

आयकर अपीलिय अधिकरण

मुंबई पीठ "के", मुंबई

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

श्री विकास अवस्थी, न्यायिक सदस्य एवं
श्री नबीन कुमार प्रधान, लेखा सदस्य के समक्ष
BEFORE VIKAS AWASTHY, JUDICIAL MEMBER &
SHRI N.K.PRADHAN, ACCOUNTANT MEMBER

आअसं. 130/मुं/2013 (नि.व. 2007-08)

IT(TP)A NO.130/MUM/2013(A.Y.2007-08)

M/s. L'Oreal India Pvt. Ltd.
A-Wing, 8th Floor, Marathon Futurex,
N.M. Joshi Marg, Lower Parel,
Mumbai 400 013
PAN: AAACL0738K

..... अपीलार्थी /Appellant

बनाम Vs.

The Asstt. Commissioner of Income Tax,
Circle – 6(3),
Aaykar Bhavan, M.K.Road,
Mumbai 400 020

..... प्रतिवादी/Respondent

Assessee by : Shri Niraj Sheth

Revenue by : Shri Anand Mohan

सुनवाई की तिथि/ Date of hearing : 02/03/2021

घोषणा की तिथि/ Date of pronouncement : 23/03/2021

आदेश/ ORDER

PER VIKAS AWASTHY, J.M.:

This appeal by the assessee is directed against the order of Commissioner of Income Tax (Appeals)-15, Mumbai (in short 'the CIT(A)') dated 25/10/2012 for the assessment year 2007-08.

2. The brief facts of the case as emanating from the documents on record are: The assessee is a subsidiary of L'Oreal SA, France. The assessee is an integral part of L'Oreal Group worldwide. The operations of the assessee company in India are divided in two segments:

- (i) Manufacturing of finished goods
- (ii) Distribution of imported products.

During the period relevant to the assessment year under appeal, the assessee entered into following international transactions with its group companies:

- (i) Import of raw material for manufacture of finished products;
- (ii) Import of finished goods for resale in India;
- (iii) Export of finished goods manufactured by the assessee;
- (iv) Royalty payments; and
- (v) Other reimbursement viz. bills and receipts.

In so far as above international transactions, the only issue raised by the assessee in ground No.1 of its appeal is regarding transfer pricing adjustment of Rs.5,72,99,914/- on account of international marketing expenses.

3. Shri Niraj Sheth appearing on behalf of the assessee submitted that assessee had made payments to its Associated Enterprise (AE) in respect of marketing services. The payments were made in accordance with service agreements between the assessee and L'Oreal SA France. The Transfer Pricing Officer (TPO) made adjustment in respect of the aforesaid payment primarily for the following reasons:

- (i) The assessee paid royalty for bundle of service rights. The payments made under license/royalty agreement include payment for marketing and advertisement.

(ii) There is an overlap of services/rights in various agreements with respect to advertisement and marketing.

(iii) The alleged services rendered by way of international marketing services not only pertain to the services rendered in India but they also represent what the assessee is already entitled to under the licence agreement.

(iv) The brands for which advertisement and marketing expenses are incurred, are continue to be owned by overseas AE, hence, the real benefit is to the foreign AE in the form of brand building.

3.1. The Id. Authorized Representative of the assessee submitted that the CIT(A) in the impugned order has erred in upholding the adjustment made by the TPO. The Id. AR pointed that the CIT(A) has erred in holding that arm's length price of the said transaction is to be determined at nil following CUP as most appropriate method, as no third party would pay twice for same services, once in the shape of incremental royalty and again as payment towards services. The CIT(A) has failed to appreciate that the services/rights provide to the assessee by L'Oreal SA France (AE) under service agreement and licence agreement distinct without any overlapping. The services/rights under licence agreement are with respect to activities of manufacturing, use of trademark etc., whereas, service agreement cover activities post manufacturing. The Id. AR asserted that the authorities below have failed to appreciate that the international marketing services are essential to the entire sales and marketing activity within India and outside India.

