged by Revenue in the Supreme Court. Though the Supreme Court has admitted Revenue's Special Leave Petition, it has not stayed the operation of the Delhi HC judgement and hence, it is valid in the present context. Given the same, it would be prudent to analyse the issue of AMP expenses in light of the available judicial pronouncements, legal provisions and facts of each case.

[4] Bausch & Lomb Eyecare (India) (P). Ltd vs. Addl CIT [381 ITR 237]