

**IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH 'I-1', NEW DELHI**

**BEFORE SH. N. K. BILLAIYA, ACCOUNTANT MEMBER
AND
SH. SANDEEP GOSAIN, JUDICIAL MEMBER**

ITA No.7569/DEL/2018
Assessment Year: 2014-15

MSD Pharmaceuticals Pvt. Ltd. 1544, Level 15, Eros Corporate Towers, Nehru Place, New Delhi -110019 PAN No. AAECM1106C	Vs	Additional Commissioner of Income Tax Special Range-6, New Delhi
(APPELLANT)		(RESPONDENT)

Appellant by	Ms. Rashmi Chopra, Advocate
Respondent by	Sh. Sanjay I. Bara, CIT DR

Date of hearing:	06/03/2019
Date of Pronouncement:	07/03/2019

ORDER

PER N. K. BILLAIYA, AM:

This appeal by the assessee is preferred against the order dated 26.10.2018 framed u/s 143 (3) r.w.s. 144 C of the Act pertaining to A. Y. 2014-15.

2. The substantive grievance of the assessee read :-

That on the facts and circumstances of the case, and in law;

1. The Learned Assessing Officer ("Ld. AO") following the directions of Hon'ble Dispute Resolution Panel

- 2 ("Hon'ble DRP") has erred in assessing the returned income of the Appellant of Rs. 258,415,100 g brought forward losses of Rs. 84,705,565) at Rs. 639,855,300/-.

Transfer Pricing Issues

2. The order / directions passed passed by Ld. AO/ Learned Transfer Pricing Officer ("Ld. TPO")/ Hon'ble DRP are bad in law and facts, to the extent of adjustment of Rs. 381,440,197 /- made in the impugned order.

Alleged excessive Advertising, Marketing and Promotion (AMP) expenses

2. The facts and circumstance of the case and in law, the Ld. AO/Ld. TPO/ Hon'ble DRP has grossly erred both in facts & law, in enhancing the income of the Appellant by Rs. 271,284,352/- on account of non receipt of the income for "allegedly excessive" AMP expenses incurred by the Appellant and in doing so have grossly erred in:

- 3.1. assuming jurisdiction in respect of the AMP expenditure when such expenditure did not satisfy the requisites of being an international transaction under Section 92B read with Section 92F(v) of the Act;*
- 3.2. not appreciating that expenditure incurred by the Appellant w as on account of sales activity and, could not be regarded as a 'transaction' in absence of any understanding/ arrangement between the Appellant and the associated enterprise (AE) for the promotion of brand and therefore cannot be termed as an 'international transaction' between the Appellant and the AE;*
- 3.3. not holding that the existence of international transaction in respect of AMP has to be seen through the prism of 'conduct of the parties' and the ownership of IPR(s) and their usage;*
- 3.4. in concluding that the Appellant entered into an international transaction with it's AE as a consequence of incurring a higher expenditure on AMP in the absence of any material on record and/or any powers under Chapter-X of the Act;*
- 3.5. failing to appreciate the fact that the Appellant operates in the pharmaceutical industry which is a highly regulated industry which prohibits the Appellant from undertaking any kind of advertising campaign to promote its products as alleged by the Ld. AO / TPO / Hon'ble DRP and that the alleged AMP expenses relate to medical detailing expenses, disease awareness campaigns etc.;*
- 3.6. holding that the Appellant is adding value to the products sold in India by incurring AMP expenses without appreciating the fact that AMP expenses incurred by the Appellant are primarily for the purpose of selling the products and not towards brand building activity and is interlinked and inter-connected to the distribution business of the Appellant;*
- 3.7. that the Ld. AO/Ld. TPO/ Hon'ble DRP erred on facts and in law in not appreciating that the AMP expenses are incurred by the Appellant at its own volition and for its own benefit and any benefit accruing to the AE is incidental for which no compensation is warranted;*
- 3.8. wrongly assuming that the Appellant is operating under the directions and for the purposes of / me AE;*

