IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH "I-2" NEW DELHI

BEFORE SHRI AMIT SHUKLA, JUDICIAL MEMBER
&
SHRI Dr. MITHA LAL MEENA, ACCOUNTANT MEMBER

(ITA No.1406/DEL/2018)
Assessment Year: 2008-09

Reebok India Company, The Arena Plot No.53, Sector-32, Institutional Area, Gurugram, Haryana.	v.	JCIT (OSD), New Delhi.
TAN/PAN: AAACR 3007K		
(Appellant)		(Respondent)

Appellant by:	S/Shri Ravi Sharma & Anubhav Rastogi, Adv.		
Respondent by:	Shri H.K. Chaudhary, CIT-DR		
Date of hearing:	01	11	2018
Date of pronouncement:	01	11	2018

O R D E R

PER AMIT SHUKLA, J.M.:

The aforesaid appeal has been filed by the assessee against the impugned order dated 30.01.2018, passed u/s.254/143 (3) r.w.s. 144C for the Assessment Year 2008-09. In the various grounds of appeal, the assessee has challenged the addition of Rs.10,77,54,037/- on account of adjustment made in the payment of royalty to the AE.

2. The brief facts and background of the case are that assessee is engaged in the business of selling footwear, apparels, fitness equipment and sportswear. It procures finish goods mostly from local suppliers/contract manufacturers

and resells the same to the distributors and franchisee's stores in India. The merchandise is either manufactured locally through contract manufacturer or imported from the third partly contract manufacturer with the assistance of group companies. The technical knowhow to manufacture the product has been received by the assessee under 'license agreement' from its AEs based on which the assessee provides specification/contract guidance to the third party contract manufacturers. The assessee has made payment of royalty of Rs.15,28,77,527/-, which as per the agreement was @ 5% of all the domestic sales. In the first round of proceedings, TPO held that there was no need of payment of 'royalty' to the AE and no cost benefit analysis have been provided by the assessee for such a payment. The Assessee has relied upon the approval of the rate by Ministry of Commerce to claim that the rate of 'royalty' paid should be treated at Arm's Length Price. This matter had travelled up to the stage of the Tribunal, wherein the Tribunal has deleted the said adjustment after observing and holding as under:

"14.7 We find that in this case the assessee has made the payment of royalty amounting to Rs. 152877527/- to the AE. In the Transfer of Pricing Report the transfer of royalty was benchmarked using the CUP method as the most appropriate method. The TPO was of the opinion that there was no need of payment of any royalty to the AE in this regard. The TPO observed that approval of the Ministry of Commerce. Department of Industrial, Policy and Promotion can not be treated as a valid CUP as required by Rule IOB(I)(a) of the l.T.

Rules. TPO has observed that the assessee was asked to furnish the information as to the cost benefit analysis with regard to the payment of royalty. TPO noted that no such cost benefit analysis was carried out by the Assessee. TPO has further referred that assessee has not submitted the comparable instances. TPO further noted that though there has been increase in the assessee's sales there has been decline in the net profit to sales ratio. On the basis of above, TPO did not accept the contention of the assessee that superiority of technology received by the assessee on payment of royalty was giving commercial benefits. TPO opined that payment of royalty by the assessee to the AE did not bring any commensurate benefit. TPO further observed that in an arms' length situation, no independent enterprise would make payment for royalty for technology which is not contributing to its profitability.

14.8 We find that as per Clause I of the Technology License Agreement dated 01-10-2002 between Reebok International ltd. and Reebok India Company, the assessee has been provided data, documentation, drawings and specifications relating to inventions, designs, formulae, process and similar property referred to as know how. Clause 2 of the same agreement, grants the assessee non-exclusive, non transferrable right to utilize the technology in the manufacture and distribution of Reebok Products in India. We find that assessee gets goods manufactured on the basis of technology technical know and designs provided by the AEs. In consideration of provision of technology and knowhow, the assessee pays royalty (5%. The industry in which the

assessee operates i.e. the premium sports apparel and footwear industry is highly competitive and in order to survive and grow profitably it is imperative for the assessee to continuously launch new and improved products in the market.

14.9 Assessee does not undertake any significant research and development activity on its own and totally «depends upon the associated enterprise for provision of technology. The new products are designed and developed largely in the US based Research and Development and product creation centre of the AE. The assessee regularly access this Tech Packages for use in local development and manufacturing process for the footwear and apparel styles manufactured locally in India which is largely the adaptations of the globally developed styles. The aforesaid technology has been patently by the AEs and therefore cannot be used without the permission of the AE. Thus, we agree with the submissions of the assessee that entire business of the assessee depends upon the technology provided by the AE and without the license to use such technology. The assessee would not be able to continue this business.

