

**IN THE INCOME TAX APPELLATE TRIBUNAL  
“C” BENCH : BANGALORE**

**BEFORE SHRI. N. V. VASUDEVAN, VICE PRESIDENT AND  
MS. PADMAVATHY S, ACCOUNTANT MEMBER**

IT(TP)A No.368/Bang/2022
Assessment Year : 2017-18

M/s. Motorola Mobility India Private Limited, 5 <sup>th</sup> Floor, No.66/1, Plot No.5, Bagmane Tech Park, C. V. Raman Nagar, Bengaluru – 560 093. <b>PAN : AAFCP 2261 E</b>	Vs.	DCIT, Circle – 4(1)(1), Bengaluru.
APPELLANT		RESPONDENT

Assessee by	:	Shri. Padamchand Khincha, CA
Revenue by	:	Shri. Praveen Karanth, CIT(DR)(ITAT), Bengaluru.

Date of hearing	:	08.09.2022
Date of Pronouncement	:	15.09.2022

**ORDER**

*Per Padmavathy S, Accountant Member*

This appeal is against the final Assessment Order passed by the National Faceless Appeal Centre, under section 143(3) r.w.s. 144(13) of the Income Tax Act, 1961 (the ‘Act’), dated 17.03.2022 for the Assessment Year 2017-18.

2. The assessee raised grounds pertaining to the following issues :
  - i. TP adjustments of Rs.12,85,77,521/- towards AMP expenditure pertaining to trading segment (ground Nos.3 to 18).

- ii. TP adjustment of Rs.50,73,76,084/- in relation to reimbursement of warranty expenses to AE (Ground Nos.19 to 23)
2. Ground Nos.1, 2, 24 and 26 are general in nature and does not warrant separate adjudication. Ground No.27 is consequential.
3. The assessee is primarily engaged in the business of software development services and trading of mobile phones. The assessee filed the return of income for Assessment Year 2017-18 on 28.11.2017 declaring a total income of Rs.235,41,08,150/-. The case was selected for scrutiny under CASS and accordingly notice under section 143(2) was duly served on the assessee. Since the assessee had international transactions with its AE, a reference was made to the TPO for the purpose of computing the ALP of the international transactions. The TPO passed Assessment Order under section 92CA of the Act making transfer pricing adjustment towards:
  - (i) Software development segment - Rs.8,79,08,366/-
  - (ii) AMP expenses - Rs.12,85,77,521/-
  - (iii) Warranty expenses - Rs.50,73,76,084/-.
4. The assessee raised objections before the DRP. The DRP gave partial relief to the assessee in terms of transfer pricing adjustment made in the software development segment and confirmed the adjustment made towards AMP expenses and warranty expenses. The assessee is in appeal before the Tribunal against the final order giving effect to the DRP's directions.
5. During the course of hearing, the learned AR submitted that in the order passed under section 92CA of the Act, the TPO did not propose any adjustment in the trading segment thereby accepting the ALP of the trading segment. The learned AR submitted that the AMP expenses and the warranty expenses are part of the operating cost considered while arriving

at the margins of the assessee. Therefore, the learned AR contended that since the TPO has accepted the margins of the trading segment, there cannot be a separate adjustment made towards AMP expenses and warranty cost. The learned AR further submitted if this ground is considered for adjudication, then the rest of the grounds raised towards the TP adjustment made on AMP expenses and warranty cost can be left open. The learned DR did not raise any objections and therefore we will consider this appeal for the limited purpose of adjudicating the above ground raised by the learned AR. In the TP study, the assessee has adopted Transactional Net Margin Method (TNMM) as the most appropriate method. The operating profit / operating cost ratio has been taken as the profit level indicator in TNMM analysis. The assessee has done the TP study with respect to trading segment and software development services. The assessee computed OP/OR at 5.09% as per the below computation:

**The financials of the Taxpayer for the F.Y. 2016-17 a study are as under:**

<b>Particulars</b>	<b>Trading Segment</b>
<b>Revenue</b>	
<i>Sale of Products: Mobile Phones</i>	2443134478
<i>Sale of Services: Income from research and Development services</i>	-
Revenue from operations	24431344785

