IN THE INCOME TAX APPELLATE TRIBUNAL

'B' BENCH : BANGALORE

BEFORE SHRI. CHANDRA POOJARI, ACCOUNTANT MEMBER

AND

SMT. BEENA PILLAI, JUDICIAL MEMBER

IT(TP)A 458/Bang/2016
Assessment Year : 2011 – 12

M/s. Acer India Pvt. Ltd., Embassy Heights, 6th Floor, No. 13, Magrath Road, Next to Hosmat Hospital, Bangalore – 560 025. **PAN NO : AACCA1237A**	**Vs.**	Assistant Commissioner of Income Tax, Circle – 1(1) (1), Bangalore.
APPELLANT		**RESPONDENT**

&

IT(TP)A 473/Bang/2016
Assessment Year : 2011 – 12

Assistant Commissioner of Income Tax, Circle – 1(1) (1), Bangalore.	**Vs.**	M/s. Acer India Pvt. Ltd., Embassy Heights, No. 13, 6th Floor, Magrath Road, Next to Hosmat Hospital, Bangalore – 560 025. **PAN NO : AACCA1237A**
APPELLANT		**RESPONDENT**

Appellant by	:	Shri. Chavali Narayan, CA
Respondent by	:	Mr. Muzaffar Hussain, CIT - DR

Date of Hearing	:	29-01-2020
Date of Pronouncement	:	18-02-2020

ORDER

PER BEENA PILLAI, JUDICIAL MEMBER

Present cross appeals are filed by assessee as well as revenue against order dated 21/01/16 passed by Ld. ACIT Circle – 1(1)(1),

under section 143 (3) read with 144C (5) read with 144C (13) of the Act, on following grounds of appeal:

1. The learned AO has erred in law, and on facts, in treating the payments towards purchase of 'off-the-shelf shrink-wrapped software' as 'Royalty' under the Act as well as under the India-Malaysia tax treaty.

2. The learned AO, has erred in law, and on facts, in disallowing an amount of Rs 67,85,34,686 under the provisions of Section 40(a)(i) of the Act on the ground that tax was not deducted under Section 195 of the Act.

3. Without prejudice to the above, the learned AO has erred in law, and on facts, in disallowing the payments made to local software vendors under Section 40(a)(i) of the Act.

4. Without prejudice to the above, the learned AO has erred in law, and on facts, in not restricting the disallowance under Section 40(a)(i) to the extent of amount which is outstanding or 'payable' at the end of the year.

5. The learned AO, has erred in law, and on facts, in treating the expenses incurred by the Appellant on media advertisement as capital in nature, without appreciating the fact that the expense did not provide any enduring benefit to the Appellant.

6. The learned AO, has erred in law, and on facts, in disallowing sales promotion and advertisement expense of Rs 4,96,11,362 under Section 37(1) of the Act.

7. The learned AO has erred in law, and on facts, by levying interest of Rs.13,92,24,998 under Section 234B of the Act.

8. The learned AO has erred in law, and on facts, in initiating penalty proceedings under Section 271(1)(c) of the Act.

Brief facts of the case are as under:

2. Assessee is a company and filed its return of income on 28/11/11, declaring total income of Rs.33,16,17,482/-. The case was selected for scrutiny and notice under 143 (2) was issued to assessee. Subsequently notice under section 142 (1) along with questionnaire was issued to assessee. In response to statutory notice, representative of assessee filed requisite details as called for. Ld.AO observed that assessee had international transaction with associated enterprise exceeding Rs.15 crores and accordingly

case was referred to transfer pricing officer to determine arm's length price of international transaction.

3. Upon receipt of reference, Ld.TPO called upon assessee to file economic details of international transaction in Form 3 CEB. Ld.TPO observed that assessee had following international transaction with its associated enterprises:

Particulars	Paid	Received
Import of computer components for manufacturing	3,82,73,00,938/-	
Sale of components and spare parts		16,62,526/-
Import of computer notebooks, finished goods and parts for trading	9,36,80,13,861/-	
Reimbursement of advertisement expenses		23,37,60,722/-

4. Ld.TPO observed that assessee incurred expenses in the nature of advertisement, trade discounts and sales commission which resulted into brand promotion. Ld.TPO was of the opinion that associated enterprises forced assessee to incur AMP expenses amounting to these Rs.1,61,86,95,964/-. Ld.TPO thus applied bright line test and determined 0.23% of gross sales to be towards AMP expenses.

