

INCOME TAX APPELLATE TRIBUNAL  
DELHI BENCH "I-2 ": NEW DELHI  
BEFORE SHRI KULDIP SINGH, JUDICIAL MEMBER  
AND  
SHRI PRASHANT MAHARISHI, ACCOUNTANT MEMBER

ITA No. 6804/Del/2015  
(Assessment Year: 2011-12)

|  |     |                                  |
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| Zimmer India Private Ltd,<br>14 <sup>th</sup> Floor, Tower-B, DLF<br>Building No. 05, Cyber City,<br>Phase-III, Gurgaon<br>PAN: AAEC57432H | Vs. | DCIT,<br>Circle-4(1),<br>Gurgaon |
| (Appellant)  |     | (Respondent)                     |

|                       |  |
|-----------------------|--|
| Assessee by :         | Shri Manoneet Dalal, Adv<br>Shri Sanil Malhotra, CA<br>Shri Yishu Goel, AR |
| Revenue by:           | Shri H. K. Choudhary, CIT DR<br>Ms. Nimita Pandey, Sr. DR                  |
| Date of Hearing       | 27/03/2019   |
| Date of pronouncement | 14/06/2019   |

ORDER

PER PRASHANT MAHARISHI, A. M.

1. This appeal is filed by the Zimmer India Private Limited (assessee/ appellant) against the order of the 1d DCIT, Circle-4(1), Gurgaon ( 1d AO) passed u/s 143(3) read with section 144C(13) of the Income Tax Act [ the Act] on 15.10.2015, wherein, the total income was assessed at Rs. 8,49,13,300/- against the return of income filed by the assessee on 28.09.2011 of Rs. 7,76,53,660/-, wherein, the adjustment on account of the order of the 1d Transfer Pricing Officer which were subjected to the

direction of the Id Dispute Resolution Panel-I, New Delhi dated 09.05.2015 amounting to addition of Rs. 72,59,651/- was made.

2. The assessee has raised the following grounds of appeal:-

- “1. *That on the facts and in the circumstances of the case and in law, the order passed by the Ld. Assessing Officer ("AO") is bad in law and void ab-initio*
2. *That on facts and circumstances of the case and in law, the Ld. AO/ Ld. Transfer Pricing Officer ("TPO")/ Ld. Dispute Resolution Panel ("DRP") erred on facts and circumstances of the case in determining the arm's length adjustment to the Appellant's alleged international transaction with Associated Enterprises ("AEs"), thereby resulting in the enhancement of returned income of the Appellant by Rs. 7,259,651.*
3. *That on the facts and circumstances of the case and in law, the reference made by the Ld. AO suffers from jurisdictional error as the Ld. AO has not recorded any reasons in the assessment order based on which he reached the conclusion that it was "expedient and necessary" to refer the matter to the Ld. TPO for computation of the arm's length price, as is required under section 92CA(1) of the Income Tax Act, 1961 ("Act"). Further, the Ld. AO and the Ld. Commissioner of Income-tax failed to provide an opportunity of being heard to the appellant before making the reference to the Ld. TPO.*
4. *That the Ld. AO/ Ld. TPO/ Ld. DRP erred on facts and in law in enhancing the income of the Appellant by Rs. 7,259,651 by making a Transfer Pricing ("TP") adjustment on account of "alleged excessive" advertising, marketing and promotion ("AMP") expenses incurred by the Appellant and in doing so have grossly erred in:*
  - 4.1 *disregarding that the AMP expenses incurred by the Appellant represent purely domestic transaction(s) undertaken towards third parties, not covered under the purview of Section 92 of the Act*
  - 4.2 *disregarding that the AMP expenses incurred by the Appellant are "domestic" transactions undertaken with third parties, in respect of which no TP reference has been made by the Ld. AO to*

*the Ld. TPO and therefore is beyond the powers vested with the TPO under Section 92CA of the Act;*

