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

BEFORE: SHRI G.S.PANNU, HON'BLE PRESIDENT
&
SHRI AMIT SHUKLA, JUDICIAL MEMBER

ITA No.6274/Mum/2018
(**Assessment Year :2014-15**)

M/s. ASB International Private Limited. Plot No.E-9, MIDC Industrial Area Anand Nagar Addl. Ambernath (E) Thane-421506	Vs.	DCIT, Circle-1 1st Floor, Mohan Plaza Wayle Nagar Khadakpada, Kalyan (W)-421 301
PAN/GIR No.AAACA8424A		
(Appellant)	..	**(Respondent)**

Assessee by	Shri Paras Savla a/w. Harsh Shah
Revenue by	Ms. Samruddhi Hande
Date of Hearing	**25/01/2023**
Date of Pronouncement	**19/04/2023**

आदेश / O R D E R

PER AMIT SHUKLA (J.M):

The aforesaid appeal has been filed by the assessee against final assessment order dated 25/09/2018, passed in pursuance of the direction given by the ld. DRP vide order dated 27/08/2018 for the A.Y.2014-15.

2. In various grounds of appeal, the assessee has challenged transfer pricing adjustment of Rs.7,51,00,267/- on account of royalty paid by the assessee to its AE.

3. The facts in brief are that assessee is a 100% subsidiary of a wholly owned subsidiary of Nissel ASB Machine Co Ltd (ASB Japan' or 'AE). It is engaged in manufacturing of Injection Stretch Blow Molding (ISB) machines, molds and parts, components and sub-assemblies of machines and molds. The assessee manufactures capital goods which are used by their customers to ultimately manufacture PET bottles. ASB Japan is amongst the world's leading manufacturers of such machines, and similarly, the assessee is the lender in its segment in India. ASB India's market share in India for one-step machine is nearly 90% of the total market, which constitute nearly 80% of its total sales in the Indian market of around 40% approximately.

4. The assessee has three plants operating in India. The operations can be segregated into two segments; AE segment and non-AE segment. In the AE segment, the assessee manufactures machines to sell it exclusively to ASB Japan. In other words, it is a contract manufacturer, manufacturing machines as per the directions of its AE, which makes guaranteed purchases of the machines. The contractual arrangement of the AE segment is governed by a Sales & Purchase Agreement ("SPA'). In the Non-AE segment, the assessee manufactures machines and sells it in India to unrelated parties. Under this segment, the assessee uses intangibles namely know-how and trademark licensed by ASB

Japan vide Technical License Agreement w.e.f 1.10.2010 (TLA') upon payment of royalty at 12% of domestic sales of complete machines & molds made by ASB India.

5. It has been stated that ASB Japan possesses many patents and owns the necessary technical knowhow for the production and sale for the products manufactured by the assessee. ASB Japan has been constantly investing in developing manufacturing and marketing knowhow for manufacturing and selling of injection molding machines.

6. In the TP Study Report assessee stated that royalty payment which is in connection with technology and brand name received by ASB India from its AE in Japan for which assessee is required to pay royalty @12%. The royalty is payable in respect of annual domestic sales and in the TPSR assessee used overall entity level TNMM for benchmarking the royalty payment. On sales of Rs. 116,44,01,257/- assessee had paid royalty of Rs.13,91,42,366/- and it was stated that its margin in non AE segment are high and are at ALP in comparison with comparable uncontrolled transactions.

7. The ld. TPO was of opinion that royalty constitutes separate class and accordingly, he held that entity level benchmarking undertaken by the assessee is to be rejected. Accordingly, assessee was required to provide CUP analysis. In response, assessee conducted CUP analysis on a without prejudice basis

and identified certain comparable uncontrolled transactions by referring to the Royalty- STAT data base to identify the comparable royalty transactions. The ld. TPO after analyzing the comparable agreements, proposed to reject all the comparables after giving detailed reasons contained in pages 5-15. These comparables were totally classified under different heads like royalty for use of trademark; royalty for use of technical knowhow; royalty of management and consultancy services; Thus, the ld. TPO held that comparable royalty agreement relied upon by the assessee does not fulfill the comparability criteria as provided under Rule 10B(2). He held that since comparable agreements are not similar to the international transaction, therefore, they are not reliable for the purpose of benchmarking. Accordingly, he rejected the method of the assessee. Accordingly, the ld. TPO determined the ALP at 'Nil and made adjustment of entire royalty payment of Rs.13,91,42,366/-.