<i>Liability written back to the extent no longer required</i>	59462888
Total Revenue	24490807673
Less: Non-Operating Income	
<i>Liability written back to the extent no longer required</i>	59462888
Total Non-Operating Income	59462888
<b>Operating Revenue (OR)</b>	<b>24431344785</b>
<b>Expenses</b>	
Purchase of Stock-in-trade: Mobiles Phones	20817698303
Employee Benefit Expenses	84423045
Finance Costs	34737270
Depreciation and amortization expenses	19924596
Other Expenses	2267311742
Total Expenses	23224094956
Less: Non-Operating Expenses	
Interest on Finance Lease	337616

Interest on Shortfall of advance tax	30295885
Loss on sale / write off of fixed assets	1880178
Expenditure towards Corporate Social responsibility	3990506
Total Non-Operating Expenses	36504185
Operating Expenses	23187590772
Operating Profit	1243754013
OP/OC	-
OP/OR	5.09%

6. The TPO rejected the margin of the trading segment at 5.44% as per below computation:

Particulars	Trading Segment
Revenue	
Operating Revenue (OR)	24431344785
Expenses	
Total Expenses	23224094956

Less: Finance Cost	33498266
Less: Loss on sale / write off of fixed assets	1809344
Less: Expenditure towards Corporate Social responsibility	17096862
Operating Expenses	23171690484
Operating Profit	1259654301
OP/OC	5.44%

7. The TPO did not propose any adjustment towards trading segment by holding that :

*“The taxpayer has adopted Transactional Net Margin Method as the using the Operating Profit to Operating Revenue as **PLI** and conducted a se which yielded a set of 13 comparable companies whose weighted PLI was 1. The taxpayer's PLI was 5.09%. Hence the taxpayer treated its Internal Transaction relating to Import of goods for sale to be at Arm's Length.”*

8. However, the TPO held that the assessee in the trading segment has not confined itself just to distribution of trading goods but has performed additional functions in the form of advertisement, marketing and sales promotion for which the assessee needs to be adequately compensated. The TPO proceeded to treat the AMP as a separate international transaction and made an adjustment of Rs.12,85,77,521/-. With regard to the warranty expenses, the TPO noticed that the assessee has made a provision of Rs.145,79,52,674/- and out of this provision, the assessee has reversed Rs.66,95,53,353/- which included the reimbursement of warranty expenses

of Rs.50,73,76,084/- to its AE. The assessee submitted before the TPO that the said cost is incurred by the AE on behalf of the assessee and these expenses were charged back by the AE at cost. The assessee however submitted that these charges were pure cost to cost reimbursement of third party warranty expenses incurred by the AE on behalf of the assessee and is routed through the Profit and Loss A/c and considered as part of cost based of determining arm's length nature of the trading activities of the assessee. However, the TPO treated the payment made in the form of reimbursement of warranty expenses as a class of its own and stated that it requires a separate analysis. The TPO called for evidence supporting the transaction and the assessee in support of the claim furnished back to back analysis (intercompany invoices and third party analysis) to support that it is a cost to cost reimbursement of warranty expenses. However, the TPO did not accept the submissions of the assessee and proceeded to compute the ALP of warranty expenses as Nil by stating that :

*“The taxpayer in the submission has furnished some same copies of bill for reimbursement of custom duty & clearance charges and freight, logistics and Incident charges. The taxpayer did not furnish any details regarding defect items manufactured and trend of the historical same defects. The basis on which the warranty charges has been paid is not substantiated by the taxpayer except furnishing sample bills copies for of custom duty & clearance charges. The warranty represents a term of a contract that specifies the conditions under which the vendor or producer will repair, replace, or compensate for a defective item without any cost to the buyer or user. In this regard the taxpayer failed to furnish the details of manufactured items that were defective or the defective items that were repaired or replaced. Without furnishing the details of services rendered by the third party to the taxpayer, the AE has charged the warranty expense on cost to cost basis. The submission of the taxpayer is not acceptable without the detailed working on the basis of which the taxpayer was charged warranty expense in cost to cost basis. Thus the reimbursement of warranty expense is treated as Nil.”*