3.2. The Id. AR further submitted that the CIT(A) has erred in holding that the marketing services are for brand promotion of the brands owned by the overseas AE. The Id. AR asserted that the marketing and advertisement expenses incurred by the assessee are for increasing the sales of assessee's own products. The assessee is an

independent entity and devises its own marketing strategy in line with the group policy. The TPO and the CIT(A) have erred in combining royalty and marketing services transactions. There are no overlapping of services in the agreements for services and royalty and hence, no double payment for the same services.

3.3. The Id. Authorized Representative of the assessee pointed that the CIT(A) has erred in observing that in the past no payments were made by the assessee in respect of marketing services to the AE. The Id. AR referred to the service agreements at pages 148 to 165 of the paper book to show that the agreements were executed in 2001 and licence agreements at pages 166 to 189 of the paper book to show that the agreements were executed in November 2005. Thus, the payments for marketing services were being made since Financial Year (FY) 2001-02 relevant to AY 2002-03 and for royalty from FY 2005-06 relevant to AY 2006-07. Therefore, the first year in which the payment for royalty under license agreements, as well as marketing expenses under service agreements were made was in assessment year 2006-07. The expenditure incurred by the assessee was allowed and no adjustment was made in AY 2006-07. To support his contentions, the Id. Authorized Representative of the assessee referred to the order of CIT(A-12, Mumbai dated 20/03/2012 for assessment year 2006-07 at pages 73-79 of the paper book.

3.4. The Id. Authorized Representative of the assessee, assailing the finding of lower authorities asserted that the TPO has no power to disallow expenditure or sit in judgment to examine, whether the expenditure was necessary for the business or not. The TPO has limited jurisdiction to determine the arm's length price of the transaction under transfer pricing provisions. To support his contentions, the Id. AR relied on the decision of Hon'ble Bombay High Court in the case of CIT vs. Lever India Exports Ltd., 292 CTR 393(Bom).

3.5. The Id. Authorized Representative of the assessee further referred to the observations of the CIT(A), wherein the First Appellate Authority has held that the ALP of the marketing services are nil if CUP is applied. The Id. Authorized Representative of the assessee placed reliance on the decision of Merck Ltd. vs. DCIT, reported as 179 TTJ 121 (Mum) to contend that where bundle of services are received under an agreement and the payments are made for such package and not for individual services, if the assessee does not use any particular services from such bundle of services it is not justified to hold that the payment is not warranted for that particular service that has not been utilised. The Id. Authorized Representative of the assessee further pointed that the decision of the Tribunal has been approved by Hon'ble Bombay High Court in CIT vs. Merck Ltd., 389 ITR 70 (Bom).

4. Shri Anand Mohan representing the Department vehemently defended the impugned order and prayed for dismissing ground no.1 raised by the assessee. The Id. Departmental Representative submitted that the TPO after examining various agreements executed by the assessee with its overseas AE concluded that there is a duplication of services in different set of agreements. The assessee has made payment for marketing services under royalty agreements, as well as separate service agreements. The Id. Departmental Representative further contended that the assessee has not done any benchmarking to determine the arm's length price of the transactions.

5. We have heard the submissions made by rival sides and have examined the orders of authorities below. In ground No.1 of the appeal the assessee has assailed transfer pricing adjustment on account of international marketing expenses. A perusal of the documents on record reveal that the assessee has entered into various agreements with L'Oreal SA France. The License Agreements under which the assessee has to pay royalty is in respect of use of patents and technology, marketing and distribution of L'Oreal under its brand name in India. The Service Agreement

between the assessee and L'Oreal SA France is in respect of international marketing studies, assistance in design of packaging, development of advertisement material, etc. The TPO after having examined the agreements rather than benchmarking international transactions qua marketing service, raised question on the payments made under the agreements, alleging duplication of services.

A perusal of section 92CA of the Income Tax Act, 1961 (in short 'the Act'), shows that reference is made to the TPO under provisions of sub-section (1) of section 92CA for the computation of arm's length price in respect of the international transactions. The TPO does not enjoy unfettered powers under transfer pricing mechanism, to disallow the expenditure or to check the necessity of the transaction. The jurisdiction of TPO is limited to ascertain whether the international transaction carried out by the assessee with its AE is at arm's length by applying most appropriate method as specified under section 92C(1) of the Act. The TPO can neither question commercial expediency of the transaction nor examine whether service was needed or is duplicate in nature. Further, the TPO cannot question the quantum of benefit derived by the assessee from the payment made for international transaction. The TPO has no authority to disallow the expenditure for any extraneous reasons. The jurisdiction of the TPO is only to examine international transaction and make suitable adjustment after benchmarking the transaction in line with the provisions of section 92C of the Act.

