

आयकर अपीलीय अधिकरण , 'डी' न्यायपीठ, चेन्नई
**IN THE INCOME TAX APPELLATE TRIBUNAL
"D" BENCH, CHENNAI**

श्री एन .एस. आर.गणेशन , न्यायिक सदस्य एवंश्री एस जयरामन, लेखा सदस्य केसमक्ष

**BEFORE SHRI N.R.S. GANESAN, JUDICIAL MEMBER AND
SHRI S. JAYARAMAN, ACCOUNTANT MEMBER**

आयकर अपील सं./I.T.A. No. 871/Mds/2017

निर्धारण वर्ष/Assessment Year : 2012-13

M/s. Magic Woods Exports Private
Limited,
A-8, Industrial Complex,
Maraimalai Nagar,
Kancheepuram – 603 209

Deputy Commissioner of Income Tax,
Vs. Corporate Circle -4(1),
Chennai.

[PAN: AADCM 6228N]

(अपीलार्थी/Appellant)

(प्रत्यर्थी/Respondent)

अपीलार्थीकीओरसे/Appellant by

: Shri. SriramSeshadri, CA

प्रत्यर्थीकीओरसे/Respondent by

: Mrs. Ruby George, CIT

सुनवाईकीतारीख/Date of Hearing

: 08.11.2017

घोषणाकीतारीख/Date of Pronouncement

: 06.02.2018

आदेश/ O R D E R

PER S. JAYARAMAN, ACCOUNTANT MEMBER:

The assessee filed this appeal against the order of the Deputy Commissioner of Income Tax , Corporate Circle -4(1), Chennai passed in pursuance of the directions of the DRP-2, Bengaluru dt 28.12.2016 for ay2012-13.

2. M/s. Magick Woods Exports Private Limited, the assessee, incorporated in India and has its registered office in Chennai. Assessee is in the business of manufacturing kitchen and bath furniture and the marketing is done by the Holding company. The products principally are meant for sale in Canada and USA.

3. At the time of assessment for assessment year 2012-13, the TPO found that its paid up capital consisting of Rs. 63,60,000 share of Rs. 10 each was held by Magic Woods Ltd (MWL), Canada till 17th December, 2011. The assessee acquired the trade mark, Magick Woods as per trading agreement dated 23. 12.2011, for a consideration of US Dollars 5.36 million based on calculations made by M/s Kalex Valuation Inc., Canada, Toronto, Ontario revalidated by Deloittee Touche-e Tohmastsa and Kanish& Partners, LLP India Pvt. Ltd. The value of trade mark is stated as cost plus amortization for the year 2011-12 as per AS-26. As part of related party disclosures under AS -18, Trust Investment and Marketing Inc.,and MWL, Canada are disclosed as sister concerns under AS-IS. Key management personnel identified are Indira Kumar Pathmanathan, Pathmakumar Pathmanathan and Thavakumar Pathmanathan. In such background, two significant events have taken place with close link between them. One is claim of acquisition of trade mark from the erstwhile holding company, MWL, Canada for a consideration of Rs.28,75,79,362. This is funded by availing secured loan from State Bank of India. Part of the

funding has taken place by adjustment of receivables due to from MWL, Canada. Transfer of entire shares (paid up capital) held by erstwhile holding company, of the assessee company, MWL, Canada, in favour of three persons viz., Indira Kumar Pathmanathan, Pathmakumar Pathmanathan and M/s Trust Investment & Marketing Inc., Canada who are acknowledged to be related parties. In essence, the company has made available funds by availing secured loan from State Bank of India in relation to the transaction recorded in its books as acquisition of trade mark from the erstwhile holding company which in turn divested its stakes in the assessee company in favour of three-two persons and one entity. MWL, Canada, non-resident entity divested its entire holdings in the assessee-Indian company, for a consideration of Rs.6.36 crores supported by valuation which determined the value of the shares using DCF method at minus- Rs.15.06. Since the value determined was a negative Rs.15.06, shares were required to be transferred (as per Reserve Bank of India requirements) not below the face value of Rs.10. This is the transaction matrix. The assessee parting with funds to the extent of Rs.28,75,79,362 to the erstwhile holding company and the recipient divesting its stakes in favour of the promoter shareholders who are the Canadian residents/citizens are events which have a close nexus and proximity. Thus, the TPO examined the assessee's claim and other material and rejected its claim of brand acquisition at Rs. 28,75,79,362/- for the purpose of consequential claim of depreciation as well as for the purpose of claim of deduction of interest on the corporate