8. Before the ld. DRP, assessee contented that benchmarking analysis should be done under Rule 10AB, i.e. '**Other method'.** Justifying the applicability of 'other method', Assessee has given very detailed reasons which have been discussed in detail by the ld. DRP. The ld. DRP has also sought for remand report of the ld. TPO which too has been discussed by the ld. DRP. The ld. DRP rejected the working of the 'other method' by the assessee and held that CUP is the most appropriate method.

9. Before the ld. DRP assessee has claimed that the operations of the assessee is segregated into two segments, one manufacturing the machines to be sold to the AE and second manufacturing the machines to be sold domestically in India to the unrelated customers. Thus, for the first segment it was engaged as contract manufacturing and hence, there is no transfer of intangibles from AE to the assessee. It was only in the second segment where it manufactures and sells in India that it receives technological as well as marketing intangibles from its AE. One of the main contentions of the assessee was that there are five main intangibles and there is no reliable comparable uncontrolled transaction and therefore, CUP is not applicable and under these circumstances only 'other method' can be applied. The assessee has provided the benchmarking analysis 'other method' which was rejected by the ld. DRP after observing as under:-

> *"As per the assessee, in its Non-AE segment the profits (before deduction of royalty) represent the total profit earned on account of three functions i.e. the transfer of intangibles from the AE, manufacturing profits and profits attributable to sales function. The argument of the assessee is that it has come up with a method to reasonably attributed profit pertaining to the manufacturing and sales functions in the Non-AE segment and when this is reduced from the gross profits the difference should represent the thumb rule royalty. The assessee does not maintain segment wise accounts but to support its case, the assessee has claimed that it has bifurcated its accounts between the AE and Non-AE segment on the basis of the allocation key of 'material ratios. Subsequently when the assessee found that this allocation key is not proper, it has*

claimed that the revised bifurcation of accounts has been done on the basis of 'labour hours employed in manufacturing a machine' in both the segments. The assessee has claimed that there is more labour man-hours employed in the Non-AE segment as the machines manufactured in this segment are complete machines while the machines manufactured in the AE segment are semi-finished. The assessee claims that as per its methodology the profit that can be reasonably attributable to manufacturing is 3.81%. The assessee also claims that since the Non-AE segment also does sales/marketing, a further 3% can be attributed to account for the profit on account of marketing function performed by the Non-AE segment. As per the assessee the profit before royalty in the non-AE segment is 17.98% and after reducing the figures of 6.81% (3.81% +3%), the balance 11.17% would represent royalty. To justify this procedure the assessee claims that Rule 10AB does not lay down any methodology or process but only speaks of using a rational method and therefore, calculation above should be considered and the royalty payment be benchmarked accordingly."

10. The ld. DRP observed that sales to the AE at Rs.192 Crores gives a profit margin of 1.33% in the AE category where as sales to non-AE give margin of 18.83% which indicates irrational allocation basis by the assessee which does not have any identifiable basis. It has also been observed that the there is no evidence that sales to the AE were only of semi-finished goods, since TLA refers to the licensed products as including complete or semi-complete unit and therefore, there is no indication that the sales made to the AE was only with regard to semi-finished goods. Further, no exports invoices have been produced substantiating that machines exported to AE were semi-finished.

11. One another important observation which has been made that assessee does not maintain separate books of account for its AE and non-AE activities and the cost allocation of key of labour man-hours has no basis in the absence of technical specification of each and every product manufactured / sold by the assessee. The ld. DRP held that the 'other method' is only variant of internal TNMM which cannot be expected. Finally, the ld. DRP came out with two comparables chosen by the assessee which were rejected by the ld. TPO, i.e., **Optikos Corporation and DynEco Corporation** and accordingly, directed ld. TPO to conclude the ALP of the technology know-how royalty as the average of royalty payment of these two comparable agreements and accordingly, the ld. TP adjustment was reduced to Rs.7.51 Crores and the ALP of the royalty was computed at 5.5%.