5. Ld. AO/TPO treated entire consideration paid by assessee towards purchase of computer software as 'royalty' under India-

Malasia DTAA, thereby disallowed the expenses section 40 (a) (i) of the Act for not deducting TDS on such payments.

Aggrieved by addition made by Ld.AO/TPO, assessee raised objections before DRP.

6. Before DRP assessee submitted that, it is wholly subsidiary of Acer Holding Inc. British Virgin Islands, and is the only group entity in India which is authorised under long term royalty fee arrangement to manufacture/distribute Acer products in the market. It was submitted that assessee is engaged in manufacturing of text of computers, servers and distribution of laptops, monitors, projectors and peripherals products under the license from its AE's. Assessee submitted that all these products are sold to distributors, who in turn resell the same to the sellers or retailers located in India. It is also been submitted that assessee also sells products to final end customer in certain cases. Assessee submitted that for these activities, assessee imports certain components and parts from its associated enterprises in relation to its manufacturing activity and also imports laptops, monitors, projectors another finished products from its associated enterprises for distribution in India, without any corresponding royalty charged from the AE's.

7. Assessee submitted that it bears all internal risk and receives limited assistance from its AE is in respect of its operations. It was submitted that during assessment proceedings before Ld. TPO, international transactions undertaken by assessee with associated enterprises was examined and accepted to be at arm's length, under manufacturing and distribution segments. However, adverse observation was made by Ld. TPO that assessee incurred

huge expenses for purposes of advertisement, market promotion and development of intangibles of AEs and concluded that such expenses should be reimbursed by AE along with a mark-up. Ld. TPO thus computed adjustment at Rs.1,56,75,58,922/-.

8. DRP upon analysing submissions of assessee, directed Ld. AO/TPO to delete proposed addition on account of AMP expenses. However, it was directed that expenses amounting to Rs.4.96 crore incurred on media advertisement are in the nature of capital expenditure which resulted in enduring benefit in the form of creating brand of assessee, and therefore cannot be said to have been incurred wholly and exclusively for business carried out. DRP thus directed advertisement expenses to be disallowed under section 37 (1) of the Act.

9. Upon receipt of DRP directions, Ld.AO/TPO disallowed expenses incurred towards media advertisement under section 37 (1) of the Act. Assessing Officer observed that assessee incurred software expenses, against which assessee did not deducted tax at source. Accordingly, same was disallowed under provisions of section 40(a) (ia) of the Act.

10. Ld.AO/TPO further disallowed warranty provisions amounting to Rs.30,92,90,373/-. Ld.AO/TPO disallowed foreign currency loss incurred by assessee related to trading receipt incurred on purchase of computer systems/equipment's/raw materials/spare parts for purposes of trading/operations in ordinary course of business.

Aggrieved by additions/deletion made by Ld.AO/TPO, assessee as well as revenue are in appeal before us now.

<u>Assessee's Appeal:</u>

11. Ground No. 1-2: It is submitted that authorities below have disallowed software expenses under section 40(a) (i) for non-deduction of TDS. Both sides submitted that the issue is against assessee vide decision of *Hon'ble Karnataka High Court* in *CIT v Samsung Electronics Co. Ltd.,* reported in *[2012] 345 ITR 494*, wherein it is held that payments towards purchase of software are in the nature of 'royalty' and liable for TDS.

Accordingly, we do not find any infirmity in the view of Ld. CIT(A) and the same is upheld.

Regarding **Ground No.3** Ld. AR submitted that it does not arise out of order passed by authorities below.

Accordingly based upon the submissions, this ground stands dismissed.

12. Ground No. 4: Ld. AR submitted that assessee do not wish to press this ground.

Accordingly, the same is dismissed.

13. Ground No. 5-6 are in respect of disallowance made by Ld. AO of sales promotion and advertisement expenses amounting to Rs.4,96,11,362/- under section 37 (1) of the Act.