- 4.3 disregarding submissions made by the Appellant on the functional and risk characterization of its marketing function to demonstrate that the AMP expenses incurred by the Appellant were in respect of its own business requirements/ considerations/ purposes as an independent decision maker and that all benefit resulting from such expenditure are to its own account and benefit, if any, to the overseas AEs, was purely incidental;*
- 4.4 ignoring that the 'bright line test' is simply a tool and not a method prescribed under the Act read with the Income-tax Rules, 1962 ("the Rules") and hence the arithmetic mean of the AMP expenses of comparable companies should not be considered for computing the impugned TP adjustment, thus contradicting the principles laid down by Hon'ble High Court (in case of M/s Sony Ericsson India Limited and others);*
- 4.5 by incorrectly holding that by undertaking/incurred AMP functions/expenses, the Appellant provides "brand building" services to AEs purely on the basis of the bright line test and not by demonstrating existence of an arrangement or agreement, thus contradicting the principles laid down by Hon'ble Delhi High Court (in case of M/s Maruti Suzuki);*
- 4.6 by incorrectly disregarding the nature of sales and sponsorship expenses incurred by the Appellant which clearly set forth that the expenses were incurred by Appellant on various events and conferences organized which were in the nature of selling expenses and have been incurred in connection with product specific programs/ events in relation to orthopedic surgery and have no nexus with brand promotion or creation of marketing intangible, thus contradicting the principles laid down by Hon'ble High Court (in case of M/s Sony Ericsson India Limited and various others);*

- 4.7 *by incorrectly holding that the AMP functions need to be analyzed separately from the distribution function and therefore by incorrectly determining a transfer pricing adjustment even when the Appellant's gross margins as well as net margins were found to be at arm's length under Resale Price Method ("RPM") as the primary method corroborated by Transactional Net Margin Method ("TNMM"), thus contradicting the principles laid down by Hon'ble High Court (in case of M/s Sony Ericsson India Limited and various others)*
- 4.8 *erroneously holding that the Appellant has rendered services to the AEs by incurring 'excessive' AMP expenses and by holding that a mark-up has to be earned by the Appellant in respect of the "alleged excessive" AMP expenses and erroneously applying an ad-hoc mark-up of 12.21% in respect of Appellant's "alleged excessive" AMP expenses, without any basis for the same whatsoever;*
- 4 *That the Ld. AO erred in facts and in law in charging interest under section 234D and 244A of the Act.*
- 5 *That on the facts and circumstances of the case and in law, the Ld. AO has erred in initiating penalty proceedings u/s 271(l)(c) of the Act mechanically and without recording any adequate satisfaction for such initiation."*
3. The brief facts of the case show that the assessee filed its return of income on 28.09.2011. The assessee has entered into the international transactions with associated enterprises for purchase and payment of services charges, which were benchmarked adopting the Transactional Net Margin Method (TNMM) as the most appropriate method adopting Profit Level Indicator (PLI) of operating profit/ operating income (OP/OI) and stated that those are at arm's length.
4. The assessee is primarily engaged in the business of importing, marketing, and distributing orthopedic implants and instruments to customers in India. The Id TPO during the course of determination of ALP of the international transaction noted that there are certain expenditure incurred

by the assessee with respect to sponsorship and sales promotion expenditure, commission on sales and discount allowed, which were according to him advertisement, marketing and promotion expenditure, which amounted to international transactions as according to him they have been incurred for the benefit to the associated enterprises of the assessee who were owning the brand. For benchmarking, he applied the bright line test and worked out the margin of the comparable of AMP/ sales of 3.78%. The margin of the assessee was computed of 7.34%. The difference was treated as excessive AMP expenditure incurred. Accordingly, he benchmarked the above expenditure using the bright line test under the cost plus method . He further imputed the mark up of 12.21% and made an adjustment of Rs. 3.72 crores. Accordingly, the draft assessment order was passed.