12. We have heard both the parties and perused the relevant finding given in the impugned orders as well as the materials referred to before us. It is not in dispute that the assessee does not possess any technical knowhow and it is manufacturing molding machines as well as designing and manufacturing molds which is a huge technology intensive activity. This technical knowhow has been provided by ASB Japan. It has been contended before us that assessee makes machines for molding of PET bottles and there are various factors and check points in molding the PET bottles such as weight, production, volume, thickness etc., and only ASB, Japan has the technology for changing the form of the mold, changing the parts, machinery

options, changing the normal molding process and change of temperature adjustment etc. There is a constant research and development which is undertaken by the ASB, Japan as it alone has requisite knowledge and repertoire to address any problem. It has been further stated that assessee receives various benefits from ASB Japan in the form of intangibles like;

a. License to use brand 'ASB': ASB Japan had granted Assessee a license to use the name 'ASB' in corporate name, trade name, trade mark, etc.

b. License to use technical know-how: ASB Japan has licensed technical know-how to the Assessee for manufacturing and selling products. The technical know-how is supplied in the form of engineering data, design data, specifications, drawings, sketches, photographs including detailed drawings of injection units and temperature controllers, standard drawings of preforms, preform molds and blow molds, detailed drawings for the machines and machine parts, information, technique and design with respect to jigs, tools, patterns and molds. In relation to this, ASB Japan also provides on the job training, supervising and check and review, Further, the assessee also sends out 'consultation request to the AE if the conditions are even slightly different from the cases that assessee itself has experienced in the past or within the collection of reference drawings Besides these daily consultation requests, selection of new mother machines and layouts are also advised by AE.

13. On the contrary, the assessee does not have any research and development (R&D) expenditure of its own. It relies on ASB

Japan, which has developed a vast knowledge base, which is essentially proprietary. Thus, it has been contended that -

- ASB Japan is the sole developer and manager of the technology intangibles and know-how and has been the only pioneer in establishing the brand of ASB' in PET Industry Technical know- how existing with ASB Japan is the result of strenuous and dedicated research for over 40 years. Further, this technical know-how is still evolving due to painstaking effort by AE.
- The assessee neither has any research and development facility of its own nor it owns any intangibles. It relies entirely on the knowledge repertoire cumulated by ASB Japan.
- The intangibles created and developed by ASB Japan are unique, one of its kind and not routine. Further, their uniqueness and peculiar nature makes them highly valuable for the assessee because devoid the intangibles Assessee's business will not survive.

14. Before us ld. Counsel submitted that the intangibles involved in this transaction are one of their kind. Such intangibles are difficult to find which consequentially creates a dearth of comparables. Hence, the CUP method in the case of the Assessee is highly ill-suited due to the simple fact that there are no accurate comparables (the royalty agreements adopted for benchmarking has been dealt with later). Rule 10C (20(c) also specifies that availability and reliability of data shall be relevant

in determining the MAM. The assessee submits that in the case at hand, there is inability to find comparables, especially in the case when the goods being manufactured are capital goods. Even the OECD Guidelines prescribe that in cases of unique and valuable intangibles, the applicability of CUP is not reliable, and the taxpayer must turn to other methods available at its disposal. He further submitted that CUP analysis was submitted on a without prejudice basis and in view of the reasons explained above the Assessee always pleaded with the ld.TPO/ ld. DRP that CUP is not the MAM. In any case, for the following reasons, the lower authorities have erred in taking into consideration the royalty agreements namely, **Optikos Corporation** and **DynEco Corporation** for use of technical knowhow only and ignoring the other two baskets of royalty agreements:-

(i) The chosen agreements grant exclusive and worldwide license to the licensees therein, whereas as par TLA, the assessee has a non-exclusive license for use in India and in certain nearby countries only;

(ii) The chosen agreements permit the licensees therein to grant the sub-license, which is not the case under TLA;

(iii) The royalty payment under the chosen agreements is only with respect to technical know-how, the TLA on the other hand provides for the payment of royalty for technical know-how, trademark and management and consultancy services;

(iv) The chosen agreements have a slab rate of royalty, while the TLA provides for a flat rate of royalty.

15. Further, apart from the above, the technical know-how in two agreements is totally different due to the reasons that:-

(i) Optikos Corporation is engaged in providing innovative applications of optical technology. Its products include lens testing equipment, camera testing equipment, ophthalmic testing equipment. It also renders in-house services which help the customers assess the performance of lens or camera system. The technology as defined in the agreement is reproduced below:

> *"1.14 TECHNOLOGY" shall mean certain property rights, concepts and technologies related to the optical detection of characteristics of packaged containers (including height of fill) which includes all of the following intellectual property of Optikos"*

(ii) DynEco Corporation is engaged in mechanical or industrial engineering solutions and the technology in the agreement (enclosed at Page 437 of the Paperbook) is of air compressors and hydrogen circulators for fuel cell air management systems. The relevant definition is reproduced below:-

> *"1.1 Licensed Products: Shall mean <u>air compressors and hydrogen circulators,</u> including but not limited to the products identified on Exhibit A hereto. The products covered by the term & quot; Licensed Products & quot; may be updated or modified by mutual written agreement between the parties.*

16. Accordingly, ld. Counsel submitted that since two parties as finally directed by the ld. DRP are for different products wherein technical know-how and R & D costs would be significantly

different than the products manufactured by ASB India and therefore, same cannot be compared in the facts of the assessee's case. Thus, accordingly, he submitted that the only appropriate method would be 'other method' as per Rule 10AB.

