

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

BEFORE SHRI N.K. BILLAIYA, ACCOUNTANT MEMBER, AND
SHRI N.K. CHOUDHARY, JUDICIAL MEMBER

ITA No. 2264/DEL/2009
[Assessment Year: 2004-05]

The A.C.I.T
Circle 7(1)
New Delhi

Vs.

Swatch Group [India] Pvt Ltd
4th Floor, DLF Rectangle One
Plot No. D-4, Saket Distt. Centre
Saket, New Delhi

PAN: AAFCS 7516 R

[Appellant]

[Respondent]

Date of Hearing : 20.01.2020

Date of Pronouncement : 30.01.2020

Assessee by : Shri Nageshwar Rao, Adv
Shri Sandep S. Karhail, Adv

Revenue by : Shri Dinesh Antil, Sr. DR

ORDER

PER N.K. BILLAIYA, ACCOUNTANT MEMBER,

This appeal by the Revenue is preferred against the order of the
Commissioner of Income Tax [Appeals] - IX, New Delhi dated
31.03.2009 pertaining to assessment year 2004-05.

2. Substantive grievances of the Revenue read as under:

“1. The Id. CIT(A) erred in law, on facts and in the circumstances of the case in deleting the addition of Rs. 4,01,47,762/- made by the Assessing Officer on account of difference in Arm’s Length Price

2. The Id. CIT(A) erred in law , on facts and in the circumstances of the case in deleting the addition of Rs. 1,86,81,972/- made by the Assessing Officer on account of advertisement and business promotion.”

3. Briefly stated, the facts of the case are that the assessee-company is a wholly owned subsidiary of the Swatch Group Limited, Switzerland. Swatch India is distributor of watches manufactured by Swatch Group brands, in India. The company commenced its operations from January 2002 in India. The company also provides customer services in the nature of after sales services to customers. Swatch Group India has the exclusive license to undertake wholesaling operations of Swatch Group brands in India. Swatch Group India adapts global advertising campaigns for its products in India.

4. For all brands present in the country, international celebrities are used in local periodicals and mainline, which mention brand retailers in specially created dealer panels. In addition to primary advertising in the print media, the company relies on below-the-line marketing activities, which includes in-store promotions, sales promotions and public relations campaign. Swatch Group India relies solely on the print media, and does not use television or radio as a medium.

5. Group India directly sells to the retailers. There are no sub-distributors involved in the entire network. Swatch Group India supplies to approximately 160 retail outlets in India. It is also responsible for providing after sales support and service facility to its dealers. It has a network of 13 service centres all over the country. Its India's headquarters at New Delhi office is the mother service centre for Omega, Longines, Swatch and Tissot. The standard warranty for Swatch Group watches is two years on the watch mechanics. The warranty does not extend to the exterior of the watch and holds good only if the guarantee card is complete with vendor's name, date of sale and other details specified therein.

6. During the year, the assessee has undertaken the following international transactions:

Sl No	International Transactions	Method	Value (In Rs.)
1	Import of watches and spares for resale	RPM	23,41,86,927
2	Pricing support/subsidy to support and push sales of Swatch India	RPM	3,43,44.890
3	Import of spares for after-sales service	TNM	5,13,052
4	Cost reimbursement for implementation of firewall	Cost Rech	2,77,600
5	Reimbursement of travel costs, communication costs, etc to AEs	Cost Rech	26,08.409
6	Interest on External commercial borrowing	CUP	3,26,693

7. Resale price method for import of watches and spares for resale has been applied by the assessee. The second transaction has been clubbed with the import of watches on the ground that subsidy being a support for discounted price of products in India by Swatch Group India is considered as a subsidy on the cost of goods sold and hence is closely linked to the trading business of Swatch Group India. The transaction relating to pricing support/subsidy to support and push sales of Swatch India has also been analyzed using the RPM method.

8. The gross margin of M/s Swatch Group India has been computed at 26.10% and gross margin for the comparables has been computed at 24.78% and the transaction was reported to be at ALP at arm's length.