loan used for such acquisition. The AO following the TPO's findings disallowed proportionate interest on the corporate loan at Rs. 63,68,478/-. Further, the AO disallowed Rs. 35,46,298/- being proportionate interest relatable to the advances given to the directors and its group companies. Aggrieved, the assessee filed its objections before the DRP. The DRP upheld the actions of the AO/TPO.

4. Aggrieved, the assessee filed this appeal with following grounds of appeal:

" The grounds mentioned herein are without prejudice to one another.

General:

1. The Learned Assessing Officer ("Ld. AO"), the Learned Transfer Pricing Officer ("Ld. TPO") and the Learned Dispute Resolution Panel ("Ld. DRP") has erred in finalizing an order of assessment to the extent prejudicial to the interest of the Appellant, against the principles of natural justice and the provisions of the Act, devoid of merits, without appreciating the facts involved and the documents submitted in proper light and without conduct of adequate inquiries and as such is without jurisdiction.

Transfer Pricing Issues

2. The Ld. TPO, Ld. AO and the Ld. DRP have erred in determining the Arm's Length Price ("ALP") of Trademarks at Nil.

3. The Ld. TPO and Ld. DRP have erred in law and on facts:

- a. in establishing that the Appellant, its associated enterprise ("AE") and the ultimate shareholders of the AE are all members of the same group / family, without appreciating that such relationship is germane to applicability of transfer pricing ("TP") regulations and as such, it has no relevance on the determination of the Arm's Length Price ("ALP") of trademark acquired;*
- b. in concluding that the Appellant made available funds to its AEs and their Shareholders by establishing a non-existent nexus between the acquisition of*

trademark and the disinvestment of Magick Woods Limited, Canada in business of the Appellant;

c. in concluding that the said Trademark must not have been valued as a going concern merely because the AE, which sold such trademark, was eventually liquidated;

d. in disregarding the valuation report obtained from an independent valuer justifying the value at which the trademark was acquired;

e. in determining the ALP of acquisition of trademark at NIL on an adhoc basis without applying one of the accepted methodologies, as prescribed under TP regulations;

f. in determining the ALP of the said transaction as NIL on the basis that negative future cash flows would accrue to the Appellant, as per the Share Valuation Report;

g. in rejecting the additional evidence submitted by the Appellant by disregarding the reasons for submission of additional evidence and erroneously relying on Rule 46A of the Income-Tax Rules.

4. Without prejudice to the above grounds, the Ld. TPO, Ld. AO and the Ld. DRP have erred in concluding that the value of trademarks should be NIL, despite Ld. TPO's own re-computation of ALP value of Trademark acquisition based on projections of sales as per Share Valuation Report being in the range of INR 18 - 20 crores.

5. Without prejudice to our above grounds, the Ld. TPO, Ld. AO and the Ld. DRP have erred in computing the value of trademark based on the projections of sales as per Share Valuation Report by using the 'derived export value' instead of 'actual export value'.

Corporate Tax Issues

Disallowance of interest on corporate loan

6. The Ld. TPO erred in suggesting disallowance of the interest paid on secured loan to State Bank of India ("SBI"), an independent Bank, which is not an International Transaction, thus exceeding his jurisdiction;

7. The Ld. AO and the Ld. DRP have erred in law and on facts by disallowing the interest paid to SBI for loan obtained for acquisition of trademark merely on the basis of the suggestion of the Ld. TPO without conducting any further inquiries into the facts of the case;

8. *The Ld. AO and the Ld. DRP erred in concluding that the interest paid to SBI was not wholly and exclusively for the purpose of business without any factual and legal basis. Disallowance of notional interest*

9. *The Ld. AO and the Ld. DRP have erred in law and on facts by disallowing the notional working capital interest, proportionate to the funds advanced to related parties;*

10. *The Ld. AO and the Ld. DRP have erred in law and on facts by disallowing the notional interest:*

a. without appreciating that the Appellant had its own funds to the extent of advances made to the related parties;

b. without establishing that the borrowed funds were used for non-business purposes.