17. Ld. Counsel has also provided a formula to arrive at arm's length royalty as per 'other method' in the following manner:-

The formula to arrive at the arm's length price of Royalty as per "Other Method" is as under:-

Royalty (Profit of Non-AE segment before royalty) less (Profit reasonably attributable to the functions performed by the Non-AE segment)

The functions performed by the Non-AE segment are manufacturing and sales.

As a benchmark of the manufacturing function, the Assessee proposes that the four comparable companies, identified in the contract manufacturing set for benchmarking the AE segment submitted before the ITAT as additional evidence, ought to be used

As a benchmark of the sales function, the Assessee seeks to rely on the trading set of comparable companies, which the Assessee has filed as additional evidence before this Tribunal.

Particulars		***OP/OR***
Royalty Rate as per the Technical License Agreement		*12.00%*
*Royalty as a percentage of Non-AE segment sales**	*A*	*10.85%*
Non-AE segment profit (after royalty,	*B*	*15.85%*

as per segmental res		
Profit before royalty	*C = A + B*	*26.70%*
Profit reasonably attributable to manufacturing	*D*	*5.46%*
Profit reasonably attributable to sales	*E*	*5.38%*
Profit attributable to Non-AE segment	*F = D + E*	*10.84%*
Royalty attributable	*G = C-F*	*15.86%*

**Non AE Sales includes sales of parts on which royally i.s not paid as per Section 3 of TLA*

18. On the other hand, ld. DR strongly relied upon observation made by the ld.DRP and submitted that the manner in which assessee is trying to compare the profit of non-AE segment while making the analysis with the AE transaction is completely fallacious, because it is very difficult to hold that the extra profit is on account of royalty when location of the costs is not discernable in absence of any segmental data. Otherwise also, the ld. DRP rightly upheld CUP to the MAM, accordingly, the direction given by the ld. DRP should be upheld.

19. After considering the aforesaid submissions and facts and the material brought on record, the main controversy before us is, whether on the facts and circumstances, CUP is the most appropriate method for benchmarking the royalty payment made by the assessee to its AE; Or “Other Method” can be treated as

MAM on the facts of the present case. Undoubtedly, CUP method is based on comparing the price of uncontrolled transactions which requires high degree of comparability and availability of comparables with similar products and market and agreements. It has been stated at length before us that, the intangibles involved in the transactions are very unique and therefore, it was for this reason it was very difficult to find a suitable comparable even under the Royalty STAT and this is the reason why both ld. TPO and ld. DRP found it difficult to find a suitable comparable. Even the two comparables which have been selected by the ld. DRP, i.e., Optikos Corporation and DynEco Corporation as noted above, are entirely different from the agreement of the assessee with its AE. The technical knowhow and R & D cost would be different than the products which are subject to comparability under CUP. In a scenario where it is difficult to identify the comparables under CUP method and the search in Royalty STAT data has not thrown appropriate comparables and looking to the unique and valuable intangibles which has been licensed to the assessee, we are unable to uphold that the CUP could be the most appropriate method in the case of the assessee.

20. In so far as other methods are concerned, i.e. RPM, CPM and PSM, the same are ostensibly are not applicable which has been admitted by both the parties. Even the TNMM also as agreed by both the parties under these facts are also not applicable because TNMM is one sided method which makes it difficult to apply in the cases where royalty transactions have

been benchmarked wherein there is a transfer of valuable intangibles and therefore, TNMM would not give accurate results.