The assessee has computed the gross margin as under:

Summary of financials for trading/ (All figures in Rs.) distribution business		
		Year ending 31 st March 2004
Sales		401.065.696
Opening Stock		44,024.469
Add : Purchase value of traded		
Purchase Value of traded products (net of marketing subsidy)		199.842.038
Customs Duty		150.350.604
Other expenses related to purchases		1.107,890
Less : Closing stock		98,957,492
Cost of Goods Sold		296.367.509
Gross Profit		104.698.187
Gross Margin		26.10%

9. The TPO observed that in the purchase value of traded products, purchase value of traded product has been used net of marketing subsidy. The marketing subsidy is of Rs. 3,43,44,890/-. In audited profit and loss account, pricing support/subsidy has been shown under the head 'Service Income' and for calculation of accounting ratio, this marketing subsidy has not been taken either in the sales or in the cost of sales. Accordingly, a show cause notice was issued to the assessee asking it to justify its claim of aggregation of marketing subsidy with cost of import, wages and sale thereof.

10. In its reply, the assessee explained that it forced to follow-price lines that are acceptable in the Indian market, and hence sold Swatch products at competitive prices in order to push sales volumes. Therefore, in order to support and push sales of Swatch India, the AEs provided price by the AEs was in fact a gesture of genuine assistance and support and could be considered as a marketing support service that was provided by the AEs to Swatch India.

11. It was explained that the price support or marketing subsidy amounting to Rs. 34,344,890/- which was received from the various brands, being a support for pricing of products in India by Swatch

India, was considered as a subsidy on the cost of goods sold and hence was treated as being closely linked to the trading business or distribution business of Swatch India

12. After considering the reply of the assessee, though the TPO was convinced with the application of RPM as MAM, but was not convinced with the aggregation of price support or marketing subsidy received from the AEs. The TPO observed from the functions performed, assets used and risk assumed it is held that the marketing support services received by M/s Swatch India is not for the discounting of the product but for the functions performed by M/s Swatch India.

13. Product discount is product specific and it is never lumpsum or company specific, therefore, the treatment of pricing support/subsidy in TP is not correct. The TPO, accordingly, excluded Rs. 3,43,44,890/- from the international transactions for import of watches and spares for resale. However, the TPO concluded by stating that for this year of transfer pricing study, no adverse inference has been drawn and this international transaction is held to be at Arm's Length.

14. Coming to the analysis of comparables, the TPO observed that though the method selected by the assessee is correct but the selection of comparable is not appropriate for the fact of the case and as product of Swatch India is of unique intangible, if comparables used by the assessee are adopted, results will be inaccurate.

15. Thereafter, fresh search was undertaken by the TPO and following comparables were used:

S. NO	Company Name	31-Dec-03	31-Dec-02
1	SRM Spa	54.37%	55.62%
2	Calvellini pietro Spa	28.11%	28.99%
3	DA RO Dassi Roveda Spa	32.24%	29.04%
4	Faro Spa	14.16%	11.35%
5	Italgala Spa	NA	18.43%
6	Promotional Spa	18.27%	19.85%
7	Songa Antonio Spa	22.34%	20.37%
	<i>Average Gross Profit Margin</i>	<i>28.25%</i>	<i>26.24%</i>

16. The TPO finally concluded by holding that the GP margin of comparables identified as above, will be used for bench marking of international transaction and ALP was determined as under:

G.P. sales of comparable	-	28.25% = ALP
Sales of Swatch India	-	40.26,80.400
Arm's length GP	-	0.2825X40.26,89,460
G.P. Shown by Swatch India	-	11,37,59,772
Adjustment required	-	7,36,12,010
Value of international transaction-		4,01,47,762
ALP of international transaction	-	23,41,86,927
% of adjustment to ALP	-	19,40,39,165
		20.6%

Adjustment of Rs. 4,01,47,762 (20.6%) is more than 5%, proviso to section 92c(2) is not applicable.

17. The assessee agitated the matter before the Id. CIT(A) and vehemently stated that the comparables used by the TPO were not in accordance with the provisions of law. It was brought to the notice of the Id. CIT(A) that foreign comparables have been used and it was contended that when the tested party is an Indian taxpayer, Indian companies should have been selected as comparables to test the arm's length nature of the international transactions.

18. It was contended that the TPO selected foreign comparables which are primarily Italian companies, which operate in a well developed market like Italy and Europe. In contrast, the assessee

operates in a significantly under developed or developing luxury watch market, which suffers from a high unorganized market and a significant grey market for the luxury watch segment, high customs duty on import of luxury watches, price sensitive consumer behaviour and low per capita GDP.