6. The Hon'ble Bombay High Court in the case of CIT vs. Lever India Exports Ltd.(supra) has held that in transfer pricing proceedings the role of TPO is to examine whether or not method adopted to determine arm's length price is most appropriate and also whether comparables selected are appropriate or not. It is not part of TPO's jurisdiction to consider whether or not expenditure incurred by assessee has passed the test of section 37 of the Act. The relevant extract of observations made by the Hon'ble High Court are reproduced herein under:-

“7. We note that the Tribunal has recorded the fact that the respondent assessee has launched new products which involved huge advertisement expenditure. The sharing of such expenditure by the respondent assessee is a strategy to develop its business. This results in improving the brand image of the products, resulting in higher profit to the respondent assessee due to higher sales. Further, it must be emphasized that the TPO's jurisdiction was to only determine the ALP of an International Transaction. In the above view, the TPO has to examine whether or not the method adopted to determine the ALP is the most appropriate and also whether the comparables selected are appropriate or not. It is not part of the TPO's jurisdiction to consider whether or not the expenditure which has been incurred by the respondent assessee passed the test of Section 37 of the Act and/or genuineness of the expenditure. This exercise has to be done, if at all, by the Assessing Officer in exercise of his jurisdiction to determine the income of the assessee in accordance with the Act. In the present case, the Assessing Officer has not disallowed the expenditure but only adopted the TPO's determination of ALP of the advertisement expenses. Therefore, the issue for examination in this appeal is only the issue of ALP as determined by the TPO in respect of advertisement expenses. The jurisdiction of the TPO is specific and limited i.e. to determine the ALP of an International Transaction in terms of Chapter X of the Act read with Rule 10A to 10E of the Income Tax Rules. The determination of the ALP by the respondent assessee of its advertisement expenses has not been disputed on the parameters set out in Chapter X of the Act and the relevant Rules. In fact, as found both by the CIT (A) as well as the Tribunal that neither the method selected as the most appropriate method to determine the ALP is challenged nor the comparables taken by the respondent assessee is challenged by the TPO. Therefore, the ad-hoc determination of ALP by the TPO dehors Section 92C of the Act cannot be sustained.”

7. The Hon'ble Delhi High Court in the case of CIT vs. EKL Appliances Ltd. reported as 345 ITR 241, after referring to OECD guidelines para 1.36 to 1.41 observed:

“17. The significance of the aforesaid guidelines lies in the fact that they recognise that barring exceptional cases, the tax administration should not disregard the actual transaction or substitute other transactions for them and the examination of a controlled transaction should ordinarily be based on the transaction as it has been actually undertaken and structured by the associated enterprises. It is of further significance that the guidelines discourage re-structuring of legitimate business transactions. The reason for characterisation of such re-structuring as an arbitrary exercise, as given in the guidelines, is that it has the potential to create double taxation if the other tax administration does not share the same view as to how the transaction should be structured.

18. Two exceptions have been allowed to the aforesaid principle and they are (i) where the economic substance of a transaction differs from its form and (ii) where the form and substance of the transaction are the same but arrangements made in relation to the transaction, viewed in their totality, differ from those which would

have been adopted by independent enterprises behaving in a commercially rational manner.”

The Hon'ble Court after considering relevant provisions of the Act, OECD guidelines and catena of judgements held:

“21. The position emerging from the above decisions is that it is not necessary for the assessee to show that any legitimate expenditure incurred by him was also incurred out of necessity. It is also not necessary for the assessee to show that any expenditure incurred by him for the purpose of business carried on by him has actually resulted in profit or income either in the same year or in any of the subsequent years. The only condition is that the expenditure should have been incurred “wholly and exclusively” for the purpose of business and nothing more. It is this principle that inter alia finds expression in the OECD guidelines, in the paragraphs which we have quoted above.

