IN THE INCOME TAX APPELLATE TRIBUNAL,
MUMBAI BENCH "J", MUMBAI

BEFORE SHRI SAKTIJIT DEY, JUDICIAL MEMBER AND
SHRI RAJESH KUMAR, ACCOUNTANT MEMBER

ITA No.6775/M/2014
Assessment Year: 2009-10

ITA No.1950/M/2015
Assessment Year: 2010-11

ITA No.4284/M/2016
Assessment Year: 2011-12

ACIT-10(3)(1), Room No.212, Aayakar Bhavan, M.K. Road, Mumbai – 400020	Vs.	M/s. Nycomed Pharma Pvt. Ltd., (in Liquidation), 2/E, Court Chambers, 35, New Marine Lines, Mumbai – 400 020 **PAN: AAECA5696H**
(Appellant)		(Respondent)

Present for:
Assessee by : Shri R.S. Samaria, A.R.
Revenue by : Shri Manoj Kumar Singh, D.R.

Date of Hearing : 27.09.2019
Date of Pronouncement : 29.11.2019

O R D E R

Per Rajesh Kumar, Accountant Member:

The above tiled three appeals have been preferred by the Revenue against the order dated 28.08.2014, 15.01.2015 & 29.12.2015 of the Commissioner of Income Tax (Appeals) [hereinafter referred to as the CIT(A)] relevant to assessment years 2009-10, 2010-11 and 2011-12 respectively. All these appeals have common issue and therefore are being adjudicated by this consolidated order for the sake of convenience. First we will take up ITA No.6775/Mum/2014 for Assessment Year 2009-10.

2. The grounds raised by the revenue in assessment year 2009-10 are extracted below:

> "1. Whether on the facts and in the circumstances of the case and in law, the learned CIT(A) erred in allowing the appeal and accepting the proposed payment of Rs.7,27,75,078/- as an ALP and ignoring the fact that there was no contractual obligation on that part of the assessee company to make such payments and also that no payments were made during the relevant year?"

3. The brief facts are that the assessee company, a wholly owned subsidiary company of Nycomed Gmbh Germany, is engaged in the business of running a research and development centre for synthesizing of test compounds that are potential drug development candidates and in preliminary testing and is an export oriented unit. The company is also engaged in licensing/sub licensing of drug Pantoprazole, design and maintenance IT infrastructure. The assessee company's AE (Nycomed Gmbh Germany) had developed this proprietary compound Pantoprazole for which it had obtained patents in various countries. For commercializing this compound in India, Bangladesh, Bhutan, Nepal, Sri Lanka, Nizeria and Sudan, the AE had granted a license to the assessee company along with a right to sub license the same. During the year the assessee has sub licensed the manufacturing and sale of Pantoprazole to Cadila Health Care and Zydus Health Care and earned from the said sub licensing the royalty of Rs.7,67,08,905/- and in turn paid royalty of Rs.7,27,75,078/- to its AE who has granted license to the assessee. The assessee remitted royalty to the AE which was calculated by retaining 1% of the total sale consideration received from this sub licensing business.

4. The entire royalty payment of Rs.7,27,75,078/- was recommended by the TPO as a transfer pricing adjustment mainly for the reason that there was no agreement between the

assessee company and the AE for making any such payment and therefore no enforceable legal liability cast on the assessee company for making any such payment of royalty to its AE. In the result, the ALP of royalty payment by the assessee company to its AE was quantified by the TPO at Nil and the entire payment was recommended as a transfer pricing adjustment to the returned income vide order dated 13.10.2012 passed under section 92CA(iii) of the Act. Thereafter, the AO framed the assessment order under section 143(3) read with 144C(3) of the Act dated 07.12.2012 giving effect to the direction of the Ld. TPO.

5. In the appellate proceedings, the Ld. CIT(A) allowed the appeal of the assessee after taking into consideration the submission and contention of the assessee by observing and holding as under:

> "In this regard it is seen that clause (c) to Rule IOB(2) of the Income Tax Rules speaks of the contractual terms (whether or not such terms are formal or in writing) of the international transaction under consideration for the purposes of establishing the comparability of the tested international transaction with an uncontrolled transaction. Therefore, what is required to be established is whether the royalty payment was made by the assessee company to its AE under contractual terms as understood, accepted and acted upon by both the parties, or not. It is seen from the facts of the present case that the compound pantoprazole had been sub licensed by the AE to Cadila right from 1998. After the assessee company was incorporated, another joint venture agreement was entered into in 2007 and, as a part of this new joint venture agreement, a license to commercially exploit the compound pantoprazole was granted by the AE to the assessee company. Further, a sub-Licensing Agreement for the same compound was entered into between the assessee company and Cadila with the AE as a consenting party. The rate of royalty payable by Cadila was retained at the same level as earlier and only the recipient was changed from the AE to the assessee company in this new agreement.
>
> However, any obligation on the assessee company to pay royalty to its AE was not mentioned in the Licensing Agreement of the assessee with Cadila. From the copies of the Board Resolutions of the assessee company and its AE, it is seen that the Licensing Agreement between them were at the draft stage awaiting necessary clearances from Germany authorities. It was only in October 2010 that the

agreement for payment of royalty between the assessee company and its AE was finalized, though the agreement was made retrospective and became operational with effect from 1.4.2008. In the intervening period;' including the period presently under consideration, the assessee had raised credit notes for the royalty payable by it to its AE after deduction of TDS on such credits which were also subjected to the provisions of service tax . The entire transactions were duly stated in the notes to accounts appended to the Balance Sheet prepared for the period under consideration by the auditors of the company. The actual transmission of payments took place in 2010 and 2011. The agreement for payment of royalty by the assessee company to its AE though executed in October, 2010 was made specifically applicable to the period presently under consideration. As per the TPO/AO, it was not beyond the legal competence of the two parties to do so. This agreement has to be seen along with the copies of the Board Resolutions, e-mail correspondences exchanged, credit notes raised towards royalty payments , notes to the audited accounts, deduction of TDS and provisioning for service tax liability would together go to establish that the assessee and its AE were both working on a common understanding that the assessee company would pay royalty to its AE after retaining its share of one percent out of the royalty collected from Cadila though the actual payments being made on a subsequent dates after the end of the relevant financial year. According to the assessee it can not be a ground to negate an accrued liability under the mercantile system of accounting in pursuance of which the assessee was preparing its annual accounts.