The Appellant wishes to submit that each of the above grounds are alternative and without prejudice to each other.

The Appellant craves leave to add, substitute, amend, delete, or otherwise modify any of the grounds of appeal stated hereinabove before commencement of or at the time of hearing."

5. The assessee also filed the petition for admitting additional grounds of appeal as under:

"The Appellant wishes to raise the following additional ground of appeal before Your Honors in this appeal (enclosed in Annexure 1):

1. The Ld. AO ought to allow depreciation on the value of Trademark as determined by Your Honours at the rate of 25 percent as eligible under the Act.

Reasons for raising additional ground of appeal:

The appellant states that it is raising the above ground for the first time before Your Honors.

The Appellant humbly submits that it had inadvertently omitted to claim the depreciation on the said acquired trademark as eligible under the Income-tax Act, 1961 ("Act").

As Your Honours would appreciate, the claim of depreciation is a mandatory deduction under the Act pursuant to the introduction of explanation 5 to section 32 of the Act by the Finance Act, 2001 with effect from 1-4-2002. It is no more

at the option of the Appellant to claim such depreciation and even in the absence of the claim by the Appellant, it is the obligation of the Ld. AO to grant such depreciation while computing the total income of the Appellant.

With reference to above, the Appellant wishes to rely upon the order of the Jurisdictional High Court of Madras in the case of SreeSenhavalli Textiles (P.) Ltd. [[2003] 259 ITR 77] and the order of the Mumbai bench of the Income Tax Appellate Tribunal in the case of Kellogg India (P.) Ltd. [(2006) 8 SOT 679], wherein it is held that the assessing officer is bound to allow the eligible depreciation to the assessee, irrespective of whether the same has been claimed by the assessee in the return of income.

Further reliance is placed by the appellant on the circular no. 14 (XL - 35), dated 11 April 1995, issued by the Central Board of Direct Taxes (CBDT), wherein the following instructions were given to the officers:

- The officers of the department must not take advantage of ignorance of assessee to collect more tax than what is legitimately due;*
- It is one of the duties of the officers to assist a taxpayers in every reasonable way, particularly in the matter" of claiming and securing reliefs and in this regard the Officers should take the initiative in guiding a taxpayer where proceedings or other particulars before them indicate that some refund or relief is due to him.*

In this regard, the Appellant respectfully submits that while the depreciation is a mandatory allowance, which ought to be allowed by the Ld.AO while giving effect to the order of Your Honours for determining the value of the trademark, the appellant wishes to submit this additional ground out of abundant caution, even though it may be considered as a consequential claim.

It is further submitted that the additional grounds being raised by the Appellant are purely legal grounds requiring no further examination of facts. Hence, it is humbly requested that the additional grounds be admitted based on the order of the Hon'ble supreme court in the case of National Thermal Power Corporation [229 ITR 383 (SC)].

ADDITIONAL GROUND OF APPEAL

- 1. The Ld. AO ought to allow depreciation on the value of Trademark as determined by Your Honours at the rate of 25 percent as eligible under the Act."*

6. We heard the rival contentions and the additional ground and admit them on merits.

7. The AR submitted that its claim is based upon the valuation report furnished by M/s. Kalex Valuation Inc., Canada and reaffirmed by M/s. Deloitte Touche Tohmatsu India Pvt. Ltd. The shares were transferred based on share valuation certificate prepared by M/s. R.G. Rajan Associates, Chennai which relied on the discounted cash flow (DCF) method. The purchase of Trademark was essential to the very business as MWI, since its presence in the overseas market was dependant on the said trademark. Though, the TPO has determined the value of the said TradeMark (TM) in para 19 & 20 at certain value, however, concluded the ALP as nil in para 22 & 23 which are extracted as under:

"19. The submissions are considered in the light of the factual matrix presented above. The assessee's claim of inadvertent omission to consider the revised estimates cannot be accepted. It is the management's responsibility to furnish the correct projections of sales and it is specifically mentioned in the valuation report that they are guided by the management's projections of sales.