19. It was also brought to the notice of the first appellate authority that besides the differences, there are significant differences in terms of taxes, duties, etc levied in the Indian market vis a vis Italy on the import of luxury watches, which result in significant bearing on the gross and operating margins of the Indian companies engaged in resale of imported luxury watches in India.

20. After considering the facts and submissions and referring to Rule 10B(2) of the IT Rules and also referring to the OECD TP Guidelines for Multinationals and Tax Administrators, the Id. CIT(A) observed that use of foreign comparables is appropriate in light of the lack of information on comparables dealing in luxury watches in the year under consideration.

21. However, the Id. CIT(A) further observed that although the use of foreign comparables has been agreed, but it is essential to undertake reasonable adjustments to establish comparability between the foreign comparables used and the assessee. One of the adjustments related to customs duty. The Id. CIT(A) was of the opinion that the TPO while selecting the foreign comparables did not consider the differences in custom duty rate prevalent in India vis a vis Italy.

22. The first appellate authority observed that the high custom duty rates on luxury watches in India accounted for 32.37% of the net sales of the assessee and custom duty paid by the assessee on the import of watches and spares was above 50% of the total cost of goods sold. According to the Id. CIT(A), high custom duty rates in India are bound to have significant bearing on the gross margins as well as operating margins of the assessee vis a vis Italian comparables.

23. Accordingly, the Id. CIT(A) was convinced that high cost of importing goods into India should be adjusted for, since the foreign comparables operating in Italy enjoy the benefit of NIL or negligible customs duty and do not have to spend the same proportion of import

duty cost as the assessee. Hence, in view of the provision of Rule 10B(2)(d) and 10B(3) of the Rules, appropriate adjustments for differences on account of geographical location, size of market, level of competition, government regulations is called for and the Id. CIT(A) accordingly, held that reasonable quantitative adjustments should be made in order to make a comparison of the profitability of the assessee vis a vis the comparable companies and computed the gross margin as under:

	<i>Year ending 31st March 2004*</i>
<i>Sales</i>	<i>401,065,696</i>
<i>Opening Stock</i>	<i>44,024,469</i>
<i>Add: Purchase value of traded products</i>	
<i>Purchase Value of traded products (net of marketing subsidy)</i>	<i>199,842,038</i>
<i>Customs Duty (normalizing to 5 percent of purchase value)</i>	<i>9,992,102</i>
<i>Other expenses related to purchases</i>	<i>1,107,890</i>
<i>Less: Closing stock</i>	<i>98,957,492</i>
<i>Cost of Goods Sold</i>	<i>156,009,007</i>
<i>Gross Profit</i>	<i>245,056,689</i>
<i>Gross Margin</i>	<i>61.10%</i>

24. Since the gross margin computed as above was 61.10% which was higher than the margin of the comparable companies, the ld. CIT(A) directed for deletion of the adjustment of Rs. 40,10,65,606/-.

25. Before us, the ld. DR strongly supported the findings of the TPO. It is the say of the ld. DR that any adjustment can only be made in case of comparables and not in case of the assessee. The ld. DR vehemently stated that the ld. CIT(A) allowed the adjustments on account of differences in customs duty, which issue was never raised by the assessee before the TPO and the ld. CIT(A) ought to have given an opportunity to the TPO or should have called for remand report. The ld. DR prays for restoration of this issue to the file of the TPO for fresh adjudication.

26. Per contra, the ld. counsel for the assessee reiterated what has been stated before the lower authorities. It is the say of the ld. counsel for the assessee that the ld. CIT(A) was well within his powers for making adjustment himself. The ld. counsel for the assessee stated that if there is any error in calculation of the ld. CIT(A), the ld. DR should have pointed out the same and there is no need for restoration of the issue to the file of the TPO.

27. We have given thoughtful consideration to the orders of the authorities below. There is no dispute in so far as the application of the most appropriate method is concerned. The assessee has used Resale Price Method as the most appropriate method in bench marking its international transactions and the TPO has accepted the same. In our considered view, the entire quarrel revolves around the adjustment of custom duty given by the Id. CIT(A) in the hands of the appellant. Reliability and accuracy of adjustment would largely depend upon the availability of reliable and accurate data.

