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IN THE HIGH COURT OF DELHI AT NEW DELHI

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ITA 137/2014

COMMISSIONER OF INCOME TAX

..... Appellant

Through: Mr G.C. Srivastava, Mr Daksh S.

Bhardwaj, Mr Akash Vajpai and Mr Rohit Madan,
Advocates.

versus

CANON INDIA PRIVATE LIMITED

..... Respondent

Through: Mr Mukesh Butani, Mr Vishal Kalra, Mr
Gaurav Gupta and Mr S.S. Tomar, Advocates.

AND

16.

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ITA 138/2014

COMMISSIONER OF INCOME TAX

..... Appellant

Through: Mr Rohit Madan and Mr Akash Vajpai,
Advocates.

versus

CANON INDIA PRIVATE LIMITED

..... Respondent

Through: Mr Mukesh Butani, Mr Vishal Kalra, Mr
Gaurav Gupta and Mr S.S. Tomar, Advocates.

CORAM:

HON'BLE DR. JUSTICE S. MURALIDHAR

HON'BLE MR. JUSTICE VIBHU BAKHRU

ORDER

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03.08.2015

Vibhu Bakhru J.

1. The present Appeals are filed by the Revenue against a common order dated 3rd May, 2013 passed by the Income Tax Appellate Tribunal (hereafter 'Tribunal') in respect of ITA Nos. 4602/Del/2010, 5593/Del/2011 and 6086/Del/2012; these appeals were filed by the Assessee challenging the orders of the Dispute Resolution Panel (DRP) passed under Section 143(3)/144C of the Income Tax Act, 1961(hereafter 'The Act') in respect of Assessment Years (hereafter 'AY's') 2006-07, 2007-08 and 2008-09 respectively.

2. The Assessee is a wholly owned subsidiary of M/s Canon Singapore Pvt. Ltd. (hereafter 'CSPL'). The Assessee started its operations in India in 1996. During the course of its business, the Assessee entered into various agreements/transactions with the Canon Group of Companies. These transactions pertained to purchase and resale of Canon products such as photocopiers, printers, scanners and cameras in India. The Assessee is also engaged in software development and as a part of its business, exports software and provides software related services to other Canon Group of Companies.

3. The Assessee filed its return of income for the AYs in question and disclosed the transactions with its Associated Enterprises (hereafter the 'AEs'). The Assessing Officer (hereafter 'AO') made a reference under Section 92CA of the Act to the Transfer Pricing Officer (hereafter 'TPO') for determination of Arm's Length Price (hereafter 'ALP') in respect of various transactions entered into by the Assessee during the relevant AYs.

4. On 28th September, 2010 and 17th October, 2011 the TPO completed the transfer pricing reports for the AYs 2007-08 & 2008-09 respectively. The TPO found that the reported international transactions entered into by the Assessee with its AE's were at arm's length. However, the TPO found that the Assessee had incurred Advertisement, Marketing and Promotional (hereafter 'AMP') expenditure, which was much in excess of the expenditure incurred by other comparable entities. On the aforesaid basis, the TPO concluded that the part of the AMP expenditure was incurred by the Assessee on building/promoting the brand 'Canon' and the corresponding benefit of such excess expenditure had been passed on to the Assessee's holding company - CSPL. The TPO, accordingly, made transfer pricing adjustments ('TP adjustments') and directed the AO to add Rs. 33,25,04,380/- and Rs. 52,19,78,244/- to the taxable income of the Assessee for the AY's 2007-08 and 2008-09 respectively.

5. On the basis of the TPO's report, the AO issued draft Assessment Orders dated 10th December, 2010 and 28th December, 2011 for AYs 2007-08 and 2008-09 respectively. These were objected to by the Assessee before the DRP. However, the Assessee was unsuccessful and the TP adjustments made on account of AMP expenditure were upheld by the DRP. Resultantly, the AO passed the final assessment orders dated 25th October, 2011 and 29th October, 2012 for AYs 2007-08 and 2008-09 respectively, making the additions as directed by the DRP.

6. In addition to the above, the AO also added Rs.7,62,58,434/- which was unutilised subsidy, to the total income of the Assessee for the AY 2007-08. Similarly, the AO added a sum of Rs.10,51,00,000/- to the total income of the

Assessee for the AY 2008-09 which reflected unutilised subsidy received by the Assessee from its holding company - CSPL. The AO observed that the subsidies received by the Assessee became its property notwithstanding that the same had not been spent for the purposes for which they were received. And, on the aforesaid basis, the AO held that the subsidies received by the Assessee were required to be treated as its income for the relevant previous year.

7. The aforementioned final orders passed by the AO were assailed by the Assessee before the Tribunal. Insofar as the TP adjustments on account of AMP expenditure are concerned, the Tribunal held that the following receipt/expenses were to be excluded from the scope of AMP expenditure:

- (i) Subsidy;
- (ii) Trade discount in volume rebate;
- (iii) Cash discount;
- (iv) Commission.