The TPO had also noticed in the course of the proceedings before him that the assessee could not produce any approval from the Ministry of Commerce or the RBI for payment of royalty to its AE. It was further noted by the TPO that during the relevant period, in terms of the RBI Circular dated 21 July, 2003 there was a statutory requirement to get the approval of the Ministry of Commerce and RBI for payment of royalty exceeding 8% of export sales and 5% of domestic sales. Therefore, no payment of royalty by the assessee company to its AE under the automatic route was possible in excess of such rates. As has been emphasized by the assessee in the present appellate proceedings, the RBI/ Ministry clearance is required for the remittance of foreign exchange alone. ……..

The assessee company, in the proceedings before the TPO had argued that the assessee company has charged royalty from Cadila Health Care and in turn pays royalty to its AE after retaining a margin of 1% for itself. The assessee company, in this arrangement, had not undertaken any significant function or utilized any assets or assumed any significant risk. Accordingly, no economic analysis was required to determine the appropriateness of the amounts paid to its AE. However, a secondary analysis had been undertaken to compare the margins earned by the assessee company with those of companies engaged in trading in software. Such secondary analysis was found by the TPO to be inappropriate because the six comparables selected were found to be not comparable on account of the significant inventory risk borne by the comparables while the assessee had no such risk. Even during the present appellate proceedings, the assessee's representative could not address this issue of inventory risk assumed being different from the comparable selected. The objection of the TPO is found to be legitimate and the second analysis carried out in the transfer pricing study report is found to be not

correct. However, it is necessary to consider the primary analysis put forward by the assessee company.

The assessee had obtained the license to commercial exploitation of pantoprazole from its AE. The appropriate ALP of the royalty payment being made by the assessee to its AE is presently under consideration. The very same license for commercial exploitation of pantoprazole was granted by the assessee company to Cadila during the same period. The assessee company and Cadila are unrelated parties. Considering that the assessee company had not undertaken any major functions with reference to the receipt and payment of royalty, the terms of the agreement between the assessee company and Cadila would constitute an internal CUP for benchmarking the royalty payments made by the assessee company to its AE. To the extent that the assessee company retained a small portion of the royalty collected by it while remitting the balance to its AE, the actual price at which the international transaction had taken place would be below the ALP determined by the gross amount of the royalty collected by the assessee from Cadila. Hence no further transfer pricing adjustment would be called for on the facts of this case. The AO / TPO are hereby directed to delete the transfer pricing adjustment made in the assessment order. Appeal filed by the assessee company for AY 2009-10, for statistical purposes, may be treated as allowed.

6. After hearing the rival parties and perusing the records as placed before us, the undisputed position is that the assessee had obtained the license for commercial exploitation of pantoprazole from its AE. The only issue before us is with regards to ALP of the royalty payment made by the assessee to its AE in consideration of exploitation of pantoprazole. The very same license for commercial exploitation of pantoprazole was granted by the assessee company to Cadila Health Care during the same period and received royalty in consideration thereof. This is also undisputed that the assessee company and Cadila Health Care are unrelated parties. The ld CIT(A) recorded a clearcut finding that the assessee company had not undertaken any major activities/functions with reference to the receipt and payment of royalty, the terms of the agreement between the assessee company and Cadila Health Care would constitute an

internal CUP for benchmarking the royalty payments made by the assessee company to its AE. In view of that the assessee company retained a small portion of the royalty collected by it which was calculated at 1% of the total consideration received while remitting the balance of 99% to its AE. Further the main reasons for computing ALP at NIL was on the basis that there was no agreement for payment of royalty which was only entered into in the subsequent years though effective from back date. But on this issue also we find merits in the contentions of the assessee that rule 10B(2)(c) does not require the agreement to be in writing. Considering all these facts, we do not find any infirmity in the order of CIT(A) to take a contrary view and accordingly the appeal of the revenue is dismissed by upholding the order of ld CIT(A).

The appeal of the Revenue is dismissed.

7. The issue raised in ITA No. 1950/M/2015 Assessment Year: 2010-11 and ITA No.4284/M/2016 Assessment Year: 2011-12 by the revenue is identical to one as decided by us in ITA No.6775/M/2014 Assessment Year: 2009-10. Therefore our decision in ITA No. ITA No.6775/M/2014 would, mutatis mutandis, apply to these appeals as well and consequently the appeals of the revenue are dismissed.

8. In result, all the three appeals of the Revenue are dismissed.

Order pronounced in the open court on 29.11.2019.

Sd/-	**Sd/-**
(Saktijit Dey)	**(Rajesh Kumar)**
JUDICIAL MEMBER	**ACCOUNTANT MEMBER**

Mumbai, Dated: 29.11.2019.

* Kishore, Sr. P.S.

Copy to: The Appellant
The Respondent
The CIT, Concerned, Mumbai
The CIT (A) Concerned, Mumbai
The DR Concerned Bench

//True Copy//

By Order

Dy/Asstt. Registrar, ITAT, Mumbai.