20. The value of trademarks claimed to be worth Rs.28.75 crores as per the Valuation Report of M/s. Kalex Valuation Inc. would stand reduced to Rs.20,47,38,609 if the projection of export sales as determined in Para 17 is adopted. Taking into account the lower end of the value determined by the Canadian Valuer, with adjustment towards export sales as proposed would result in the value getting determined at Rs. 18,71,62,770. On the other hand, taking the midpoint value as the basis, subject to the above adjustment, the value of trademarks would be determined at Rs.19,59,50,690/- crores. The relevant calculations form part of the annexure to this order.

21. The projections of discounted net cash inflows after acquisition of the trademark are reproduced at the cost of repetition once again hereunder:

FREE CASH FLOW

<i>Year</i>	<i>Rs. In crores</i>
<i>2011-12</i>	<i>(-) 8.53</i>
<i>2012-13</i>	<i>(+)0.16</i>
<i>2013-14</i>	<i>0.00</i>
<i>2014-15</i>	<i>0.00</i>
<i>2015-16</i>	<i>0.00</i>
<i>Primary Value (A)</i>	<i>(-)8.37</i>
<i>Terminal value (B)</i>	<i>(-)2.87</i>
<i>Enterprise Value (C)</i>	<i>(-)11.25</i>
<i>Less Debt</i>	<i>3.85</i>
<i>Total Equity value (D)</i>	<i>(-)15.06</i>

22. Taking this into account the fact that it is the assessee's own perception about the present value of the future net cash inflows that the acquisition of the trademarks would not benefit the assessee throughout the lifetime of its business. Therefore, as per the assessee's own admission, since the trademarks acquired would not result in positive net cash inflows, a third party would not be interested in acquiring it for a consideration of Rs.28.75 crores. Therefore, the ALP of such acquisition of trademarks is determined at nil.

23. It is proposed to the AO that a downward adjustment of Rs.28,75,79,362 may be made to the value of trademarks, on which the assessee has claimed depreciation, It is also suggested that since the so called acquisition is funded out of a secured loan taken from State Bank of India, Overseas Branch, Chennai 1, the corresponding disallowance of interest may also be made under appropriate provisions of the Income tax Act."

7.1. The AR further submitted that against the above order, when the assessee approached the DRP with certain additional evidences, the DRP without considering the additional evidences rejected its plea. The AR

submitted relying on various case laws that the commercial expediency cannot be questioned by TPO, the assessee was not given adequate opportunity of being heard and the DRP denied the additional evidences, though Rule 9 of DRP Rules, 2009 empowers the Ld. DRP to entertain additional evidence. The relevant extract is reproduced below:

" Power to call for or permit additional evidence- where the panel deems it necessary, it may call upon or, as the case may be, permit the eligible assessee to produce any document or examine any witness or file any affidavit to enable it to issue proper directions:

Proved that the panel shall, while so permitting the eligible assessee record its reasons for such permission."

And relied on the ratio of the Supreme Court in the case of Jaswant Rai 234 ITR 745 (SC) in which it is held that discretionary powers must be used by a quasi-judicial authority when all the required conditions for the use of such power are satisfied. Thereafter, the assessee sought our attention to the various material and case laws in the paper book etc to submit that on merits it is having a case in its favour. Per contra, the DR supported the orders of the TPO/AO and the DRP.

8. We heard the rival submissions. The relevant portion of the DRP order is extracted as under:

"6. Panel: These objections are related and therefore are taken up together. The founder of Magic Woods Ltd (MWL), Canada is Indy Pathmanathan (founded in 1993). Indian company was fully owned subsidiary of MWL Canada. Magick Woods Exports Private Limited is incorporated in India and its directors are Indy Pathmanathan and family members.