Ld. AR submitted that AMP expenses consists of 3 components:

- Trade Discounts-Rs.1,45,10,72,170/-
- Advertisement Expenses -Rs.4,96,11,362/-
- Sales Commission-Rs.11,18,12,432/-

13.1. It has been submitted that what has been disallowed by Ld.AO/TPO is only the advertisement expenses amounting to Rs.4,96,11,362/-, and that these expenses have been incurred wholly and exclusively for the purpose of assessee's business and

no enduring benefit is derived by assessee. Placing reliance on pages 859-862 of paper book part-II, Ld. AR submitted that these cannot be considered to be capital in nature. He placed reliance upon decision of *Hon'ble Karnataka High Court* in case of *CIT vs Indo Nisan Foods Ltd.,* reported in *(2013) 35 Taxmann.com 637,* decision of *Hon'ble Bombay High Court* in case of *CIT vs Asian Paints (India) Ltd.,* reported in *(2016) 75 Taxmann.com 152* and decision of *Hon'ble Delhi High Court* in case of *CIT vs Spice Distribution Ltd.,* reported in *(2015) 54 Taxmann.com 325.*
Ld. AR submitted that all these decisions are placed in paper book at page 307-316.

13.2 On the contrary, Ld. CIT DR placed reliance upon orders passed by authorities below.

13.3 We have perused submissions advanced by both sides in light of records placed before us.
In the decisions relied upon by Ld. AR *Hon'ble Courts* have discussed the tests of enduring benefit. *Hon'ble Court*, have opined that expenditure incurred towards advertisement to promote sales can in no way treated as capital expenditure. And that if argument of the revenue is upheld then no expenditure could be considered of having been incurred for purposes of business. Even otherwise there are number of decisions by *Hon'ble High Courts* which holds advertisement expenses to be revenue in nature because advertisements do not have long-lasting effect and once advertisement stop, effect thereof under general public and customer, diminishes and vanishes. *Hon'ble Court* observed that, if expenditure is incurred for advertisement is to promote sales, then it cannot be held to be capital in nature.

13.3.1 In the present facts of the case the expenditure towards advertisement has been incurred by assessee for promoting sales and therefore, ratio laid down by *Hon'ble Courts* in the decisions relied upon by Ld. AR is squarely applicable.

Accordingly, we direct Ld. AO/TPO to delete addition made on account of advertisement expenses under section 37 (1) of the Act.

14. Ground No.7 is consequential in nature and **Ground No.8** is premature at this stage.

In the result, appeal filed by assessee stands partly allowed as indicated above.

<u>Revenue's Appeal</u>

15. Ground no.1 is general in nature. Therefore, do not require any adjudication.

16. Ground no. 2-4 raised by revenue is regarding warranty expenses being allowed by Ld. AO/TPO amounting to Rs.30,92,90, 373/-.

16.1 Ld. CIT DR submitted that assessee has not conclusively proved that, expenditures pertain to actual utilisation of warranty pertaining to sale invoices, which are under warranty period. He thus placed reliance upon orders passed by authorities below.

16.2 On the contrary, Ld. AR submitted, that warranty provision is created based on a scientific methodology and estimation on the basis of actual warranty expenses incurred in the past as ascertained liability. He submitted that, creation of warranty provision does not make it a provision for and under ascertained or contingent liability, as various expenses are certain

to be incurred, however estimated and provided for. This does not make the underlying expenses to be contingent in nature. Admittedly, assessee is following a scientific computation of provision for warranty every year consistently.

16.3 We have perused submissions advanced by both sides in light of records placed before us.

Ld. AR submitted that, identical issue in assessee's own case for assessment year 2004-05 to 2006-07 has been dealt with as under:

> *We have heard the learned Departmental Representative as well as learned Authorised Representative and considered the relevant material on record. At the outset we note that this is a recurring issue for last several assessment years and has been decided in favour of the assessee by this Tribunal. This Tribunal in assessee's own case for A. Ys : 2007 – 08 & 2008 – 09 vide order dt. 4.11.2015 in ITA Nos. 1179 & 1180/Bang/2012 has held in paras 9 to 12 as under:*

" 9. We have also heard the learned Departmental Representative and considered the facts and materials on record including the decisions cited before us.