- 3.9. *applying Bright Line Test (BLT) for computing adjustment on account of expenditure on AMP without appreciating that in absence of specific provision under the Transfer Pricing regulations in India, an adjustment on account of the arm's length price of AMP expenses could not be made;*
- 3.10. *erred in applying BLT against the binding precedent as laid down by the Hon'ble Delhi High Court in case of Sony Mobile Communications [374 ITR 118 (Del)];*
- 3.11. *not appreciating that 'bright line limit' is not a prescribed method under the purview of section 92C of the Act;*
- 3.12. *not appreciating that Transactional Net Margin Method ('TNMM) analysis included AMP expenses and could not be benchmarked and adjusted as a part of the adjustment pertaining to marketing intangibles;*
- 3.13. *applying an ad-hoc mark-up of 10.19% percent on allegedly excess AMP expenses incurred by the Appellant;*
- 3.14. *erred in considering selling and distribution expenses within the ambit of AMP expenses which is against the binding principles laid down by the Hon'ble Delhi High Court in case of Sony Mobile Communications (supra)*
- 3.15. *without prejudice, Ld. AO/ Ld. TPO/ Hon'ble DRP has erred on facts and in law in giving an erroneous finding of using companies selected by Ld. TPO, which are, neither functionally comparable, nor into similar business activities to benchmark the AMP expenses of the Appellant*

Adjustment on account of provision of coordination and other support services

4. *That on the facts and circumstance of the case and in law', the Ld. AO/Ld. TPO/ Hon'ble DRP has erred in proposing TP adjustment on account of co-ordination & other support sendees provided by the Assessee and in doing so have grossly erred in:*

- 4.1. *ignoring the principle of consistency in tax proceedings.*
 - 4.2. *computing the entity level operating margin of the Assessee instead of co-ordination and other support service segment by disregarding the segmental analysis and not appropriately excluding non-operating income/ expenses and including operating income/ expenses.*
 - 4.3. *calculating incorrect margin of comparables, despite of corrected margins submitted during the course of TP assessment;*
 - 4.4. *considering functionally dissimilar companies for computing the ALP;*
 - 4.5. *Disregarding the approach adopted by the Assessee of using the multiple year data in the TP documentation and holding that current year (i.e. FY 2013-14) data for comparable companies should be used despite the fact that the same was not necessarily available to the Assessee at the time of preparing its TP documentation.*
5. *That Ld. AO/TPO has ignored the fact that Appellant has filed a rectification application against the order of Ld. TPO pursuant to DRP directions.*

Others

6. *The Ld. AO / Hon'ble DRP has erred in not granting set-off of brought forward loss amounting to Rs. 84,705,565 of AY 2012-13.*
7. *The Ld. AO/Hon'ble DRP has erred in not granting Minimum Alternative Tax ('MAT') credit amounting to Rs. 18,081,414 while computing the tax liability of the Applicant. The Ld. AO*

failed to appreciate the fact that during AY 2013-14, the Appellant had paid taxes under the provisions of section 115JB of the Act and accordingly, Appellant is eligible for utilization of MAT credit against the tax liability for AY 2014-15 computed under the normal provisions of the Act.

8. *The Ld. AO erred in disregarding the sound TP principles and judicial pronouncements in India in undertaking the TP Adjustments.*
9. *The Ld. AO has erred in levying interest under section 234A of the Act while calculating the amount of demand, without appreciating the fact that the Appellant has filed its return of income within the prescribed due date mentioned under section 139(1) of the Act.*
10. *The Ld. AO has while calculating the amount of demand due from the Appellant, computed the interest to be levied on the Appellant erroneously.*
11. *The Ld.AO/Hon'ble DRP has erred in holding that the Appellant has furnished inaccurate particulars of income in respect of each item of disallowance / additions and in initiating penalty proceedings under Section 271 (1) (c) of the Act.*
12. *That the Appellant reserves its right to add, alter, amend or withdraw any ground of objections either before or at the time of hearing of these objections.*

The above grounds are without prejudice to each other.”

3. Vide application dated 23.12.2018 the assessee sought permission to file additional evidence in support of the appeal.