5. The assessee filed objection before the ld DRP. The ld DRP excluded selling expenses from the total advertisement, marketing expenditure and accordingly, the adjustment was restricted to Rs. 0.72 crores. The assessment order incorporated the above adjustment and it is challenged before us by the assessee.
6. Ground number 1 of the appeal is general in nature and therefore it is dismissed.
7. Ground number 2 is challenging the overall adjustment on account of the transfer pricing adjustment of INR 7 259651/-. This ground is also general in nature and therefore the same is dismissed.
8. Ground number 3 of the appeal is against the challenge for not recording any reasons in the assessment order for the referenced made to the learned transfer-pricing officer. No arguments were advanced by the learned authorised representative during the course of hearing and therefore it is dismissed.
9. Ground number 4 is with respect to the adjustment of AMP of INR 7 259651/- on account of alleged expensive advertisement marketing and promotion expenses incurred by the appellant.
10. The ld AR submitted as under:-
  - a. That advertisement marketing, promotion expenditure incurred by the assessee are purely domestic transaction as it incurred with the 3<sup>rd</sup>

parties and same does not go to benefit to the associated enterprises as they are pertaining to the business of the assessee. He referred to the details of such expenditure and stated that the Id AO has not brought on record anything to establish any arrangement between the assessee and the associated enterprises so as to bring the above transactions within the meaning of international transactions. He stated that unless the Id AO bring from existence an international transaction the addition cannot be made. He referred to several judicial precedents on this issue.

- b. He further stated that advertisement, AMP expenditure does not result into creation of any brand value.
- c. He stated that bright line test is not the method which can be applied for the purpose of bench marking AMP expenditure.
- d. He submitted that even otherwise, the selling expenses deserve to be excluded. In view of this, he submitted that the addition and adjustment made by the Id TPO is not sustainable.

11. The Id DR relied upon the order of the Id TPO/ AO and DRP.

12. We have carefully considered the rival contentions and perused the orders of the lower authorities. Admittedly, in the present case during the previous year the assessee imported heap, Knee and trauma implants from its associated enterprises. For benchmarking of the purchase of finished goods as well as other assets the assessee employed transactional Net margin method as the most appropriate method adopting the profit level indicator of operating profit/operating income and found that comparables PLI is 8.97% whereas the assessee's margin for assessment year 11- 12 is 6.03%. Further the purchase of finished goods were benchmarked using the resale price method and found to be at arm's length. The learned transfer-pricing officer did not found any infirmity in the benchmarking methodology and the benchmarking analysis of the assessee of its reported international transactions. However, the learned AO noted that from the audited accounts and other documents placed on record during the course of transfer pricing audit that the assessee is incurring huge amount on advertisement marketing and promotion expenditure. He noted that apparently the assessee spending this amount on extending the reach of the

brand owned by the associated enterprise and the final beneficiary is only the associated enterprise as the brand is owned by it, are gaining in value due to the marketing efforts of the assessee. The learned transfer pricing officer noted that assessee is in effect creating marketing intangibles in favour of the associated enterprise by the AMP efforts that it carries out in the Indian subcontinent. Therefore, according to him the assessee company should have been suitably compensated by the associated enterprise. Accordingly, the show cause notice was issued. The assessee submitted its reply. The learned TPO held that the assessee is in effect creating marketing intangibles in favour of the assessee by the AMP afford that it carries out in the Indian subcontinent. He further held that the assessee has necessary to use the brand name and logo of the parent company hence if any intangible is being created it is being created by the assessee and the benefit is accruing to the parent. He therefore based on the comparables found that 3.78% is the AMP/sales ratio of the comparable companies and thereafter proceeded to determine the arm's-length price of such AMP expenditure. He found that AMP/sales ratio of the assessee 7.34 percentage. Therefore he stated that the total sales of the assessee 929306967/- and the arm's-length price of AMP expenditure at the rate of 3.78% should have been 35127805 whereas the assessee has incurred actual AMP expenditure of INR 6 8248793/- and therefore the balance amount of INR 3 3120910/- has been incurred by the assessee on creation of intangibles. He added mark up at the rate of 1 to 21% on the above sum amounting to INR 4044073/- and proposed an adjustment of INR 3 7164983/-. This approach of the transfer-pricing officer was further upheld by the learned dispute resolution panel. Therefore, in the present case the learned transfer-pricing officer has applied bright line test for making AMP expenditure. However, on reading of the order of the learned transfer-pricing officer we did not find that the learned transfer-pricing officer has established that there exists an international transaction. In absence of proving that there is an international transaction between the assessee and its associated enterprise in terms of the provisions of the income tax act, the issue of its benchmarking and determination of ALP does not arise. At the very outset, the Id. AR stated that Bright Line Test adopted by the TPO has

