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Tax and Transfer Pricing Alert

Insight with information

Brand usage - not an international transaction

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Executive Summary

Income Tax Appellate Tribunal, Chennai Bench (the Tribunal) recently pronounced an important ruling in the case of Hyundai Motor India Limited (HMIL, the taxpayer, the company) on marketing intangibles pertaining to three assessment years (AY) - 2009-10, 2010-11 and 2011-12.

The Tribunal held that the accretion of brand value as a result of brand usage by the tax payer under technology agreement with the foreign Associated Enterprise (AE), is not an international transaction, warranting separate benchmarking. Accordingly, addition arising on the ground that the tax payer carried out brand promotion activity for which it should have been compensated by its holding company, was deleted.

Facts

- The taxpayer is engaged in the business of manufacturing and sale of passenger cars within and outside India. It is a wholly-owned subsidiary of Hyundai Motor Company, Korea (HMC).
- The Transfer Pricing Officer (TPO) during the course of assessment proceedings held that the tax payer was mandated to use the brand name 'Hyundai' in every vehicle manufactured by it as per the technology agreement. This, the TPO argued, resulted in enhancement of the brand value of HMC, the legal owner. The TPO concluded that the tax payer was rendering brand promotion services to the parent company in India for which it was not adequately compensated.
- The TPO proposed an adjustment in the form of a brand fee to be received by HMIL by adopting various techniques for each AY under consideration. Brand fee to be received by HMIL in the first year was determined using the increase in global brand value of 'Hyundai' on the basis of brand valuation report published by a consulting firm, 'Interbrand'. For the following years, statistical methods were adopted to establish the correlation between market capitalization and the brand value of Hyundai.
- DRP upheld TPO's analysis and confirmed the brand fee adjustment proposed by the TPO.
- Aggrieved by the orders of lower authorities, the company filed an appeal before the Tribunal.

Issue before the Tribunal

Whether the usage of foreign Associated Enterprise (AE) brand name on the cars manufactured and sold by the tax payer amounted to rendering of brand promotion service, and whether it constituted an international transaction under section 92B of the Income-tax Act, 1961(Act).

Observations & Ruling of the Tribunal

- The Tribunal's ruling analysed whether the benefit accruing to HMC, Korea as a result of increased brand value due to the sale of Hyundai cars by HMIL is an international transaction as per Section 92B of the Act.
- The Tribunal held that accretion of brand value through advertising, marketing and promotion is a conscious effort, but brand building by increased sales is a subliminal exercise and a by-product of economic activity of selling the products in the Indian market.
- Accretion of brand value was analyzed by the Tribunal on two aspects - nature of arrangement using the brand name by the tax payer, and the scope of the definition of international transaction as per Section 92B of the Act. The Tribunal indicated that usage of brand name on the vehicles manufactured by the tax payer is a privilege, a marketing compulsion and amounts to direct and substantial benefits to the tax payer due to the credibility and reputation of the brand name.
- An important industry phenomenon which was acknowledged by the Tribunal was that it is common commercial practice to have the foreign entity's brand name as mandatory, as it is essential in the technology agreement to protect the intellectual property owned by the foreign parent.
- The ruling also mentioned that there can never be a comparable uncontrolled price for such a transaction as in these circumstances the entities entering into the transactions will become AEs as per the deeming provisions of Section 92A(2)(g) of the Act.
- The accretion of brand value was also analyzed by the Tribunal in terms of the provisions of Section 92B of the Act by examining each and every part of the definition. It was established that though the scope of definition includes intangibles, the issue under consideration did not deal with purchase or sale or lease of intangibles, and hence the same was not covered.
- The Tribunal also held that the technology agreement was examined by the TPO and the arm's length nature of consideration flowing out of the said agreement was not contested by the TPO. Therefore the arrangement as per the technology agreement, which permits the tax payer to use to the brand name, was held to be at arm's length, and a separate benchmarking was not warranted.
- The Tribunal further ruled that even though the international transaction definition includes a clause for "provision of services", mere accretion of brand value as a result of using the brand name of the foreign parent cannot be construed as a service; on the contrary, it is a privilege provided to the tax payer. Further, an incidental benefit accruing to an AE cannot be benchmarked unless it is owing to a specific service rendered by the tax payer.
- Lastly, the Tribunal demonstrated that the accretion in brand value is not covered by the residuary clause of the definition as it is not on account of costs incurred by the tax payer and does not result in impact on income, expenses, losses, assets of the tax payer.

Conclusion

The above ruling is one of the significant rulings on a highly litigated issue - marketing intangible. Transfer pricing aspects of marketing intangibles have gained prominence over recent years and there have been several court rulings on the subject.

Most of the earlier rulings have primarily focused on excess advertising, marketing and promotion expenses incurred by the tax payer. The present ruling has highlighted a different side of the subject and dealt in detail brand building activity and related attribution. The ruling negates tax department's basic argument of notional brand fee income to be received by the tax payer for building the brand of the foreign entity in India. The ruling also presents an in-depth analysis of the definition of international transaction under Section 92B of the Act, and held that notional income - brand fees - is not covered under the said definition.

Source: Hyundai Motor India Limited (I.T.A. No. 739 and 853/Chny/2014, 563 and 614/Chny/2015, 842 and 761/Chny/16 and CO 73/Chny/16 Assessment years: 2009-10, 2010-11 and 2011-12)

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