The contents of the said application read :-

1. *“In the captioned appeal preferred by Appellant, against the order dated October 26, 2018 passed by the Joint Commissioner of Income Tax, Special Range -6, New Delhi under section 143 (3) read with section 144C of the Income Tax Act, 1961, the appellant has interalia raised grounds of appeal against an addition of INR 25,450,280 on account of provision of coordination and support services.*

2. *In this regard, Appellant humbly submits that Learned Transfer Pricing Officer (Ld. TPO) has computed the entity level operating margin instead of support service segment by disregarding the segmental analysis documented by Appellant in transfer pricing documentation and stating that reliable segmental information is not available.*

3. *In this regard, we submit herewith the certificate from the independent auditor authenticating the margin earned from the each segment of business including provision of coordination and other support services.*

In the light of the aforesaid submission, Hon'ble Bench may, with a view to advance the cause of justice, be pleased to admit these documents to the proceedings under consideration and pass specific order to that effect in this prayer.

4. The MSD Pharmaceuticals Private Limited (“MSD India” or the “Assessee” or the “Company”) is a wholly owned subsidiary of

Merck, Sharpe and Dohme B. V. and an indirect wholly-owned subsidiary of Merck & Co. Inc., a U. S. publicly- traded company (“Merck & CO. , Inc. and entities directly and indirectly related to it are hereinafter collectively referred to as “Merck Group”). The company was incorporated on December 3, 2004 and commenced its operations in January 2005.

International transactions undertaken by the assessee during the year under consideration are as under :-

No.	Nature of transaction	Method	Value of transaction
1	Purchase of trading goods	RPM	1,82,06,11,600
2	Provision of co-ordination services	CPM	448,37,860
3	Other support services	CPM	2531,333,14
4	Recovery of expenses	-	457,60,134
5	Reimbursement of expenses paid	-	139,94,817
6	Subvention Income received	Other Method	3,74,40,000

5. The factual matrix involved in the grievance of the assessee can be understood from the order giving effect to the direction of the DRP and the same read as under :-

“4. Following the directions of Hon’ble DRP, effect is being given in the manner given below :-

a. Revised Computation of Co-ordination and support services :-

Name of the company	OP/ OC (%) as per order u/s 92 CA(3)	OP/OC(%) in pursuance of DRP's direction	OP/ OC (%) after WC adjustment
Bangalore Biotech Labs Pvt. Ltd.	12.7%	4.42%	1.06%
Choksi Laboratories Ltd.	15.18%	15.18%	10.72%
Raptakos, Brett Test Laboratories Ltd.	5.32%	5.32%	3.17%
Vimla Labs Ltd.	15.85%	15.85%	11.57%
Vivo Bio Tech Ltd.	36.12%	1.16%	4.05%
Average	17.03%	8.39%	6.11%

In absence of reliable segmental working, TPO while passing order u/s 92CA(3) of the Act has calculated net margin at entity level of the assessee company @ -2.29%. In this regard, Ld. DRP has held that the TPO has cited absence of segmental data and satisfactorily allocation of expenses in this segment. We don't find adequate reason to disagree with the TPO's action and hence uphold the same. Assessee's objection in this regard are rejected.

It is further added that there is no reliable segmental data available with the assessee, hence could not be allowed. Based on the above update average PLI of comparables @6.11% in respect of provision of co-ordination and other Support Service Segment, ALP is being revised as follows :-

<i>Total Operating Cost</i>	5,567,691,546
<i>Arm's Length Price at a margin of 6.11%</i>	5,907,877,500
<i>Transfer Price received by the taxpayer</i>	5,442,979,466
<i>Shortfall of Transfer price from ALP</i>	46,48,98,033
<i>International transaction related to support services</i>	297,971,174
<i>% of transaction</i>	5.47%
<i>Proportionate Adjustment</i>	2,54,50,280

b. Purchase of Trading Goods from the AE:-

Following the directions of Hon'ble DRP, the final set of comparable with WCA updated margins are as follows:-

Name of comparable company	Intensity adjusted OP/OC (%)	Working Capital Adjusted Margin
<i>Brawn Biotech Ltd.</i>	2.38%	0.36%
<i>Emami Frank Ross Ltd.</i>	5.43%	0.04%
<i>Infugen Pharma</i>	2.84%	2.21%
<i>Oceanic Pharmachem</i>	9.40%	5.38%
<i>Zuventus Healthcare Ltd.</i>	5.63%	1.83%
Average	5.14%	1.97%

Regarding, the segmental margins of the assessee, the details submitted by the assessee does not have any audited backing. In light of this, TPO is not able to provide this relief to the assessee. Based on the above computed table, the following effect is provided in computation of Awp's Length Price:-