been discarded by the Hon'ble Delhi High Court in the case of *Sony Ericsson Mobile Communications India Pvt Ltd vs CIT 374 ITR 118 = 2015-TII-06-HC-DEL-TP*. Nowhere the TPO has brought any tangible material on record to show that there exists an international transaction in so far as AMP spend is concerned. In support of his contention, the ld. AR relied upon the decision of the Hon'ble High Court of Delhi in the case of *Maruti Suzuki India Ltd 381 ITR 117 = 2015-TII-58-HC-DEL-TP*, *Whirlpool of India Ltd vs DCIT 381 ITR 154 = 2015-TII-62-HC-DEL-TP*, *Bausch & Lomb Eye Care [India] Pvt Ltd TA No. 643/2014 and 675/2014 = 2015-TII-65-HC-DEL-TP*, *Valvoline Cummins Pvt Ltd TA No. 158/2016 = 2017-TII-57-HC-DEL-TP* and *Mary Kay Cosmetic Pvt. Ltd in ITA No. 1010/2018 = 2018-TII-256-HC-DEL-TP*. Hon'ble High Court of Delhi in these cases have categorically held that the onus is on the Revenue to demonstrate that the AMP spend is an international transaction and further stated that since there is no machinery provision, therefore, bench marking cannot be done. There is no dispute that the TPO has made adjustment-applying BLT. At the outset, we have to state that the Hon'ble High Court of Delhi in the case of *Sony Ericsson Mobile Communications India Pvt Ltd vs CIT 374 ITR 118 = 2015-TII-06-HC-DEL-TP* has discarded the BLT. The Hon'ble High Court, at para 120 held as under:

*"120. Notwithstanding the above position, the argument of the Revenue goes beyond adequate and fair compensation and the ratio of the majority decision mandates that in each case where an Indian subsidiary of a foreign AE incurs AMP expenditure should be subjected to the bright line test on the basis of comparables mentioned in paragraph 17.4. Any excess expenditure beyond the bright line should be regarded as a separate international transaction of brand building. Such a broad-brush universal approach is unwarranted and would amount to judicial legislation. During the course of arguments, it was accepted by the Revenue that the TPOs/Assessing Officers have universally applied bright line test to decipher and compute value of international transaction and thereafter applied Cost Plus Method or Cost Method to compute the arm's length price. The said approach is not mandated and*

*stipulated in the Act or the Rules. The list of parameters for ascertaining the comparables for applying bright line test in paragraph 17.4 and, thereafter, the assertion in paragraph 17.6 that comparison can be only made by choosing comparable of domestic cases not using any foreign brand, is contrary to the Rules. It amounts to writing and prescribing a mandatory procedure or test which is not stipulated in the Act or the Rules. This is beyond what the statute in Chapter X postulates. Rules also do not so stipulate."*

13. Thus respectfully following the judgment of the Hon'ble High Court of Delhi [supra], we hold that BLT has no mandate under the Act and accordingly, the same cannot be resorted to for ascertaining, if there exists an international transaction of brand promotion services between the assessee and the AE. Accordingly, ground number 4 of the appeal of the assessee is allowed as the learned transfer-pricing officer has failed to demonstrate that there exist an international transaction between the assessee and its associated enterprises with respect to any AMP expenditure incurred by the assessee.
14. Ground number 4 of the appeal is with respect to charging of interest u/s 234D and 244A of the income tax act and ground number 5 of the appeal is with respect to the initiation of penalty proceedings u/s 271 (1) © of the income tax act. The charging of the interest u/s 234D and 244F of the income tax act are consequential in nature and the initiation of the penalty proceedings u/s 271 (1) (C ) of the income tax act is premature and therefore ground number 4 and 5 of the appeal of the assessee are dismissed.
15. Appeal of the assessee is partly allowed.

-Sd/-  
(KULDIP SINGH)  
JUDICIAL MEMBER

-Sd/-  
(PRASHANT MAHARISHI)  
ACCOUNTANT MEMBER

Dated: 14/06/2019

A K Keot

Copy forwarded to

1. Applicant
2. Respondent
3. CIT
4. CIT (A)
5. DR:ITAT

ASSISTANT REGISTRAR  
ITAT, New Delhi