22. Even Rule 10B(1)(a) does not authorise disallowance of any expenditure on the ground that it was not necessary or prudent for the assessee to have incurred the same or that in the view of the Revenue the expenditure was unremunerative or that in view of the continued losses suffered by the assessee in his business, he could have fared better had he not incurred such expenditure. These are irrelevant considerations for the purpose of Rule 10B. Whether or not to enter into the transaction is for the assessee to decide. The quantum of expenditure can no doubt be examined by the TPO as per law but in judging the allowability thereof as business expenditure, he has no authority to disallow the entire expenditure or a part thereof on the ground that the assessee has suffered continuous losses.”

8. In view of the law expounded by Hon'ble High Courts, OECD guidelines and the provisions of the Act, we are of considered view that in the instant case objections raised by the TPO for making adjustment in international marketing expense and upheld by the CIT(A) are without any legal rational and thus, liable to be set aside. On merits, we observe that *per se* payment for the marketing services are not disputed by the Assessing Officer, however, the TPO has not carried out necessary exercise of benchmarking ALP of the international transaction in question, ergo, we deem it appropriate to restore this issue to the file of Assessing Officer/TPO for determination of arm's length price of the transactions, as per the provisions of section 92C of the Act. Needless to say that reasonable opportunity of hearing be afforded to the assessee, in accordance with law. The findings of the CIT(A) on the

issue of transfer pricing adjustment of international marketing expenses are set aside and **ground no.1 of the appeal is allowed for statistical purpose.**

9. In ground No.2 of the appeal the assessee has assailed addition of Rs.1,28,74,878/- under section 145A of the Act. The Id. Authorized Representative for the assessee submitted that the assessee is following exclusive method for accounting excise duty of purchases. The Assessing Officer and CIT(A) have failed to appreciate the fact that under exclusive method of accounting no adjustment is warranted as there would be no impact after adjustment under section 145A of the Act. The Id. AR referred to the details of CENVAT/Service tax credit availed and utilised at page 2 of the paper book. The Id. Pointed that CENVAT credit utilised is debited to the Profit and Loss account as excise duty expenses and unutilised CENVAT is carried forward under the head 'Loans & Advances' under Current Assets. The Assessing Officer has made addition with respect to unutilized CENVAT Credit of Rs.1,28,74,878/- as on 31/03/2007 only for the reason that the assessee has followed exclusive method of accounting. In the opinion of Assessing Officer the assessee should have followed inclusive method of accounting only. The Id. Authorized Representative for the assessee submitted that whether exclusive method of accounting is followed or inclusive method of accounting is applied there would be no adjustment required in respect of CENVAT credit. To support his submissions, the Id. Authorized Representative placed reliance on the following decisions:

- (i) CIT vs. Diamond Dye Chem. Ltd., 396 ITR 536(Bom)
- (ii) Kansai Nerolac Paints Ltd. vs. ACIT in ITA No.4175 of 2010 & ITA No.9184 of 2010 decided on 19/03/2018.

9.1. The Id. AR further submitted that in the preceding assessment years starting from AY 2002-03 to 2006-07, the Assessing Officer has made disallowance under Section 145A of the Act for similar reasons and the CIT(A) has been consistently

allowed the same in favour of the assessee. In the immediately preceding AY the CIT(A) has again allowed the claim of assessee and the Assessing Officer has already passed the order Giving Effect. The Id. AR referred to the table at page 3 of the paper book giving history of the addition u/s145A of the Act in respect of unutilised CENVAT credit. The Id.AR pointed that even in the subsequent AY i.e. AY 2008-09 the Dispute Resolution Panel granted relief and the same has been given effect by the Assessing Officer in Final Assessment order.

10. *Au contraire*, the Id. Departmental Representative vehemently defending the impugned order submitted that it is mandatory to following inclusive method of accounting w.e.f. 1999-2000. In the immediately preceding assessment year i.e. 2006-07 the Assessing Officer had made disallowance for the similar reasons, in appeal by the assessee, the CIT(A) allowed relief. In appeal before the Tribunal by the Department, the Tribunal restored the issue back to the file of Assessing Officer with direction to verify the facts to ensure that the assessee does not get the benefit of double deduction on account of Modvat account.