9. The DRP confirmed the TP adjustment proposed by the TPO.

10. Aggrieved, the assessee is in appeal before the Tribunal. Before us, learned AR submitted that the TPO has accepted the margins of the trading segment without making any TP adjustments and the impugned adjustments towards AMP expenses and warranty cost are integral part of the trading segment margins. In this regard, the learned AR drew our attention to the financial statements of the assessee to demonstrate that in schedule 24 – other expenses, the warranty cost and advertisement and publicity expenses are taken as part of the expenses

24 Other expenses	Year ended	
	March 31, 2017	March 31, 2016
Power and fuel	19,724,751	25,428,399
Rent (Refer note 31)	127,780,051	130,926,418
Repairs and maintenance- others	62,371,972	57,751,139
Insurance	11,992,307	15,953,535
Rates and taxes	82,100,632	1,301,268
Travelling Expenses	22,595,247	15,623,401
Payment to Auditors		
As auditor:		
Audit fee	4,734,000	4,345,200
Tax audit fee	300,000	300,000
Reimbursement of expenses	132,381	-
Expenditure towards Corporate Social Responsibility (CSR) activities [Refer note (a) below]	3,990,506	3,980,967
Professional fees	79,939,017	78,311,195
Warranty	1,457,952,674	-
Freight	8,449,447	4,544,962
Communication Expenses	6,840,012	9,815,462
Advertisement and Publicity Expenses	646,522,031	61,742,850
Loss on sale/ write off of fixed assets (net)	1,880,178	243,612
Net loss on foreign currency transaction and translation	17,766,186	-
Provision for doubtful debts	333,178	1,813
Miscellaneous Expenses	6,183,046	2,463,449
<b>TOTAL</b>	<b>2,561,587,616</b>	<b>412,733,670</b>

10. And in the segmental financials given for TP purposes, the operating cost of segment includes other expenses in which AMP expenses and warranty cost are part of

Particulars	Trading segment	Software development services segment
<b>REVENUE</b>		
<i>Sale of products: Mobile Phones</i>	24,43,13,44,785	-
<i>Sale of services: Income from research and development services</i>	-	95,64,61,874
Revenue from operations	24,43,13,44,785	95,64,61,874
<i>Liability written back to the extent no longer required</i>	5,94,62,888	-
Total Revenue	24,49,08,07,673	95,64,61,874
Less: Non-Operating Income		
<i>Liability written back to the extent no longer required</i>	5,94,62,888	-
Total Non-Operating Income	5,94,62,888	-
<b>Operating Revenue ("OR")</b>	<b>24,43,13,44,785</b>	<b>95,64,61,874</b>
<b>EXPENSES</b>		
Purchase of stock-in-trade: Mobile Phones	20,81,76,98,303	-
Employee benefit expense	8,44,23,045	48,36,60,594
Finance costs	3,47,37,270	72,419
Depreciation and amortisation expense	1,99,24,596	5,17,91,159
Other expenses	2,26,73,11,742	29,42,75,874
Total Expenses	23,22,40,94,956	82,98,00,047
Less: Non-Operating Expenses		
<i>Interest on Finance Lease</i>	3,37,616	-
<i>Interest on shortfall of advance tax</i>	3,02,95,885	-
<i>Loss on sale/ write off of fixed assets (net)</i>	18,80,178	-
<i>Expenditure towards Corporate Social Responsibility</i>	39,90,506	-
Total Non-Operating Expenses	3,65,04,185	-
<b>Operating Expenses ("OC")</b>	<b>23,18,75,90,772</b>	<b>82,98,00,047</b>
<b>Operating Profit ("OP")</b>	<b>1,24,37,54,013</b>	<b>12,66,61,827</b>
OP/OC	-	15.26%
OP/OR	5.09%	

11. Therefore, learned AR submitted that there cannot be a separate adjustment towards AMP expenses and warranty cost. In this regard, the learned AR relied on the decision of the Coordinate Bench of the Tribunal in the case of Epson India Pvt. Ltd., Vs. DCIT (2022) 140 taxmann.com 273 (Bangalore Tribunal).