8. The Tribunal further held that unspent subsidy was not the income of the Assessee but was held in trust by the Assessee, to be spent for the specific purposes for which it had been remitted by CSPL. Both, the Revenue and the Assessee, challenged the order of the Tribunal in respect of the AY 2006-07 in this court by filing ITA No. 132/2014 and ITA 521/2013 respectively. These appeals were considered by a Division Bench of this Court in ***Sony Ericsson Mobile Communications India Pvt. Ltd. v. Commissioner of Income Tax: (2015) 374 ITR 118 (Delhi)*** and the said appeals were disposed of by

remanding the matter to the Tribunal for a *de novo* consideration in accordance with the principles of law as enunciated in the said decision.

9. Mr. Srivastava, learned counsel for the Revenue submitted that the said decision in ***Sony Ericsson Mobile Communication India Pvt. Ltd.*** (*supra*) would also cover the present appeals in almost all the aspects. However, according to him, two issues still remained for consideration, viz., the issue relating to exclusion of subsidy from AMP expenditure and the issue as to the character of the unutilised subsidy. He referred to questions (A) & (C) proposed by the Revenue which read as under:

- “A. Whether the Hon’ble ITAT was correct in law and in facts in directing exclusion of the expenses in the nature of (i) Subsidy; (ii) Trade discount and volume rebate; (iii) Cash discount & (iv) Commission from the ambit of the AMP expenditure following the decision of the ***ITAT, Chandigarh Bench, in the matter of M/s Glaxo Smithkline Healthcare Limited***, while the nature of expenses adjudicated by ***ITAT, Chandigarh Bench, in the matter of M/s Glaxo Smithkline Healthcare Limited*** (*supra*) were completely different and dealt with (i) Discount Sales; (ii) Market Research; (iii) Sales Promotion; (iv) Selling and Distribution and (v) Service Charge(s) paid to Selling Agent(s);
- C. Whether the character of the subsidy has to be determined w.r.t. the purpose for which the subsidy is given and therefore, the total subsidy received by Canon India from Canon Singapore was liable to be treated as Revenue Receipt and therefore the unutilized portion of the subsidy in the hands of Respondent/Canon India was liable to be added back to the income of the Respondent/Assessee;”

10. Mr. Srivastava submitted that question (A), to the extent that it relates to subsidy, and question (C) would require consideration. Mr. Srivastava submitted that although the quantum of subsidy received would have to be considered at the time of making TP adjustments but the same could not be reduced from the AMP expenditure at the threshold to arrive at the net expenditure on AMP for considering whether the same were at ALP and determining the consequent TP adjustment, if any. He submitted that the entire AMP expenditure incurred by the Assessee would have to be considered in determining whether the same required any TP adjustments. Mr. Srivastava did not dispute that while making such adjustments the quantum of subsidy received by the Assessee would have to be considered. However, he urged that the subsidy received could not be reduced from the expenditure at the threshold.

11. Mr. Srivastava further submitted that the Tribunal had erred in not treating the unutilised subsidy as income of the Assessee.

12. Countering the arguments advanced on behalf of the Revenue, Mr. Mukesh Butani, learned counsel appearing for the Assessee submitted that subsidy was received by the Assessee for meeting specific advertisement and sales promotion expenditure and the Assessee was obliged to utilise the amount of subsidy for the specified purposes. In the circumstances, the unutilised subsidy could not be treated as income in the hands of the Assessee.

13. Insofar as the issue of deducting the subsidy received from the AMP expense is concerned, Mr. Butani submitted that the said issue had been

conclusively decided in favour of the Assessee by the decision of the Tribunal's Special Bench in the case of ***LG Electronics Private Limited 2013 (24) ITR (Trib.) 634 (Del)***. He referred to paragraph 4.2.2 of the impugned order passed by the Tribunal and submitted that the Tribunal had recorded that the AO had the duty to exclude the amount of subsidy received for meeting AMP expenses at the threshold itself, that is, before commencing the exercise of benchmarking the AMP expenditure. He further submitted that the aforesaid aspect had not been contested by the Revenue before the Tribunal and has been raised for the first time in oral submissions before this Court. He pointed out that the said issue also did not find any specific mention in the petition. Mr. Butani submitted that in the circumstances, it was not open for the Revenue to raise the dispute regarding the stage of exclusion of subsidy in the present proceeding.

