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

+ **ITA 923/2015**

COMMISSIONER OF INCOME TAX-IV Appellant
Through Mr. Raghvendra Singh, Advocate

versus

HERO MOTOCORP LIMITED. Respondent
Through Mr. Ajay Vohra, Sr. Advocate with
Ms. Kavita Jha and Ms. Rupali Gupta,
Advocates

CORAM:
JUSTICE S. MURALIDHAR
JUSTICE ANIL KUMAR CHAWLA

ORDER
% **08.05.2017**

Dr. S. Muralidhar, J.:

1. This is an appeal by the Revenue under Section 260A of the Income Tax Act, 1961 ('Act') directed against the order dated 23rd November, 2012 passed by the Income Tax Appellate Tribunal ('ITAT') in ITA No. 5130/Del/2010 for the Assessment Year ('AY') 2006-07.

2. By its order dated 14th January, 2016, the Court issued notice confined to the following question (which incidentally was the fourth of the five questions urged by the Revenue):

"Whether on the facts and circumstances, the ITAT was correct in law in holding that by export of specified models to specified countries, the Assessee company had benefited and therefore by deleting addition of Rs. 12.19 crores made by AO on account of

export commission without appreciating the fact that the Assessee has to export motorcycles to underdeveloped countries in very restrictive environment and on such terms and conditions which were detrimental to the Assessee and were for the benefit of the subsidiaries of the AE."

Background facts

3. The background facts relevant to the question projected are that the Assessee is engaged in the business of manufacture and sale of motorcycles using technology licensed by Honda Motor Co.Ltd., Japan ('HMCL'). The Assessee set up its plant in the year 1984 to manufacture models of motorcycles by using know-how of HMCL through a Technical Collaboration Contract dated 24th January, 1984. Under the said agreement, the Assessee was provided with technical assistance not only for manufacture, assembly and service of the products but was also provided with information, drawings and designs for the setting up of the plant. The said agreement expired in 1994.

4. On 2nd June, 1995 a License and Technical Assistance Agreement ('LTAA') was entered into between HMCL and the Assessee on fresh terms for a further period of ten years. By another LTAA dated 2nd June, 2004, the earlier LTAA was extended for an additional period of ten years. By the said LTAA, HMCL (described as Licensor) granted to the Assessee (described as Licensee) an "indivisible, non-transferable and exclusive right and license, without the right to grant sublicenses, to manufacture, assemble, sell and distribute the products and parts" during the term of the LTAA "within the Territory" (defined as India).

5. On 21st June, 2004 a separate Export Agreement ('EA') was entered into between HMCL and the Assessee whereby HMCL accorded consent to the Appellant to export specific models of two wheelers to certain countries on payment of export commission @ 5% of the FOB value of such exports. The Assessee explained that the payment of export commission was made by it to HMCL as consideration for HMCL according consent to the Assessee to export two wheelers in the specified overseas territories, which were earlier being supplied only by HMCL or its other affiliates.

6. Today during the course of submissions, Mr. Raghvendra Singh, learned counsel for the Revenue, submitted that there were two aspects to the payment by the Assessee of export commission of Rs. 12.91 crores to its Associated Enterprise ('AE') i.e., HMCL (at the rate of 5%) during the AY in question. One was to treat it as an international transaction thereby entailing a transfer pricing ('TP') adjustment. The alternative approach of the Revenue was to disallow the payment of export commission under the general provisions of the Act. This was by construing the export commission as royalty which in turn would require the Assessee to deduct tax at source under Section 195 of the Act. The failure to do so would lead to the disallowance under Section 40 (a) (i) of the Act of the entire payment of the export commission as a deduction.

Treatment of export commission as an international transaction

7. As it transpired, the question as projected in the present appeal by the Revenue and on which notice was issued pertained to treating the payment of export commission as an international transaction entailing a TP

adjustment. In this context, it requires to be noted that the Transfer Pricing Officer ('TPO') held that the payment of export commission by the Assessee to its AE i.e., HMCL was unnecessary; that it was detrimental to the Assessee and only with a view to benefitting the AE's units/subsidiaries in those countries to which the Assessee was permitted to export the vehicles. On this basis, the TPO proceeded to hold that the Arm's Length Price ('ALP') of the said transaction i.e., the payment of export commission was nil. He recommended a TP adjustment of the entire sum of Rs. 12.19 crores paid by the Assessee to its AE as export commission during the AY in question. After the DRP concurred with the TPO and the Assessing Officer ('AO') passed the final assessment order on that basis, the Assessee filed an appeal before the ITAT.