7. *The Magic Woods Ltd (MWL), Canada has been liquidated. Just before the liquidation, the trademark is valued at certain price as above and amount is paid by the Indian company. The TPO has analysed the relationship between the assessee its AE and the directors. It is basically one family which is owning all the entities.*

8. *In para 10.6 of the order the TPO has held that trademark is only assigned to the assessee and there is no transfer of ownership. No ALP has been found out by the assessee except saying that it is using the sixth method prescribed by the CBDT. Details regarding Liquidation of the Canadian company and benefits assigned on liquidation are not available on record. Trademark Royalty not been paid for the years preceding the sale of trademark.*

9. *The valuation report clearly says that value of the assets of a going concern is more than the value of assets of a concern under liquidation*

20. *The assets method is used to determine the value of shares either where: (a) asset values constitute the prime determinant of corporate worth, depending on the nature of the operations (e.g. a real estate holding company or an investment holding company); or. (b) liquidation is contemplated because the business is not viable as an ongoing operation.*

21. *Where it is determined that the assets method is appropriate. a company's shares can generally be valued on one of the following bases:*

a. Adjusted book value or adjusted shareholders' equity which is the equity that results when goodwill is eliminated from an unadjusted balance sheet and all other assets are restated to fair market value. Each asset and liability is adjusted to its current or (fair market value at the valuation dated, on a going concern basis (as opposed to realizable liquidation values). An appropriate amount/or income taxes arising as a result of the above adjustments may be deducted. depending on the circumstances.

b. Liquidation value which is the net amount of money, if any, available to equity owners following a voluntary, orderly liquidation or a forced sale. Under this scenario, a going concern is not assumed.

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24. *The earning power of a going concern entity is often greater than the value of the individual assets owned by it. This is because the value of assets can be realized only if the business is liquidated and the process of*

liquidation may often reduce asset values substantially. The earnings method therefore suggests the continuation of the business operations, and is based upon the purchaser's desire to acquire, or to share in, the earning power or the future profits of the enterprise.

10. However, although under liquidation the trademark of the AE (Le. MWL) has been valued on a going concern basis; and average range 4.8% to 5.1 % has been considered for the same.

40. Based on our review, we found the market royalty rates of comparable licenses to be in a range of 1.0% to 12.0% with an average in the low range of 4.8% and an average in the high range of 5.1 %.

41 Based on our analysis of comparable royalty rates and our evaluation of the strengths and weaknesses of the Trademarks, we have selected a pre-tax royalty rate in the range of 4.8%

11. The seller and purchaser are members of the same family

The proposal to purchase the Trade Mark and Brand "MAGIC WOODS" from the company's parent company Mis. Magick Woods Limited, Canada for a value of USD 5.36 million was placed before the Board for its consideration. A detailed presentation of the trade marks agreement to-be entered into with Messrs Magick Woods Limited, Canada. Messrs Magick Woods Exports Private Limited and Indrakumar Pathmanathan, the parties to the agreement and valuation report in this connection from Kalex Valuations Income Tax Act., Valuations dated December 14th 2011 was made during the meeting and the same was taken note of by the Board. The process of settlement of consideration of USD 5.36 million was presented during the meeting. Mr.Indrakumar Pathmanathan further explained that the necessity to buy and owned brand by Mrs.Magick Woods Exports Pvt. Ltd. that the company has been using the brand for the export business in USA & Canada since 2007, free of cost, with consent of Magick Woods Canada. As per the vendor agreement with buyers like Menards etc. that the Company should owned the brand minimum period of 10 years since this buyers are spending large amount for the promotion of the Magick Woods. The Board discussed at length the matters presented and thereafter passed the following resolutions.

RESOLVED THAT approval of the Board be and is hereby accorded to purchase the Trade Marks & Brand "MAGICK WOODS" bearing Registration Nos.TMA 683212 & TMA 676014 from M/s. Magick Woods Limited, Canada, the Company's parent company for a total consideration of USD 5.36 million

(Rupee equivalent Rs.26.53 Crores @Rs.49.50J USD) as per the valuation report from Kalex Valuations Inc. placed before the meeting

RESOLVED FURTHER TJIAT the company do enter into an agreement for purchase of Trade Marks & Brand as per the draft placed before the Board and Mr. Thavakumar Pathmanathan, Director' and Mr. Pathmakumar Pathmanathan, Director be and is hereby authorised severally to negotiate, finalise and decide the terms of the agreement and to sign, execute, file, verify and authenticate the documents, papers, agreements, applications etc., on behalf of the Company and to submit I register such applications, agreements and other requisite documents, writings and deeds as may be deemed necessary or expedient with such registering authorities in Canada and India or such other countries.