9.1 While dealing with the issue in the order dated 30-1-2009 in ITA No. 774/Bang/2010 it has been observed as under:

"5. We have heard the rival contentions and perused the material available on record. We are of the considered view that the assessee's case clearly falls in line with the legal ratio set out by the various appellate decisions cited at Bar in so far as the provision for warranty stood crystallized as soon as the sale was made which a customer would like to be fulfilled within the warranty period and is at the cost of an assessee's goodwill. Therefore, the residual amount purported to have been held by the Assessing Officer as an excess provision cannot be considered as a contingent provision and not an ascertained liability. The warranty period continues beyond an year which fact was rightly considered by the ld.CIT(A) confining to the various decisions such as IBM India Ltd. (supra) reported in 290 ITR (AT) 183. Similar view has been taken by other co-ordinate Benches of the Tribunal therefore requires no further deliberation. In the light of the above, we hold the view that the decision of the ld.CIT(A) requires no further interference on the issue. The revenue's appeal stands dismissed."

10. Again in the order dated 25-2-2011 in ITA No.784/Bang/2010, it has been observed as under:

"11.2 The assessee creates provision for warranty based on the estimation of expenditure likely to be incurred on the past sales made on yearly basis at then prevailing market prices for spares and labour. For the relevant previous year, the assessee estimated the warranty liability at Rs.12,76,77,530/- and created a provision only for Rs.12,16,75,204/- in the books of account by charging a provision of Rs.8,24,29,136/- to the debit in the P&L account and claimed it as ITA 22(Bang)/2011 Page 5 of 7 deduction. The assessee company had created the provision based on the estimation of warranty liability, which is based on failure rates of the past year data/experience and industry trends and not on adhoc basis.

The assessee has not changed the method of computing the warranty provision and it has been followed consistently.

11.3 The decision of the Hon'ble Supreme Court in the case of Rotork Controls India Pvt. Ltd. 314 ITR 62 would be squarely applicable to the facts of the case. The Hon'ble Supreme Court has held that provision made on past experience is a scientific method and is the most appropriate method. The relevant extract of the decision is provided below:-

'In this case, we are concerned with Product Warranties. To give an example of Product Warranties, a company dealing in computers gives warranty for a period of 36 months from the date of supply. The said company considers following options: (a) account for warranty expense in the year in which it is incurred; (b) it makes a provision for warranty only when the customer makes a claim; and (c) it provides for warranty at 2% of turnover of the company based on past experience (historical trend) ....

Under the circumstances, the third option is most appropriate because it fulfills accrual concept as well as the matching concept. For determining an appropriate historical trend, it is important that the company has a proper accounting system for capturing relationship between the nature of the sales, the warranty provisions made and the actual expenses incurred against it subsequently"........

If warranty provisions are based on experience and historical trend(s) and if the working is robust then the question of reversal in the subsequent two years, in the above example, may not arise in a significant way'.

11. In the assessee's own case in identical facts for the immediately preceding year, the Tribunal in ITA No.22/Bang/2011 assessment year 2006-07 vide order dated 16.03.2012 has decided the issue in favour of the assessee, following the orders of the Tribunal for earlier years namely. 2004-05 and 2005-06.

12. Following the above decisions for the earlier years passed by the Co-ordinate Bench of Bangalore, we hold that the CIT(A) is not justified in upholding the disallowance of provision for warranty and accordingly dismiss the ground of appeal of the revenue on this issue."

Following the earlier orders of this Tribunal in assessee's own case, we do not find any error or illegality in the impugned order of CIT (Appeals) qua this issue.

There is no difference in facts and circumstances far year under consideration vis-a-vis earlier years respectfully following

aforestated view, we do not find any infirmity in the view taken by Ld. AO and the same is upheld.

Accordingly, this ground raised by revenue stands dismissed.

17. Ground No. 5 is against Ld. AO to allow claim of assessee regarding disallowance of foreign exchange loss.

Ld. CIT DR submitted that foreign exchange loss cannot be allowed, as the transactions are speculative in nature and contingent in character. He submitted that such losses can be allowed if actual sales had taken place and transaction is complete.

