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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

+ ITA 708/2016

GRUNER INDIA PRIVATE LIMITED Appellant
Through: Ms. Prem Lata Bansal, Sr. Adv. with Mr.
Paras Chaudhary, Adv.

versus

DIRECTOR OF INCOME TAX
(TRANSFAR PRICING)-1 Respondent
Through: Mr. Dileep Shivpuri, Mr. Sanjay Kumar
and Mr. Vikrant A. Maheshwari, Advs.

CORAM:

HON'BLE MR. JUSTICE S. RAVINDRA BHAT

HON'BLE MR. JUSTICE NAJMI WAZIRI

ORDER

% **20.12.2016**

1. Issue notice.
2. Mr. Dileep Shivpuri accepts notice for the respondent. With consent, the appeal is taken up for disposal.
3. The question of law sought to be urged in this appeal by the assessee is: whether the Income Tax Appellate Tribunal (in short the Tribunal) was right in holding that segregation of the transaction including *inter alia* royalty and fee for technical services, was not permissible in the circumstances of the case.
4. The facts necessary for disposal of this appeal, having regard to the final order that this Court proposes to pass, are that the assessee entered into an arrangement with the Gruner AG towards licensing of its brand and also for supply of technical know-how. These were

evidenced by two agreements dated 06.03.2009 and 25.06.2009. The first agreement was a trademark and technical know-how licensing arrangement which required the assessee to pay a fixed percentage i.e. 8% of the net ex-factory sale price exclusive of excise and other duties, in accordance with the formulae agreed upon by the parties. The second agreement dated 25.06.2009 was for the purposes of providing “High Technical Support” on a continuous monitoring basis. In terms of the latter agreement the assessee agreed to the posting of foreign company’s personnel in its unit; their principal/ employer cost to be reimbursed on the basis of a calculation agreed upon in terms of the contract.

5. The consideration was reimbursable on man-hour basis. In the concerned Assessment Year (AY) i.e. AY 2011-12 the assessee’s Transfer Pricing (TP) Report was considered and the two transactions, which were aggregated were considered, and the TPO decided to desegregate the technical support arrangement and the amounts remitted thereunder and applied the Comparable Uncontrolled Price (CUP) method. The assessee’s appeal – to the Dispute Resolution Panel (DRP) and thereafter to the Tribunal, were to no avail. Therefore, this appeal is preferred before this Court under Section 260A of the Income Tax Act 1961(in short the Act).

6. It is urged by Ms. Bansal, the learned senior counsel, that two agreements and the amounts paid thereunder were part of a composite understanding between the parties i.e. the licensor on the one hand and the assessee on the other. It was a commercial compulsion which drove the assessee to accept the terms of this agreement. In the

circumstances, the Revenue's action in desegregating a part or a component of the package and subjecting it to a separate method, to arrive at the ALP i.e. the CUP method was inappropriate. The learned counsel highlighted that so far as the other transactions were concerned, the AO accepted the application of the Transactional Net Margin (TNM) method.

7. Mr. Shivpuri, the learned counsel for the respondent, urged that once the de-segregation is possible, the most appropriate method mandated by law, i.e. Section 92C of the Act along with Rule 10B, is that the separated transactions are to be viewed independently through the most appropriate method and that the corollary, therefore, was the application of the CUP method.

8. So far as the question of aggregation or desegregation, as the case may be concerned, we notice that there can be no strait jacket or inviolable rule in this regard. The recent judgment of this Court in ***Sony Ericsson Mobile Communication India (P) Ltd. vs Commissioner of Income Tax (2015) 374 ITR 118 (Del)*** stated that aggregation of such transaction is permissible and relied upon the OECD Commentary in this regard. At the same time the observations are not in fact determinative or conclusive. The Court was careful to leave the issue open for examination having regard to the facts of each case. In other words, as to whether the assessee's claim that aggregation is essential in a given case is an entirely fact dependent exercise to be viewed having regard to the nature of the transaction and the surrounding circumstances. The assessee contends that the amounts paid under the royalty license and technical support

agreements had to be viewed along with all other expenses and, therefore, aggregated. The Revenue's contention, however, is to the contrary.