14.10. Further the premium value of the product allows the assessee to increase the sales and charge higher price which the leads to higher profitability. It would also be noted that during the relevant previous year the total revenue of the assessee increased to Rs. 451.97 crores from Rs. 360.95 crores in the preceding previous year registering a growth of 25.21 %. The growth in the revenue of the assessee clearly

demonstrates the benefits derived by the assessee from the use of technology. In this regard, Assessing Officer has observed that since there is a fall in the net profit by sales ratio in the relevant previous year as compared to the preceding previous year. This ratio for financial year 2007-08 was 7.4% as against 8.96% in financial year 2006-07. On the strength of these figures Assessing Officer had made a bizarre conclusion that assessee was not deriving any commercial benefit from the payment of royalty and that payment of royalty by the assessee to the AE did not bring any commensurate benefit. In our considered opinion, on the facts and circumstances of the case, the above conclusion by the Assessing Officer is totally unsustainable. It has been clearly demonstrated that the very survival of the assessee in the industry depend upon the Iicence and technology & know how provided by the AE. There has been a considerable increase in the sales figures. The growth in the revenue of the assessee clearly demonstrates the benefits derived by the assessee from the use of technology.

14.11 In this regard, assessee's submission are note worthy that profitability of the assessee can be lower due to various business reasons and the lower profitability in the current year as compared to previous year cannot form the basis for arriving at a conclusion that no benefits were derived by the assessee. It has been submitted that the profit during the current year were lower on account of substantial provision of bad debt, high rent and increase in legal cost. These averments have not been disputed by the Revenue. Accordingly, the inference drawn by the TPO that no benefits

were derived by the assessee for use of technology and technical know how is not tenable.

14.12 We further agree with the contention of the assessee that assessee is free to conduct business in the manner that assessee deem fit and the commercial and business expediency of incurring any expenditure is to be seen from the assessee's point of view. We find that it is a settled law that the Revenue cannot sit into the shoe of the assessee and decide what is prudent for the business. In this regard.,we place reliance upon the decision of the Hon'ble Apex Court in the case of CIT v. Walchand & Co. (P.) Ltd [1967]65 ITR 381, wherein it was held that "in applying the test of commercial expediency for determining whether an expenditure was wholly and exclusively for business, the expenditure has to be adjudged from the point of view of the businessman and not of revenue".

14.13 We further note that it is on the basis of the same agreement the royalty was paid in earlier years. In earlier years the payment of royalty has not been held to be non-bonafide expenditure by the TPO. On these basis also the TPO's conclusion that there is no benefit to the assessee from the payment of royalty is unsustainable. In view of the foregoing discussions, we hold that payment or royalty in this case satisfies the benefit test. The benefit is undoubtedly tangible and it not passive as argued by the Ld. Departmental Representative.

14.14 Furthermore. assessee has duly submitted comparable instances to bench mark royalty as under:-

(i) Instances of royalty paid by third party licensees/ distributors

(ii) Agreement between Double D'import SAR.I (France) with Adidas International for payment of royalty @ 12%

(iii) Agreement of sportsvision with Adidas international for payment of royalty @ 10%

(iv) Agreement of Molten Corporation Japan with Adidas International Marketing BV for payment of royalty @ 12%

14.15 Thus, the observation of the TPO that comparable instances were not given by the assessee does not hold water any more. We find that the case laws relied upon by the DR have been cogently rebutted in the assessee's submissions and rejoinder as above.

14.16 We further find that assessee has sought to justify the payment of the royalty on the basis that in the case of the assessee the concerned Ministry of Government Of India has scrutinized the payment of royalty and granted the approval, the payment cannot be regarded as non-bona fide so as to hold the arms length price thereof as NIL. In this regard, we agree that though it is not a conclusive proof, the above approval of the Government has to be given consideration while considering the arms length price of the transaction. Admittedly, in this case assessee has been granted due permission from the concerned Ministry of Government in this regard.

14.17 We are further in agreement with the Id. Counsel of the assessee that Rule I0B (1) states that for the purpose of section 92C (2) the arms length price shall be determined by one of the five methods which is found to be most appropriate method and goes on to lay down the manner of determination of the ALP under each method. The five methods recognized by the rule are (i) comparable uncontrolled price method (CUP), (ii) re-sale price method, (iii) cost plus method, (iv) profit split method and (v) transactional net marginal method(TNMM). The assessee has rightly considered the comparable uncontrolled price method for determining the arms length price. In this context, the conclusion of the TPO that the arms length price of the royalty payment should be NIL without specifying any cogent basis is not sustainable. The TPO's determination is on the basis of assumption and surmises. Hence, the adjustment made by the TPO is liable to be deleted.