<i>Operating Revenue</i>	5,442,979,466
<i>Arm's Length Price at a margin of 1.97%</i>	10,72,26,695
<i>Arm's length Price</i>	5,335,752,771
<i>Price paid by the assessee</i>	5,567,691,546
<i>Difference</i>	23,19,38,775
<i>Less: Reimbursement received</i>	400,000,000
<i>Difference after reimbursement</i>	NIL
<i>Proportionate Adjustment</i>	NIL

c. Re-computation of ALP for creation of marketing intangibles (AMP):-
Following the directions of Hon'ble DRP, the final set of comparable for apply of
k-up with updated margins are as follows:-

Name of comparable company	GP/OC Margin (%)
<i>Crystal Hues Ltd</i>	6.60%
<i>Goldmine Advertising Ltd.</i>	5.34%
<i>ICRA Management Consulting Services Ltd.</i>	5.36%
<i>Kestone Integrated Mkg. Services Ltd.</i>	8.27%
<i>Killick Agencies & Mkg. Ltd.</i>	25.39%
Average	10.19%

The amount which represents the bright line and the amount that should have been compensated to the assessee company are computed hereunder:-

Particulars	Value (INR)
<i>Value of Gross Sale of assessee (A)</i>	5442583284
<i>Arithmetic mean of AMP/Sales of comparables (B)</i>	0.61%
<i>Amount that represents price for routine AMP activities (C=B*A)</i>	33353250
<i>Total expenditure incurred by assessee on AMP (D)</i>	642559487
<i>Arm's length price of the service/expenditure for creation of marketing intangible in India in favour of the AE (E=D-C)</i>	609206237
<i>Mark-up (a), 10.19% (F)</i>	62078115
<i>The amount by which assessee company should have been reimbursed by AE, and for which adjustment is required to be made (G=E+F)</i>	671284352
<i>Less: Price received from the AE for creation of marketing intangibles</i>	400000000
<i>Revised Adjustment for creation of marketing intangibles</i>	27,12,84,352

Thus, giving effect to the directions of Hon'ble DRP and based on the above computation, an adjustment of Rs 27,12,84,352/- to the total income of the assessee on account of marketing and market development function carried out for the AE for which the assessee company was not adequately compensated is required to be carried out. However, benchmarking carried out above is on protective basis.

6. A perusal of the above shows that the grievance of the assessee has boiled down to adjustment of Rs.27,12,84,352/- to the total income of the assessee on account of marketing and marketing development function carried out for the AE however this bench marketing is carried out on protective basis.

7. At the outset the counsel for the assessee stated that an identical issue on identical set of facts was considered by the Tribunal in ITA No.6565/Del/2017. It is the say of the counsel that since the facts for the year under consideration are identical to the facts considered in A. Y. 2013-14, the grievance raised by the assessee has been decided by the Tribunal in favour of the assessee and against the revenue.

8. Per contra the DR stated that though bright line test (BLT) has been discarded by the Hon'ble Jurisdictional High Court in case of Sony Mobile Communications 374 ITR 118, therefore, the matter should be restored to the file of the TPO to decide the AMP adjustment without applying BLT.

9. We have given a thoughtful consideration to the orders of the authorities below. As can be seen from the order giving effect to the directions of the DRP the only dispute before us is the

bench marketing done on protective basis. Since the order of the DRP has been accepted by the revenue and since the revenue is not appeal before us, we are only adjudicating on the issues raised by the assessee before us.

10. We find force in the contention of the Ld. Counsel for the assessee. On identical set of facts the coordinate bench in A. Y. 2013-14 in ITA No.6565/Del/2017 has deleted the addition made on protective basis. The relevant findings of the Tribunal read :-