12. The assessee has submitted more documents which are in the nature of additional evidence. No reasons are given for not producing the same before AO.

13. As per Rule 46A of the IT Rules, the appellant is not entitled to produce any evidence, oral or documentary other than produced before the AO. The following exceptions have been provided in the said Rules:

- The AO has refused to admit which ought to have been admitted.*
- The appellant was prevented by sufficient cause from producing evidence, which he was called upon to produce by the AO.*
- The appellant was prevented by sufficient cause from producing the evidence before the AO, which is relevant to the grounds in appeal.*
- The AO has made order without giving sufficient opportunity to the appellant to adduce evidence relevant to any ground in appeal.*

14. As per rules of admission of the evidence the additional evidence cannot be entertained without giving an opportunity to the AO to rebut the evidences produced by the assessee. The case is time bound and limitation is within this month and therefore, giving an opportunity to the AO is not possible. The ITAT, Bangalore in case of Anupam Kothari, ITA No. 937(Bang) 2012 has held that for admission of additional evidence, it is required for the assessee to show that authorities had decided its grounds without giving sufficient opportunity to adduce evidence. Therefore, the panel is unable to admit the additional evidence as the same will be.

15. The TPO has clearly brought out in para 11.1 to 13.1 of the order that different figures of sales projection have been followed by the assessee for share valuation and trademark valuation. Higher figures of sales projection have been adopted by the assessee for trademark valuation. No reasonable explanation has been given by

the assessee for this difference. The Panel finds that the evaluation of free cash flow and sales projection are correctly done by the TPO. The objections are accordingly rejected.

16. Objections Ground No.8: The ACIT/TPO failed to appreciate that the consequential adaptation of TPO's suggestion/findings for making disallowance of the proportionate interest on the corporate loan used for acquiring the said brand was wrong, erroneous, unjustified, incorrect and not sustainable in law.

Objections Ground No.9: The ACIT went wrong in recording the findings in this regard in para 4 & .5 of the draft assessment order/impugned order without assigning proper reasons and justification.

Objections Ground No.10: The ACIT/TPO failed to appreciate that having used the corporate loan taken for brand acquisition which should be construed as utilized for business purposes, the proportionate disallowance of interest in relation thereto was wholly unjustified.

17. Panel: These objections are related and therefore are taken up together. The AO has based his order on the findings of the TPO. Since the amount of interest paid is not wholly and exclusively for the business the same has been disallowed. So, the objections of the assessee are not accepted."

9. From the above, it is clear that the relevant material required for the determination of the issues have not be properly appreciated. In the facts and circumstances, we deem it fit to set aside the orders of the lower authorities and remit these issues, which are inter connected, including the issues raised in the additional ground, back to the AO/TPO for a fresh examination and passing a speaking order, afresh, after affording adequate opportunity to the assessee in accordance with law. The assessee shall furnish all relevant material in its support before the TPO/AO, as the case may be, as required under the provisions of law. Needless to say that such an order would be subject to the provisions of section 144C and its consequences, afresh.

10. In the result, the assessee's appeal is treated as allowed for statistical purposes.

Order pronounced on Tuesday, the 06th day of February, 2018 at Chennai.

Sd/-
(एन.आर.एस .गणेशन)
(**N.R.S. GANESAN**)
न्यायिकसदस्य/**Judicial Member**

Sd/-
(एसजयरामन)
(**S. JAYARAMAN**)
लेखासदस्य/**Accountant Member**

चेन्नई/Chennai,

दिनांक/Dated: 06th February, 2018

JPV

आदेशकीप्रतिलिपिअग्रेषित/Copy to:

1. अपीलार्थी/Appellant
2. प्रत्यर्थी/Respondent
3. आयकरआयुक्त) अपील(/CIT(A)
4. आयकरआयुक्त/CIT
5. विभागीयप्रतिनिधि/DR
6. गार्डफाईल/GF