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Transfer Pricing
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Technical fee and brand payments - direct nexus with business; AMP is not an international transaction

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In this issue:

Executive Summary

The Hon'ble Income Tax Appellate Tribunal (the Tribunal), Delhi bench pronounced a ruling on April 29, 2016 in the case of Goodyear India Limited (Goodyear India, company, taxpayer) wherein the Tribunal acknowledged direct nexus between the manufacturing activities of the taxpayer and the payment of trademark fee, and thus ruled that arm's length price can be determined for such payment under aggregation approach at the entity level for manufacturing activities. Tribunal also held that if an international transaction was not undertaken in the preceding year, it would not mean that the same cannot be undertaken subsequently under sound commercial reason.

While adjudication on the AMP expenditure, the Tribunal held that there is no arrangement of brand building between the taxpayer and its AE and so, that does not constitute an international transaction.

Facts

- The taxpayer, a subsidiary of Goodyear Tyre and Rubber Company (Goodyear USA), is engaged in the manufacturing and trading of tyres for passenger cars and commercial vehicles. It supplies tyres to third parties in India and caters to replacement market as well as export market. .
- During the year, the taxpayer made payment of trade mark fee as per the Trademark License Agreement entered into with the Goodyear, USA. As per this agreement, the taxpayer was granted a right to use the name "Goodyear" in its company name, and to use the licensed trademarks in respect of all the products, services, advertising and promotional materials dealt in by the taxpayer for a trademark fee calculated at one per cent of the (net) domestic sales and 2 per cent of the (net) export sales of its manufactured products.
- For the purpose of benchmarking, the payment of trademark fee was aggregated with the other international related party transactions under the manufacturing segment under TNMM with OP/Sales as the Profit Level Indicator (PLI).

- During assessment proceedings, the TPO held the arm's length price of the trademark fees as "nil". The TPO further held that the taxpayer had, through its marketing efforts, created marketing intangible for its AE since "Goodyear" was a weak brand. Based on this premise, it held that instead of making payment for trademark fee, the taxpayer should have received compensation from its AE, equivalent to the trademark fee payable by the taxpayer. The Dispute Resolution Panel (DRP) confirmed the TP adjustment made by the TPO.
- Consequently, the taxpayer filed an appeal before the Tribunal.

Issues before the Tribunal

- Whether the arm's length price of the technical fee paid by the taxpayer should be considered as Nil?
- Whether AMP expenditure should be considered as an international transaction?

Observations & Ruling of the Tribunal

ALP determination through aggregation under TNMM

- The Tribunal agreed with the taxpayer's submission that the entire operation of the taxpayer was based on the rights and license to manufacture the automobile tyres and tubes, for which technical fee/ brand royalty was paid. The Tribunal also agreed that the international transactions of the taxpayer primarily related to its business of manufacturing of tyres and such international transactions are closely "*interlinked or inter-twined*". Further, the Tribunal also disagreed with the contention of the Revenue that no recognizable benefit was received by the taxpayer as the " Goodyear" brand was a weak brand.
- Relying on the Hon'ble High Court (HC) decisions in case of Maruti and Lumax[1], the Tribunal held that there was a direct nexus between the revenue earned by the taxpayer and the payment of technical fee and brand royalty made to the AE for using brand name. Therefore, it would not be correct to analyze the transaction of payment

[1] Maruti Suzuki India Limited vs CIT [ITA 110/2014]- Delhi HC; Honda Siel Power Products vs DCIT [ITA 346/2015]- Delhi HC

of royalty in isolation. Accordingly, the Tribunal held the payment of royalty to be arm's length since the operating margin of the Taxpayer in the manufacturing segment was higher than the comparable companies.

ALP determination based on transaction between other group entities

- The Tribunal analysed Rule 10B(1)(a) and held that the international transactions entered into by the taxpayer with its AE cannot be compared with the international related party transaction entered by another AE.

Non-charging of trademark fee by the AE in earlier years

- The Revenue contended that the taxpayer had not made payment of trademark fee in earlier years and the AE had used this device to shift profits out of India since the profit margins of the taxpayer has started rising.
- The Tribunal appreciated the reasoning provided by the taxpayer that the AE was not charging royalty prior to financial year 2006-07 due to (a) the losses incurred by the taxpayer and (b) prior to year 2000, no Indian companies were allowed to pay trademark fees under automatic route. The Tribunal held that if an international transaction was not undertaken in the preceding year, it would not mean that the same cannot be subsequently undertaken.

AMP not an international transaction

- The Tribunal after analysing the terms and conditions of the trademark license agreement and the TP study observed that the same do not lead to an inference on the existence of an arrangement of brand building of " Goodyear" brand. Further, the Tribunal found this issue is squarely covered by the decision of Delhi High Court in the cases of Maruti and Honda Siel Power Products and held that there was absence of any international transaction, relating to incurring AMP expenditure for brand building.

Conclusion

The brand related payments are the important consideration for MNEs. This ruling brings some certainty to the transfer pricing aspects of these payments and discourage tax authorities to disregard such payments abruptly on their conjectures and surmises.

Further, under the licensed manufacturing business arrangements, the manufacturers generally operate as entrepreneurs which are involved in complex operations of manufacture and sale under licensing arrangement with MNEs. These manufacturers are the economic owners of the brand and trademark and garner the benefit of their AMP activities. Therefore, as long as their international transaction are in line with transfer price, the AMP expenditure incurred by them cannot be inferred to have benefitted the AEs.

Source: Goodyear India Limited vs. DCIT (ITA No. 5650/Del/2011, 6240/Del/2012 and 916/Del/2014)

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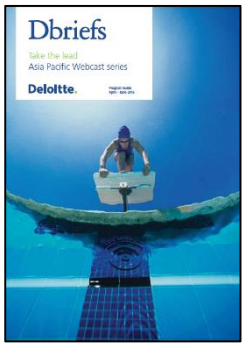

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