28. In our considered opinion, for certain types of adjustments, relevant data for comparables may either not be available in public domain or may not be reliably determinable based on information available in public domain, whereas, it may be possible to make equally reliable and accurate adjustments on the tested party whose data would generally be easily accessible.

29. Rule 10B(3)(ii) provides for making "reasonably accurate adjustments" for eliminating any material differences between the two transactions being compared. It is an undisputed fact that import of watches carry heavy customs duty which may not be there in so far as Italian companies are concerned. The purpose or intent of the

comparability analysis is to examine as to whether or not, the values stated for the international transactions are at ALP. We are of the view that the regulations do not restrict or provide that adjustments cannot be made on the results of the tested party. We are also of the view that net profit margin of the tested party drawn from its financial accounts can be suitably adjusted to facilitate its comparison with other uncontrolled entities/transactions as per sub-clause (i) of Rule 10B(1)(e) of the Rules. There is no specific provision in Rule 10B(1)(e)(iii) of the Rules, which would impede the adjustment of the profit margin of the tested party.

30. As far as rate of custom duty is concerned, it can be easily taken from the official website of the European Union and we find that the rate at the relevant point of time was 4.5% whereas the custom duty paid by the assessee accounts for more than 75% of the purchase value and 50% of the total cost of goods sold. In our considered opinion, such difference on account of custom duty paid by the assessee and that existing in the location where comparable companies operate, cannot be ignored. Considering all these facts in totality, we decline to interfere with the findings of the Id. CIT(A). Ground No. 1 is, accordingly, dismissed.

31. Facts relating to Ground No. 2 show that during the year under consideration, the assessee claimed an expenditure of Rs. 2,80,22,958/- on advertisement and business promotion. The Assessing Officer noticed that these expenses were incurred on sponsorship of events/newspaper/magazines/electronic media/all painting. The Assessing Officer was of the firm belief that the advertisement expenses were capital in nature and bring enduring benefit to the assessee and accordingly, amortized the expenditure in three years and thereby allowed 1/3rd of the expenditure in the current A.Y and balance 2/3 of the expenditure was added back.

32. The assessee agitated the matter before the Id. CIT(A) and it was explained that the expenditure was primarily incurred by the assessee on the visuals, banners and other visibility material installed at retailers' premises including business expenses for holding retailers' conferences, participation in exhibitions, in-store expense for various new stores opened during the year, printing of banners and leaflets, etc. It also included expenses on advertisements in newspapers, magazines and electronic media in India. It was strongly contended that since the assessee is engaged in distribution of watches of various Swatch Group brands in India viz. Omega, Rado, Tissot, Longines and

Swatch, it is imperative for the assessee's business to have a marketing strategy in place to promote distribution of products dealt in.

33. Therefore, any expenditure incurred on marketing strategy essentially to promote business objectives and sale of products dealt in is legitimate business expenditure which was incurred in the ordinary course of assessee's distribution business and hence it is purely a revenue expenditure. It was explained that such expenditure on advertisement is an ongoing and continuous process. In a competitive scenario, it would be difficult to hold the long lasting benefit accrued from such advertisement expenditure.

34. After considering the facts and submissions, the Id. CIT(A) observed that advertisement expenditure does not fall under an allowable expenditure under any section between section 30 to section 36 and it is an allowable expenditure u/s 37 of the Act. The Id. CIT(A) further observed that to claim an expenditure as an allowable expenditure only that expenditure is allowable which is wholly and exclusively for the purpose of business and it is not in the nature of capital expenditure or personal nature. There is no such clause which allows the Assessing Officer to amortize the advertisement expenditure

unless it falls under the category of capital expenditure. Accordingly, the ld. CIT(A) directed for deletion of addition of Rs. 1,86,81,972/-.

35. Before us, the ld. DR strongly supported the findings of the Assessing Officer. It is the say of the ld. DR that the assessee has incurred AMP expenses for brand building. The ld. DR further stated that the assessee itself has entered into an agreement with its AE for providing test marketing services and expenses on brand promotion is evidently capital expenditure and has been rightly treated as such by the Assessing Officer.