“6. Having heard the rival contentions and having perused the material on record, we are unable to see any merits in the impugned ALP adjustment of Rs. 23,83,92,783 on, what has been termed as, protective basis. Learned Departmental Representative has not even disputed that the issue is covered against the revenue authorities by binding judicial precedents, but his worry is about protecting legitimate interests of the revenue. These apprehensions, however, are not really justified. There is no dispute that the application of bright line test, for making ALP adjustments in respect of the AMP expenses, is held to be unsustainable in law by Hon’ble jurisdictional High Court, and the TPO himself states so in so many words. It is also elementary that it is not, cannot be, open to us to disregard the binding judicial precedents and uphold the application of bright line test, for determining the ALP adjustment in respect of AMP expenses, merely because a binding judicial precedent from Hon’ble jurisdictional High Court has been challenged by the revenue authorities before the Hon’ble Supreme Court. The binding nature of a judicial precedent, as long as it holds the field i.e. is not overturned, remains unaffected by whether or not it has been challenged before a higher forum. As a corollary to this legal position, the impugned addition of Rs'23,83,92.783 must stand deleted. The very concept of protective addition is relevant only when an income is to be added in the hands of more than one taxpayer, in a situation in which there is an element of ambiguity as to in whose hands the said income can be rightly brought to tax. That’s not the case before us. In our humble understanding, therefore, the concept of ‘protective assessment’, as is known to the income tax law, has no application in the cases like the one before us.

7. In view of the above discussions, the addition of Rs 23,83,92,783 stands deleted.

8. So far as the question of set off of the brought forward business losses is incurred, learned representatives fairly agree that the matter is required to be remitted to the file of the Assessing Officer for fresh adjudication in the light of the result of the appellate proceedings in respect of the preceding assessment years in which the related disputed additions have been made. It is pointed out by the learned counsel that, in any event, the assessee has claimed set off of the loss of Rs 26,25,85,933 incurred in the assessment year 2012-13 which could not have been set off for the

prior years, and the only year following the said assessment year is the year before us. It is also pointed out that the ALP adjustment, in respect of AMP expenses by applying the bright line test (BLT), which is now decided in favour of the assessee. While learned Departmental Representative did not really address on all these aspects, he fairly agreed to our suggestion that the matter is required to be examined afresh by the Assessing Officer in the light of outcome of the appellate proceedings for the other assessment years as also by way of a speaking order dealing with the specific contentions of the assessee. In the light of this undisputed position within a narrow compass of material facts, we remit the matter to the file of the Assessing Officer for fresh adjudication in the light of our above observations. We also direct the assessee to fully cooperate with the Assessing Officer in expeditious disposal of the remanded proceedings. Ordered, accordingly.”

11. Respectfully following the findings of the coordinate bench the addition of Rs.27,12,84,352/- is deleted.

12. The second quarrel relates to the adjustment on account of provision of coordination and other support services.

13. We find that the root cause of this adjustment is the absence of segmental data and satisfactorily allocation of expenses in the segment.

14. The Counsel stated that at the time of the assessment proceedings audited segmental data were not available which caused the impugned adjustment. It is the say of the Counsel that with the application under rule 29 the assessee has prayed to admit the audited segmental data.

15. We have carefully perused the application under rule 29 and the audit certificate filed. In our considered view since now the audited segmental data are available the TPO must examine the same and decide the issue afresh after giving a reasonable opportunity of being heard to the assessee.

16. We accordingly restored this issue to the files of the TPO with a direction to consider and examine the audited segmental data and decide the issue accordingly. The assessee is directed to furnish relevant data before the TPO. Ground No.4 is treated as allowed for statistical purpose.

17. In the result, the appeal filed by the assessee is partly allowed for statistical purpose. Before closing since no other issue was argued before us there was no occasion to adjudicate on them.

Sd/-

(SANDEEP GOSAIN)
JUDICIAL MEMBER

NEHA

Date:- 07 .03.2019

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT(Appeals)
5. DR: ITAT

Sd/-

(N. K. BILLAIYA)
ACCOUNTANT MEMBER

ASSISTANT REGISTRAR
ITAT NEW DELHI

Date of dictation	05.03.2019
Date on which the typed draft is placed before the dictating Member	
Date on which the typed draft is placed before the Other member	
Date on which the approved draft comes to the Sr.PS/PS	
Date on which the fair order is placed before the Dictating Member for Pronouncement	
Date on which the fair order comes back to the Sr. PS/ PS	
Date on which the final order is uploaded on the website of ITAT	07.03.2019
Date on which the file goes to the Bench Clerk	
Date on which file goes to the Head Clerk.	
The date on which file goes to the Assistant Registrar for signature on the order	
Date of dispatch of the Order	