12. The learned DR submitted that the assessee has spent considerable amount towards sales, promotion and advertisement expenses to the tune of 2.65% of the sales but has not carried out any exercise to determine the ALP of such expenses though the expenses bring an intangible benefit in the form of brand value for AE. The learned DR therefore supported the order of the DRP where the DRP has given a finding that the AMP expenses is a separate international transaction and has to be bench marked separately with regard to warranty expenses. The learned DR relied on the order of the DRP.

13. We heard the rival submissions and perused the material on record. We notice that in schedule 234 of the financial statements of the assessee, the AMP expenses and warranty expenses are part of the overall other expenses amounting to Rs.256,15,87,616/-. We also notice that in the segment financials considered for TP analysis, the said other expenses have been split between trading segment and software development segment to be Rs.226,73,11,742/- and Rs.29,42,75,874/- respectively. From this fact, it is clear that the warranty expenses and AMP expenses have been considered as part of operating cost for the purpose of computing the margins of the assessee. We also notice from the order passed under section 92CA of the Act that the TPO has not made any adjustments towards the margin of trading segment thereby accepting the ALP analysis of the assessee with regard to trading segment. The Coordinate Bench of the Tribunal in the case of Epson India (supra) has considered similar issue and held that :

*“8. We have heard the rival submissions and perused the materials on record. The assessee has chosen RPM as the most appropriate method (MAM) for arriving at ALP. The assessee has chosen 7 comparables based on various filters applied and the median of weighted average of adjusted gross profit on sales % of these comparables was 4.44% (page 189 to 190 of paper book). The gross profit margin of the assessee from undertaking distribution activities during the year under consideration resulted in gross profit of 17.87% on sales (Page 254 of the paper book). Since the assessee's margin is more than the arm's length range, the margin of the assessee from its distribution activities is considered to be at arm's length from TP perspective. In a corroborative analysis done under Transaction Net Margin Method (TNMM) the assessee's margin is taken to be at arm's length as the median of the comparables was 1.08% whereas the operating profit of the assessee from undertaking the distribution activities was 3.12% (Page 255 of the paper book). We notice that the while arriving at the operating profit of the assessee the 'Selling and Marketing expenses' to the tune of Rs.68,16,40,898 has been included. The TPO in the order (Page 13 of TPO order para 4.7.5) has mentioned that TP analysis*

*with respect to AMP and the mark up the methods as used by the assessee like RPM with GPM as the PLI and TNMM with OP/OC as the PLI are not suitable, however he had not rejected the TP analysis of the distribution segment. This issue is particularly dealt with by the Hon'ble Delhi High Court in the case of Sony Ericsson mobile communication India Private Limited (supra) where it is held that -*

*101. However, once the Assessing Officer/TPO accepts and adopts TNM Method, but then chooses to treat a particular expenditure like AMP as a separate international transaction without bifurcation/segregation, it would as noticed above, lead to unusual and incongruous results as AMP expenses is the cost or expense and is not diverse. It is factored in the net profit of the inter-linked transaction. This would be also in consonance with Rule 10B(1)(e), which mandates only arriving at the net profit margin by comparing the profits and loss account of the tested party with the comparable. The TNM Method proceeds on the assumption that functions, assets and risk being broadly similar and once suitable adjustments have been made all things get taken into account and stand reconciled when computing the net profit margin. Once the comparables pass the functional analysis test and adjustments have been made, then the profit margin as declared when matches with the comparables would result in affirmation of the transfer price as the arm's length price. Then to make a comparison of a horizontal item without segregation would be impermissible.*

