

Delhi ITAT upholds applicability of TP provisions on brand building activities undertaken by Indian BO

Summary

It is a well-settled principle of taxation that a person cannot transact with self. Recently, in the case of FUJIFILM Corporation, India Branch Office¹ (the taxpayer), the applicability of Transfer Pricing (TP) provisions on transactions between an Indian Branch Office (Indian BO) and the Foreign Head Office (Foreign HO) was disputed on the ground of principle of mutuality before the Delhi Bench of the Income Tax Appellate Tribunal (ITAT). Upholding the applicability of TP provisions on brand building activities undertaken by the Indian BO for the Foreign HO, the ITAT observed that such transactions are not tax neutral and their arm's length price (ALP) may impact the quantum of non-resident's taxable income in India.

Facts of the case

- The taxpayer is a Japanese company carrying on operations through a branch office in India during the Assessment Year (AY) 2007-08 and AY 2008-09.
- The Indian BO was engaged in import and resale of Fujifilm products in India. It also provided marketing and technical support services on cost plus basis (hereinafter referred to as 'MSS and TSS') to the Foreign HO.
- During AY 2007-08, the Indian BO had filed a return of income declaring a loss of INR 61,406,692.
- During assessment, the Transfer Pricing Officer (TPO) proposed adjustments in respect of the following transactions:
 - Provision of MSS and TSS – The TPO modified the set of comparable companies;
 - Brand building activities – The TPO alleged that the Indian BO incurred significant Advertising, Marketing and Promotion (AMP) expenses to promote the brand name of "FUJI" in India and proposed an adjustment by application of the bright line test.
- The Dispute Resolution Panel (DRP) concurred with the TPO's view regarding AMP expenses, however, granted some relief for MSS and TSS adjustment.

¹ FUJIFILM Corporation, India Branch Office vs. ITO [TS-224-ITAT-2018(DEL)-TP]

- In order to seek full relief for MSS and TSS adjustment, the taxpayer preferred an appeal before the ITAT.
- The taxpayer also disputed the TP adjustment made on account of AMP expenses and raised following additional grounds before the ITAT:
 - The taxpayer, being an extension of the Foreign HO in India,
 - cannot be subjected to TP provisions;
 - cannot have rendered any brand building services to self.
 - Article 7(3) of the India-Japan Double Taxation Avoidance Agreement (DTAA) entitles a taxpayer to claim deduction of all expenses incurred for the purposes of the permanent establishment (PE), including executive and general administrative expenses so incurred.

Held by the ITAT

- For the transaction of MSS and TSS, the ITAT accepted the taxpayer's contentions in respect of exclusion of comparables.
- Regarding the issue of AMP expenses, the ITAT rejected the taxpayer's contention of non-applicability of TP provisions on transactions between head office and branch office based on the following observations:
 - PE is an "enterprise" within the meaning of section 92F(iii) of the Indian Income Tax Act, 1961 ("the Act"), hence any transaction between the two enterprises, i.e., the foreign enterprise and its PE in India is subject to Indian TP Regulations.
 - Taxpayer has itself reported various international transactions between the head office and the branch office.
 - The transactions are taking place between the Indian BO and Foreign HO, which are not tax neutral and thus distinguished it from Aithent Technologies Pvt. Ltd. vs DCIT². In that case the assessee was an Indian resident, which had a branch office in Canada and the entire global income of such resident assessee was taxable in India.
- Taxpayer's contention that there can be no transaction with self was rejected on following counts:
 - The business activities carried through the Indian BO constitutes a "business connection" of the non-resident in India – income from such Indian BO is taxable in India within the meaning of sections 4³ and 5⁴ read with section 9⁵ of the Act. Similar position is also provided under India-Japan DTAA (based on the provisions of Article 5⁶ and Article 7⁷).

² (2015) 155 ITD 0266 (Delhi)

³ Creates charge of income tax

⁴ Provides scope of total income/ taxable income of an assessee

⁵ Defines income deemed to accrue or arise in India – among other things, it provides that all income accruing or arising, directly or indirectly, through or from any business connection in India, is deemed to accrue or arise in India.

⁶ Lays down the scope of the term "PE"

⁷ Lays down the criteria and manner of computing business profits of a non-resident enterprise to be taxed in the source country

- Transactions between the Indian BO and the Foreign HO need to adhere to the arm's length principle in order to ensure correct profit attribution to the Indian BO and doing so does not vitiate the rule of mutuality.
- Taxpayer has not raised a similar question in respect of applicability of TP provisions to MSS and TSS transaction.
- Regarding additional ground no. 2, ITAT observed that the revenue authorities have not questioned the deduction of AMP expenses as permitted by Article 7(3) of the India-Japan DTAA - instead they have challenged the amount of income which should be attributed to the Indian BO in respect of its brand building activities.
- The ITAT remanded the matter back to the TPO for fresh determination, with a direction to establish whether the AMP expenses constitute a separate international transaction, in light of the various recent High Court ("HC") and ITAT judgments and determine ALP if a separate transaction existed.
- Additionally, in line with the view taken by the jurisdictional HC, the TPO was directed to exclude selling expenses from the purview of AMP expenses for the purpose of such ALP determination, although revenue authorities have filed a special leave petition before Apex Court against the HC judgement.
- The ITAT stated there are no judgments till date, which provide for inclusion of selling expenses within the ambit of AMP. Unless the Apex Court takes a divergent view, the ruling of the jurisdictional HC is binding on all the sub-ordinate authorities working under its jurisdiction.

Our comments

The above ruling reaffirms the applicability of TP provisions on transactions between an Indian BO and Foreign HO, recognising the possible profit shifting which may occur by virtue of non-arm's length transactions between them.

Taxpayers need to determine whether brand building may constitute an international transaction based on the facts of their business and in light of the various judgments pronounced in this context.



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