21. The 'other method' as per Rule 10B reads as under:-

> **10AB.** *For the purposes of clause (*f*) of sub-section (1) of section 92C, the other method for determination of the arm's length price in relation to an international transaction* **[***or a specified domestic transaction***]** *shall be any method which takes into account the price which has been charged or paid, or would have been charged or paid, for the same or similar uncontrolled transaction, with or between non-associated enterprises, under similar circumstances, considering all the relevant facts.***]**

Thus, 'other method' takes into account the price which has been charged or paid, or would have been charged or paid, for the same or similar uncontrolled transaction, with or between non-associated enterprises, under similar circumstances. Even the OCED Guidelines prescribe the use of 'other method' in cases where the complexities of businesses make it difficult for application of the traditional methods. Further, at various instances the OECD Guidelines have encouraged the use of other methods, especially in the cases of hard-to-value intangibles. Paras 6.136 and 6.139 of the OECD Guidelines 2017 state that in cases of intangibles, where obtaining the comparables becomes difficult and the intangibles are unique and valuable in nature then the usual methods will not be able to provide reliable ALP.

22. Thus, the OECD Guidelines have also strongly encouraged use of an alternative method in involving transfer of intangibles where there arise practical difficulties in application of traditional methods. Thus on facts of the present case, when there is no comparable available that will be a perfect fit for valuing the intangibles licensed by ASD Japan, it will be preferable to adopt "Other method" as MAM to benchmark the price for paid for Royalty. This exercise also becomes relevant when all the comparables provided by the assessee has been rejected by the lower authorities and their inability to find any other comparable. Another reason for no comparables is the nature and characteristics of the intangibles itself which are unique and hard to value.

23. It is also relevant to mention here another qualitative aspect relating to the application of the 'other method' in the present case. The 'other method' reflects commercial pricing in the way it actually is determined after due negotiations between parties. In other words, the 'other method' as is explained above suitably builds upon the perspectives of parties which transact with each other and determine pricing in an uncontrolled, unrelated manner. This party perspective is visible in the approach explained above since the pricing method identifies various functions performed by parties and settles the transaction price accordingly. The party perspective also appreciates the fact that the AE segment of the Assessee only carries out contract

manufacturing and that the principal, i.e., ASB Japan, being the owner of intangibles, would command a considerable amount of royalty given that the business is critically dependent on research and development and the quality of intangibles, which is entirely the responsibility of ASB Japan. Compared to other methods such as CUP and TNMM, the 'other method' is more suitable, because the former methods do not factor in this party perspective and carry out a crude comparison with other companies without adjusting such comparison to the needs of the parties involved in the business group and transactions.

24. The 'other method' is also relevant because it is price-oriented. The 'other method' builds upon the price that would have been paid in an uncontrolled scenario. This is because the this method, as explained above, directly involves percentages of segmental profits and arrives at the arm's length percentage of royalty given that the TLA also stipulates 'royalty' to be paid as a percentage of sales, the other method is directly applicable. This price-oriented approach is recognised by Rule 10AB as well which states that the other method can be any method which takes into account the price which has been charged or paid, or would have been charged or paid, for the same or similar uncontrolled transaction, with or between non-associated enterprises, under similar circumstances, considering all the relevant facts. Thus, this price-orientation also supports the selection of the other method as the MAM for the Assessee.

25. Thus cconsidering the above facts and circumstances, the method of the aassessee can be pigeonholed in the 'other method' provided in Rule 10AB r.w.s. 92C (1) and in our opinion this is the MAM in the peculiar facts of the Assessee. Accordingly, we hold that 'other method' would be a good substitute for CUP as there is lack of reliable comparables and looking to the fact that the royalty payments have been made for unique intangibles, therefore, we direct the ld. TPO to adopt 'other method' as the Most Appropriate Method. However, the working given by the assessee before us as incorporated above needs to be examined afresh by identifying the costs and profits attributable to manufacture and sales to the non-AE and to find out appropriate allocation of the costs and what could be the profits on account of royalty which can be stated to be attributable on account of royalty. The assessee is directed to substitute the working on the basis of 'other method'. With this direction, all the grounds raised by the assessee are allowed for statistical purposes.

26. In the result, appeal of the assessee is allowed for statistical purposes.

Order pronounced on 19th April 2023

Sd/-	**Sd/-**
(G.S. PANNU)	**(AMIT SHUKLA)**
PRESIDENT	**JUDICIAL MEMBER**

Mumbai; Dated 19/04/2023
KARUNA, *sr.ps*

Copy of the Order forwarded to :

1. The Appellant
2. The Respondent.
3. CIT
4. DR, ITAT, Mumbai
5. Guard file.

//True Copy//

BY ORDER,

(Asstt. Registrar)
ITAT, Mumbai