*9. The coordinate bench of the Tribunal in the case of Himalaya Drug Company (supra) has held that for the AMP expenses to fall under the category of 'international transaction' the revenue should show that there existed an agreement between the assessee and its AE in the matter of incurring AMP expenses. We notice that in assessee's case the revenue has not shown that there is any agreement in place between the assessee and the AE with regard to incurring AMP expenses. The Hon'ble Tribunal has also held that when the MAM for the entire international transaction is accepted by the TPO, no separate adjustment is required to be done for AMP expenses. The Hon'ble Tribunal has held that -*

*34. We notice that the co-ordinate bench has, following various decisions, held that the revenue has to first show that the AMP*

*expenses would fall under the category of "international transactions". For that purpose, the revenue has to show that there existed an agreement between the assessee and its AE in the matter of incurring of AMP expenses. Admittedly, it is not shown in the instant case that there existed any agreement relating to incurring of AMP expenses. Thus, we notice that there is no change in facts relating to this issue between the current year and the AY 2010- 11/2011-12. It was also held that when TNMM method is applied to benchmark the entire international transactions, then there is no requirement of making separate TP adjustment on account of AMP expenditure. In the earlier paragraphs, we have also held that TNMM as most appropriate method and has also held that the international transaction of Exports to AEs is at arms length.*

*Hence, no separate adjustment is required to be made in respect of AMP expenses on this account also.*

*10. We have considered the Ld DR's submission that the coordinate bench of the Tribunal in assessee's own case (supra) has remanded the case back to the TPO. In the said assessment years, the case was remanded back mainly for the purpose of determining whether the AMP expenses in an international transaction or not. The relevant para from the judgment is reproduced here for reference " In the present case also TPO had not brought anything on record to show existence of international transaction whereby the assessee was obliged to incur AMP expenditure for the purpose of promoting brand, intangible to its AE. Similarly the assessee- company also has not furnished FAR analysis of AMP functions in its TP study. In our considered opinion, the matter requires remission to the TPO for undertaking fresh analysis to establish existence of international transaction in respect of AMP expenditure and true nature of transaction between the appellant and its AE. After due analysis of FAR of the AMP functions carried out by the appellant and having regard to the actual conduct of the appellant vis-à-vis its AE and economic substance of the transactions between the appellant and its AE if the TPO is of the opinion that there existed an international transaction in the form of AMP function, then to undertake the exercise of determination of ALP by adopting a suitable method of compensation to the appellant for performing the AMP functions of its AE"*

*11. For the year under consideration, the issue for consideration is treating the AMP expenses as a separate transaction from the distribution segment and making TP adjustment for the same. The Ld AR submitted that whether AMP expenses is a separate international transaction is not contended in the year under consideration and prayed that the decision rendered by the coordinate bench on this specific count need not be applied in the year under consideration.*

*12. Considering the ratio laid down by the Hon'ble Delhi High Court in the case of Sony Ericsson mobile communication India Private Limited (supra) and the other decisions of the coordinate bench of the Tribunal, with respect to treating AMP expenses as a separate transaction when the TPO has not otherwise rejected the gross margin and the net margin of the assessee, we hold that there is no separate adjustment to be made in respect of AMP expenses. The appeal is allowed in favour of the assessee.”*

14. Considering the facts of the present case and respectfully following the decision of the Coordinate Bench of the Tribunal, we hold that the AMP expenses and warranty expenses cannot be treated as a separate international transaction when the TPO has not otherwise rejected the margins of the assessee in the trading segment. Therefore, the adjustments made in this regard is deleted and the appeal is allowed in favour of the assessee.

16. In the result, appeal of the assessee is allowed.

*Pronounced in the open court on the date mentioned on the caption page.*

**Sd/-**  
**(N. V. VASUDEVAN)**  
**Vice President**

**Sd/-**  
**(PADMAVATHY S)**  
**Accountant Member**

Bangalore,  
Dated: 15.09.2022.  
/NS/\*

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|---------------|---------------|
| 1. Appellants | 2. Respondent |
| 3. CIT        | 4. CIT(A)     |
| 5. DR         | 6. Guard file |

By order

Assistant Registrar,  
ITAT, Bangalore.