17.1 On the contrary, Ld. AR placed reliance upon observations of DRP.

17.2 We have perused submissions advanced by both sides in light of records placed before us.

It has been submitted that assessee has been consistently recognising gains/losses arising out of forward contracts, and has been offering income if any to tax arising from such contracts in accordance with accounting standard 11. It has been submitted that, assessee retains outstanding forward contract creditors/payables, Balance and loss/gain is recognised as expenses/income in the profit and loss account at the year end. Further there is no dispute that such contracts have been entered into by assessee in order to protect its interest against fluctuation in foreign currency in respect of consideration for export proceeds which are revenue in nature. Thus, in our view consequent effect of this accounting treatment is to recognise exchange fluctuation gain or loss in the profit and loss account as on the valuation date. *Hon'ble Supreme Court* in case of *CIT vs Woodward Governor India*

(P) Ltd., reported in *(2009) 312 ITR 254* held that, a transaction in which a legal liability has been incurred before it is actually disbursed would be regarded as revenue in nature.

In the facts of present case assessee incurred foreign exchange loss far year under consideration towards trading activities, and therefore it is directly attributable to business of assessee, which is an allowable expenditure.

Accordingly, respectfully following decision of *Hon'ble Supreme Court* in case of *CIT vs Woodward Governor India (P) Ltd., (supra)*, we dismiss this ground raised by revenue.

19. Ground No. 6-10 are against AMP expenditure being deleted by Ld. AO.

At the outset it has been submitted that this issue stands covered in favour of assessee by its own decision for *assessment year 2012-13 and 2013-14 vide order dated 10/05/19 in IT(TP)A No. 502/B/2017 and IT(TP)A No. 2837/B/2017* respectively.

19.1 On the contrary, Ld. CIT DR placed reliance upon orders passed by Ld. TPO.

19.2 We have perused submissions advanced by both sides in light of records placed before us.

It is observed that for assessment year 2012-13 and 2013-14 in assessee's own case identical issue has been analysed in detail and held as under:

> *"21. We notice that the above said decision squarely applies to the facts of the present case. In his arguments, the Ld. A.R also submitted that the economic ownership of brand lies in the hands of the assessee. As noticed earlier, the revenue has not shown that there existed any international transaction on account of incurring of AMP expenses.*

Accordingly, following the above said decision, we hold that the AO/TPO was not justified in making T.P adjustment on account of AMP expenses. Accordingly, we hold that no adjustment needs to be done in respect of AMP expenses and accordingly delete the addition made by the AO in this regard.

22. We shall now take up he appeal filed by the assessee for A Y: 2013 – 14. In this year also, the assessee is contending hat the assessment order is barred by limitation and is also contesting the T.P adjustments made by the TPO/AO in respect of AMP expenses. Identical issues were contested in A Y 2012 – 13 also and the decision rendered by us on both the issues in that year can be conveniently applied in this year also. Following the same, we reject the legal contention relating to the validity of assessment order and direct the AO to delete the T.P adjustment made".

19.3 Both sides admit that there is no difference in facts between the year under consideration vis-a-vis assessment year 2012-13 and 2013-14. Based upon the above submission, respectfully following the view taken by this *Tribunal* in assessee's own case for assessment year 2012-13 and 2013-14 (supra), we do not find any infirmity in the observation of Ld. AO/DRP.

Accordingly, this ground raised by revenue stands dismissed.

20 Ground No.11-12 general in nature and therefore do not require any adjudication.

In the result appeal filed by assessee stands partly allowed and appeal filed by revenue stands dismissed.

Order pronounced in the open court on 18th February, 2020.

Sd/-	Sd/-
(CHANDRA POOJARI)	(BEENA PILLAI)
Accountant Member	Judicial Member

Bangalore,
Dated, the 18th February, 2020.
/MK/

Copy to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR, ITAT, Bangalore
6. Guard file

By order

Assistant Registrar,
Income Tax Appellate Tribunal.
Bangalore.

		Date	**Initial**	
1.	Draft dictated on	On Dragon		Sr.PS
2.	Draft placed before author	12-02-2020		Sr.PS
3.	Draft proposed & placed before the second member			JM/AM
4.	Draft discussed/approved by Second Member.			JM/AM
5.	Approved Draft comes to the Sr.PS/PS			Sr.PS/PS
6.	Kept for pronouncement on	18-02-2020		Sr.PS
7.	Date of uploading the order on Website			Sr.PS
8.	If not uploaded, furnish the reason			Sr.PS
9.	File sent to the Bench Clerk			Sr.PS
10.	Date on which file goes to the AR			
11.	Date on which file goes to the Head Clerk.			
12.	Date of dispatch of Order.			
13.	Draft dictation sheets are attached	No		Sr.PS