14. We have heard the learned counsel for the parties.

15. In the first instance, let us consider the controversy with regard to the treatment of subsidy. The Assessee had stated before the Tribunal that it had received sum of Rs. 27,10,87,594/- and Rs. 50,16,13,022/- from CSPL during the years relevant to AYs 2007-08 and 2008-09 respectively. It was pleaded by the Assessee that these subsidies were received for meeting specific advertisements and sales promotion expenditure that had been pre-approved by CSPL. During the period of the previous year ending 31st December 2007, the Assessee had utilised a sum of Rs.19,48,29,160/- for advertisements and sales promotion activities and this amount had been directly reduced from the

relevant expenditure. The balance amount of Rs.7,62,58,434/- remaining after incurring the expenditure was reflected as “Current Liabilities” by the Assessee in its books. Out of the said sum, a further amount of Rs.39,161,177/- was utilised towards advertisements during the period from January to March 2007 and this amount had been directly debited to “Current Liabilities”. According to the Assessee, the remaining amount of Rs. 37,097,257/- continued to be reflected as “Current Liabilities” in its books as on 31st March, 2007. In the subsequent year i.e. the Previous Year relevant to the AY 2008-09, the Assessee received an amount of Rs. 50,16,13,022/-, which was directly credited to the account under the head “Current Liabilities”. All expenditure incurred against the aforesaid subsidy was directly debited to the said account. The unutilised part of the total subsidy as on 31st March, 2008 amounted to Rs.10,54,11,660/-, which continued to be reflected as Current Liabilities. The Assessee further pleaded that there were some inadvertent discrepancies in the amount of unutilised subsidy as recorded in the Assessment Order.

16. The procedure for receipt/reimbursement of subsidies against expenditure, as explained by the Assessee, was recorded in the order of the Tribunal as under:

- “(a) Initially the assessee forwards a proposal to CSPL for reimbursement of expenditure to be incurred for specific purpose (eg display charges of neon sign fabrication charges of neon sign, advertisement in news papers etc.)
- (b) Once the same is approved by CSPL, the assessee prepares debit notes from time to time for receiving the advance payment. this debit note contains the details of the particular relevant expenditure to be incurred.

(c) Thereafter, CSPL remits the advance in lump sum with a specific direction that such money is to be spent only for the specified purposes and any amount of subsidy remaining unspent/unutilized shall be held by the assessee in trust for and on behalf of CSPL and the same shall not be utilized by the assessee for any other purpose.”

17. It is not disputed by the Revenue that subsidies were received by the Assessee from CSPL against specific obligation to incur expenditure on specific activities and it was not open for the Assessee to divert the amount for any purpose other than for which it was remitted. It is also not disputed by the Revenue that Assessee is accountable to CSPL for the amount received. The Tribunal had examined the relevant facts and also concluded that the unspent amount is to be held in trust on behalf of CSPL and this was also confirmed by CSPL.

18. In view of the aforesaid facts, it would, clearly, be impermissible for the Assessee to appropriate and reflect the amount of unutilised subsidy as its income. Therefore, the Assessee has not – in our view rightly so – credited the subsidies received to its Profit & Loss Account, but reflected the same as a current liability.

19. In view of the Assessee’s obligation to utilise the same for the specific purposes, the revenue could be recognised only on the application of the subsidy for the specified purposes. In other words, the Assessee could credit the Profit & Loss Account with the quantum of subsidy only if the

corresponding expenditure was also debited to the Profit and Loss Account maintained by the Assessee.

20. We are, therefore, unable to accept the Revenue's contention that the unutilised subsidy is required to be recognised as income of the Assessee in the year of its receipt. This would be contrary to the matching concept, which is the substratal principle for computing income during a relevant period. It is necessary that income be recognised along with the corresponding expenditure incurred for earning the income. Thus, where an Assessee follows the Accrual/Mercantile system of Accounting – as in this case – income can be recognised only when the matching expenditure is also accounted for irrespective of the cash outflows/inflows during the year. It would thus, not be correct to recognise the subsidies received for incurring specific expenditure as income without accounting for the corresponding expenditure.

21. In the circumstances, we find no infirmity with the Tribunal's view on this issue. Question (C) as raised by the Revenue must, therefore, be answered in the negative; that is, in favour of the Assessee and against the Revenue.

22. The next question to be considered is with respect to the issue whether subsidy received by the Assessee has to be excluded from AMP expenditure at the threshold before making any TP adjustments. In our view, the said question would be inextricably linked with the manner in which ALP of the relevant international transaction is determined. This court has remanded the issue as to the determination of ALP to the Tribunal in terms of the decision of this Court in *Sony Ericsson Mobile Communications India Pvt. Ltd. (supra)*. In our

view, it would be premature to consider this issue in isolation and without reference to the determinative exercise to be conducted by the Tribunal or the concerned Income Tax Authority. The question whether subsidy has to be reduced from the AMP expenditure incurred by the Assessee at the threshold or by way of a later adjustment would depend on various factors including the comparables selected for the purposes of determining the ALP as also the methodology adopted. Needless to mention, it would be open for the Revenue as well as the Assessee to take all available contentions with respect to this aspect before the concerned authority.

23. The appeals are disposed of with the aforesaid observations.

VIBHU BAKHRU, J

S. MURALIDHAR, J

AUGUST 03, 2015

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