15. In the background of the aforesaid discussion, we hold that the upward adjustment of Rs. 15,28,77,527/- on account of payment of royalty cannot be sustained. Accordingly, we hold that payment of royalty in this case was fully justified.""

3. However, in the same judgment, the issue of AMP was also decided in favour. Both these matters were challenged by the Department before the Hon'ble Delhi High Court in the appeal filed u/s.260A, wherein the Hon'ble High Court by judgment and order dated 16th March, 2015 (reported in 374 ITR 118), in so far as issue of AMP is concerned, had remanded back the matter to the file of the Tribunal to be decided in line with Direction given therein. However, in so far

as the question of deletion of 'royalty' payment by the Tribunal same was upheld and thus, the issue of royalty had attained finality in favour of the assessee.

4. In remand proceedings, the Tribunal in pursuance of the direction of the Hon'ble High Court which was required to adjudicate the issue of AMP adjustment only. The Tribunal after detail discussion and observations had set aside the matter to the file of TPO/Assessing Officer. However, by oversight or by mistake the Tribunal had set aside the matter of 'royalty' adjustment also to the file of the TPO along with the matter of AMP, which was neither the mandate of the Hon'ble High Court nor was the issue for adjudication as it had finality. The relevant direction of the Tribunal reads as under:

> *"14. Accordingly, following the decision of the coordinate Bench, both the matters of determination of arm's length price of AMP expenses and royalty Payment raised in Ground Nos. 3 to 4.5 are restored back to the file of the AO/TPO to decide the matter de novo in the light of the common judgment dated 16th March, 2015 of the Hon'ble jurisdictional High Court of Delhi laid down in the appeals of the assessee and Revenue led by Sony Ericsson Mobile Communications India (P) Ltd., (supra)."*

5. Now the matter which had attained finality in the first round itself *qua* the issue of 'royalty' had again become the matter of adjudication by the TPO, who now held that 1% of the sales is justifiable for the payment of royalty; and accordingly disallowed the rest of the payment. In sums and

substance, his observations are as under:-

- "The License Agreement for payment of royalty was only to transfer profit to its foreign AE.
- The Assessee has not provided any CUP data of comparable companies in India having similar FAR as that of the Assessee which can establish that the transaction is at Arm's Length.
- Held that only 1% of sales is justifiable royalty and disallowed the rest of the amount of royalty paid by the appellant to the AE.
- Consequently, proposed an adjustment of Rs. 10,77,54,037/- to the income of the Appellant."

6. The DRP in its direction though observed that this matter stands deleted from the stage of the Hon'ble High Court, however, the Department has filed SLP against the said order which is pending and the adjustment made by the TPO has been upheld.

7. We have heard the rival submissions and also perused the relevant material placed on record. Here in this case, the issue which had attained finality in the first round of proceedings itself, wherein the Tribunal after detailed discussion and analyzing the 'license agreement' between the assessee and its AEs has upheld that rate of 5% of royalty payment is at ALP and had deleted the entire adjustment; and not only that such an order of the Tribunal has been affirmed by the Hon'ble High Court also, then it is quite unfathomable

as to how the same issue can be re-agitated in the second round of proceedings as it was completely circumscribed to the issue of AMP adjustment only. It appears that the Tribunal though was mandated to decide the issue of AMP, but under some erroneous impression has set aside the issue of 'royalty' also. It has been informed by the Ld. Counsel that against the said order, assessee has already filed Miscellaneous Application before this Tribunal however it is still pending. Thus, the addition on account of 'royalty' adjustment is unsustainable which is directed to be deleted

8. Otherwise, it is not in dispute that assessee's entire business depends upon the technology provided by the AE and without the license to use such technology, assessee company would not be able to carry on the business. Though comparability analysis should have been done by by the assessee and TPO by comparing it with uncontrolled transactions after detail analysis to arrive at correct ALP, but, since this matter has been dealt and deleted by the Tribunal after detailed discussion and analyzing the entire agreement and the facts and circumstances of the case, which also got confirmed by the Hon'ble High Court, therefore, it stands covered in favour of the assessee. Another important fact brought to our notice by the learned counsel that in Assessment Year 2009-10, i.e., in the subsequent year, the Tribunal following the earlier order dated 14th June, 2013 and also the order of the High Court (supra) has already deleted the similar addition. Thus, once the issue had attained finality uptill the stage of the High Court, then bound by such binding judicial precedence, such addition has to be deleted.

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

Order pronounced in the open Court on 1st November, 2018.

Sd/-	Sd/-
[Dr. MITHA LAL MEENA]	**[AMIT SHUKLA]**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

DATED: 1st November, 2018

PKK:

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT(A)
4. CIT
5. DR

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