36. Per contra, the ld. counsel for the assessee reiterated what has been stated before the lower authorities. It is the say of the ld. counsel for the assessee that Swatch Group companies which own respective brands have directly engaged or signed celebrities as brand ambassadors and the spend of the assessee is to promote its business in India and has nothing to do with brand building of the Swatch Group. The ld. counsel for the assessee vehemently stated that the assessee has claimed expenditure of Rs. 2,80,22,958/- whereas celebrities used as brand ambassadors are Cindy Crawford and Pierce Brosnan for

Omega, Aiswarya Rai for Longines, Lisa Ray for Rado and Michael Owen for Tissot Brand. The ld. counsel for the assessee further stated that the expenditure incurred by the assessee is nowhere near the price charged by these celebrities which itself shows that brand ambassadors have been used by Swatch Group of companies and not by the assessee.

37. We have given thoughtful consideration to the orders of the authorities below. At the very outset, we have to say that considering the names of the brand ambassadors as mentioned elsewhere, we are of the considered opinion that the advertisement spend by the assessee is peanuts to the face value of these celebrities. Further, we find that similar issue arose in A.Y 2005-06 and the matter travelled upto the Hon'ble High Court of Delhi. The relevant findings of the Hon'ble High Court read as under:

"The return filed by the assessee for the A.Y. 2005-06 had reflected expenditure of Rs.6,38,01,509/- incurred on advertisement and publicity of its brand namely "swatch" for promotion of its business. It is an admitted case that Assessee Company operates in the medium and high end luxury watch segments in India. The expenditure was incurred by the

assessee on sponsorship of the events, newspaper/magazine/electronic media advertisement, banners, wall painting and hoardings etc. The Assessing Officer was of the view that such expenditure will give benefit of enduring nature to the assessee because the expenses will help the assessee to promote its brand and products for a longer period. On this premise the Assessing Officer amortized the total expenses for three years allowing deduction of 1/3rd of expenses only for the year in question and left 2/3rd of the expenses for the next two years. Dissatisfied with the aforesaid disallowance by the Assessing Officer, the assessee preferred appeal before CIT(A) and successfully challenged the aforesaid order inasmuch as the CIT(A) allowed the entire expenditure treating the same as revenue in nature and also stated that there was no concept of deferred revenue expenditure. The Revenue filed an appeal against this order of CIT(A) which has been dismissed by the Tribunal vide the impugned order dated 30th November 2010. The Tribunal has also referred to the decision rendered by the Special Bench of ITAT in the case of ACIT, Ahmedabad v Ashima Synthetic Ltd (citation not given in the impugned order). In the said decision, the Special Bench of the Tribunal has considered a number of judgments including Alambic Chemicals Works Co. Ltd.v CIT 177 ITR 377, Madras Industrial Development Corporation 225 ITR 802, Kedarnath Jute Manufacturing Co. Ltd. 82 ITR 363 and Amar Raja Batteries Ltd. v ACIT 91 ITD 2080, Hyderabad etc. We are of the considered opinion that the expenditure incurred on

*advertisements in the aforesaid manner has to be treated as revenue in the nature and was therefore fully allowable. This issue has been considered by this Court as well in detail in **The CIT-V vs. M/s Pepsico India Holdings Pvt. Ltd., ITA No. 319 /2010** decided on 30th March, 2011.*

We, thus, find that no substantial question of law arises in this appeal. The appeal is hereby dismissed."

38. The SLP filed by the Revenue was dismissed by the Hon'ble Supreme Court vide order dated 04.02.2013 in CC 3016/2013. Considering the facts of the case in light of the decision of the Hon'ble High Court [supra], no interference is called for. Ground No. 2 is dismissed.

39. In the result, the appeal of the Revenue in ITA No. 2264/DEL/2009 is dismissed.

The order is pronounced in the open court on 30.01.2020.

Sd/-

**[N.K. CHOUDHARY]
JUDICIAL MEMBER**

Sd/-

**[N.K. BILLAIYA]
ACCOUNTANT MEMBER**

Dated: 30th January, 2020.

VL/

Copy forwarded to:

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

Asst. Registrar
ITAT, New Delhi

Date of dictation	
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 Bench	
Date on which the fair order is placed before the Dictating Member for pronouncement	
Date on which the fair order comes back to the Bench	
Date on which the final order is uploaded on the website of ITAT	
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Date on which the file goes to the Head Clerk	
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Date of dispatch of the Order	