11. Both sides heard, orders of authorities below examined. The Assessing Officer has made addition under the provisions of section 145A of the Act on account of alleged unutilized CENVAT credit. The assessee has followed exclusive method of accounting, whereas, the Assessing Officer insisted that inclusive method of accounting should have been followed. The contention of the assessee is, whether inclusive method or exclusive method of accounting is adopted, both would give same result.

12. In the case of Diamond Dye Chem Ltd. (supra), the Hon'ble Bombay High Court upheld the order of Tribunal, wherein the addition on account of Modvat credit was deleted. In the said case, the assessee therein had also adopted exclusive method of accounting. The relevant extract of the judgment reads as under:-

“5. We have considered the submissions. It is not disputed that the assessee was liable to excise duty. The assessee got credit in the excise duty already paid on the raw materials purchased by it and utilized in the manufacturing of excisable goods. The assessee was adopting the exclusive method i.e. valuing the raw-materials on the purchase price minus (-) the Modvat credit. The same would be permissible. The Apex Court in the case of Indo Nippon Chemicals Co. Ltd. (supra) while affirming the order of High Court, has observed that the income was not generated to the extent of Modvat credit or unconsumed raw-material. Merely because the Modvat credit was irreversible credit offered to manufacturers upon purchase of duty paid raw-materials, that would not amount to income which was liable to be taxed under the Act. It is also held that whichever method of accounting is adopted, the net result would be the same.”

13. In the case of Kansai Nerolac Paints Ltd. (supra) addition was made on account unutilized Modvat credit under section 145A of the Act. In the said case, the assessee therein followed exclusive method for accounting Modvat. The Department insisted for following inclusive method of accounting. The Tribunal following the decision rendered in the case of Diamond Dye Chem Ltd. (supra) deleted the addition.

14. We find that the dispute with regard to CENVAT credit in the case of assessee is perennial since AY 2002-03. The assessee has been following exclusive method of accounting as against inclusive method as required under section 145A of the Act. Under excusive method the amount of CENVAT credit is not added to the sales and purchases, but is shown separately. The assessee has filed the copies of order passed by the CIT(A) from AY 2002-03 onwards (except for AY 2003-04 when no addition was made on account of unutilised CENVAT Credit) alongwith order giving effect. The CIT(A) has been consistently allowing the benefit of CENVAT credit to the assessee. The Assessing Officer has been giving effect to the order of CIT(A), accordingly. In the impugned assessment year position is no different. We find merit in the contentions raised by the assessee. The Assessing Officer is directed to delete the addition u/s 145A of the Act. The findings of CIT(A) in the impugned order are set aside and **ground no.2 of the appeal is allowed.**

15. In ground No.3 of appeal, the assessee has assailed penalty proceedings initiated under section 271(1)(c) of the Act. Challenge to penalty proceedings under section 271(1)(c) of the Act at this stage is premature, thus, **ground No.3 raised in the appeal is dismissed**, as such.

16. In the result, appeal by the assessee is partly allowed in the terms aforesaid. Order pronounced in the open court on Tuesday the 23rd day of March, 2021.

Sd/-

(N.K.PRADHAN)

लेखा सदस्य /ACCOUNTANT MEMBER

मुंबई/ Mumbai, दिनांक/Dated 23/03/2021

Vm, Sr. PS (O/S)

प्रतिलिपि अग्रेषितCopy of the Order forwarded to :

1. अपीलार्थी/The Appellant ,
2. प्रतिवादी/ The Respondent.
3. आयकर आयुक्त(अ)/ The CIT(A)-
4. आयकर आयुक्त CIT
5. विभागीय प्रतिनिधि, आय.अपी.अधि., मुंबई/DR, ITAT, Mumbai
6. गार्ड फाइल/Guard file.

Sd/-

(VIKAS AWASTHY)

न्यायिक सदस्य/JUDICIAL MEMBER

BY ORDER,

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(Dy./Asstt. Registrar)
ITAT, Mumbai