9. Recently in the judgment of this Court in ***Magneti Marelli Powertrain India Pvt. Ltd. vs Deputy Commissioner of Income Tax (2016) 290 CTR (Del) 60***, this Court had observed after noticing the judgment in ***Sony Ericsson*** (supra) as well as in the ***Commissioner of Income Tax vs. EKL Appliances Ltd. (2012) 345 ITR 241 (Del)***, and observed as follows:

“.....14. The assessee/appellant during 2008-09 entered into four License & Technology Assistance Agreements (LTAAAs) with its overseas AE for four products for obtaining ECU technology. In return for the technical know-how, the assessee agreed to compensate the AE through a fee amounting to US \$ 2 million for each LTAA (total US\$ 8 million equivalent to over ₹ 38 crores) on installment basis. It explained that the overseas AE provides crucial and pivotal support to the assessee in carrying out its business in India by providing access to patented products and technology developed by it. The assessee argued that without receiving such technology/technical know-how/ information/assistance from the overseas AE, the assessee would not be able to conduct/carry out manufacturing and sales of ECUs in India at all. The assessee strengthened this contention by saying that it earned revenue of ₹ 42.23 crores from the sale of ECUs using the above mentioned technical know-how as a result of payment of ₹ 38.59 crores during FY 2008-09. Further, the assessee also earned aggregate revenue of ₹ 174.89 crores during a period of 3 consecutive years (i.e. FY 2008-09, FY 2009-10 and FY 2010-11) against a total payment of US \$ 8,000,000, equivalent to ₹ 38.59 crores paid in FY 2008-09. During

the transfer price proceedings, the assessee was unable to substantiate the need for payment of technical assistance fees to its foreign AE. The TPO has observed that the assessee tried to establish its case for the arm's length nature of the transaction by stating that it gained in the form of higher sales. The TPO observed that neither any cost benefit analysis nor any benchmarking exercise was undertaken at the time of entering into the agreement. The TPOs rejection of the TNMM method at entity level was undoubtedly not correct. That, however, would not conclude the issue.

15. The assessee's argument that the technology itself would not have been given to it, but for the substantial fee (paid over and above the royalty payable), in the opinion of this court, requires a closer scrutiny. The initial burden is always upon the assessee to prove that the international transaction was at Arm's Length. Its TP report necessarily had to draw a comparison with other entities (maybe competitors) to show the general degree of profitability of the venture in question. The lower authorities quite correctly turned down the method of explaining the justification of the technical fee-with "proof" of its necessity by relying on profits. Undoubtedly the assessee was obliged to make the payment and that obligation arose from the agreements, a pre-incorporation binding contract. However, that such contractual obligation existed cannot ipso facto be the end of the enquiry. ALP determination in respect of every payment that is part of an international transaction is to be conducted irrespective of such obligation undertaken by the parties. If the transactions are, in the opinion of the TPO, not at arm's length, the required adjustment has to be made, as provided in the Act, irrespective of the fact that the expenditure is allowable under other provisions of the Act. There can conceivably be various reasons not to subject such payments, such as for instance, if no similar data exists at all; or that sectional data for such payments is absent. Quite possibly, this may also be a general

pattern of expenditure which AEs may insist to part with technology; further, similarly, other models of payment-deferred or lumpsum, along with royalty or inclusive of it, may be discerned in comparable transactions. However, to say that such a substantial amount had to necessarily be paid and that it was a commercial decision, dictated by need for the technology, in the light of a specific query, it could not be said by the assessee that later profits justified it, or that has essentiality precluded the scrutiny.

16. In the light of the above discussion, this court holds that the explanation by the assessee that the payment of ₹ 38.58 crores in the circumstances was correctly not accepted. The first question is answered against the assessee. The remit directed by the impugned order is, therefore, upheld.

10. In the light of the above discussion, it is held that the entire issue as to whether aggregation is warranted in the circumstances, should be gone into afresh in view of the law declared in **Sony Ericsson** (supra) and clarified in **Magneti Marelli** (supra) above.

11. As far as the issue of most appropriate method is concerned, this Court is of the opinion that no definitive ruling ought to be given at this stage. As to whether in the event of de-segregation the CUP method is the most appropriate rather than TNM method should in our opinion be left open for consideration depending on the determination of the issue of aggregation/ de-segregation itself. In other words, that whether in the event of de-segregation, which would be the appropriate method, should be left to the TPO to decide, after hearing counsel for the parties. However, we clarify that in the event it is held that aggregation is permissible in the facts of this case, the findings of the Revenue authorities and the Tribunal that the TNMM

method was warranted, would not be disturbed.

12. In the light of the above findings, the appeal is partly allowed. The matter is remitted for re-consideration by the concerned TPO, who shall hear counsel for the parties and render findings on both aspects.

S. RAVINDRA BHAT, J

NAJMI WAZIRI, J

DECEMBER 20, 2016^{/kk}