8. By the impugned order, the ITAT reversed the above orders of the TPO, the DRP and the assessment order by holding that there was no basis for treating the payment of export commission as an international transaction. The ITAT analysed the clauses of the Agreement dated 21st June, 2004 for the payment of export commission and came to the conclusion that "the allegation of the Revenue that export agreement between the assessee and HMCL was not for the benefit of the assessee and by way of export, instead of the assessee, the subsidiaries of the AEs have been benefited, is factually incorrect." Based on the model-wise figures of export sales placed before it by the Assessee, and which was unable to be controverted by the Revenue, the ITAT held that the Assessee had in fact benefitted from the transaction inasmuch as it had earned a profit of Rs. 13.05 crores through exports. The ITAT factually found that "The export sale rate was more than the domestic

sale rate even after considering the export commission.” Consequently, the ITAT set aside the disallowance by the AO of the payment of export commission by way of a TP adjustment.

Question urged by the Revenue

9. Mr. Raghvendra Singh submitted that the Revenue might not be able to contest the above factual finding as far as treating the payment of export commission as an international transaction entailing a TP adjustment was concerned. However, he urged that this Court should frame a question on the alternative plea of the Revenue viz., that the payment of export commission was in fact payment of royalty which required the Assessee to deduct tax at source and the failure to do so led to disallowance of the deduction under Section 40 (a) (i) of the Act.

10. He further submitted that this question was critical for the companion appeals (i.e. ITA Nos. 312/2015, 538/2015 and 118/2017 – ***CIT-4 v. Honda Siel Power Products Ltd.***) where notice was issued by this Court on this very question. He pointed out that in those cases the ITAT had, in answering the question against the Revenue and in favour of that Assessee, merely followed its decision in the present matter of Hero Motocorp Ltd.

11. Consequently, although the question has in fact not been urged by the Revenue as such in the memorandum of the present appeal, the Court proceeds to examine if any question of law requires to be framed on the issue of treating the payment of export commission as royalty for the purposes of Section 9 (1) (vi) read with Section 40 (a) (i) of the Act.

Submissions on behalf of the Revenue

12. The contention of the Revenue, as articulated before the ITAT and as reiterated before this Court on its behalf by Mr. Raghvendra Singh is that under Explanation 2 below sub-clause (vi) of Section 9 (1) of the Act, 'royalty' means consideration for the purposes specified thereunder in sub-clauses (i) to (vi). The word 'consideration as defined in Section 2 the Indian Contract Act, 1872 would include a payment to do or abstain from doing a particular thing. He pointed out that under the LTAA dated 2nd June, 2004, there was a specific bar (in the form of a negative covenant) that prevented the Assessee from using the know-how to manufacture vehicles for export outside India. Within a few days on 21st June, 2004, a separate EA was entered into permitting export of the vehicles so manufactured to certain countries. The EA was in fact nothing but an extension of the LTAA itself. The preamble clauses of the EA expressly referred to the LTAA and also described the parties thereto as the Licensor and the Licensee. It is submitted that the consideration for the negative covenant under the LTAA i.e., abstaining from exporting the product outside India was monetised in the EA in the form of the export commission and was therefore a payment of royalty.

13. Mr. Singh submitted that in the absence of any principal-agent relationship between HMCL and the Assessee in terms of the EA, the payment of export commission thereunder was without consideration. It was nothing but a payment of royalty for the use of the know-how to manufacture vehicles for export to the countries specified. If at all any payment had to be made, it had to be to the subsidiaries of the AE who were

selling vehicles in those territories. The EA was nothing but a device to enable the AE to avoid paying taxes on the income earned as a result of the use by the Assessee of the know-how. The actual royalty paid had to include the payments both under the LTAA and the EA i.e., inclusive of the component of the export commission. He placed reliance on the decision of this Court in ***Commissioner of Income Tax v. Shiv Raj Gupta (2015) 372 ITR 337 (Del)***. He pointed out that the reliance placed by the ITAT on the decision of the Authority for Advance Ruling in the case of ***SPAHI Project P. Ltd. v. CIT-Central-III (2009) 315 ITR 374 (AAR)*** was misplaced as it was distinguishable on facts.

Submissions on behalf of the Assessee

14. Mr. Ajay Vohra, learned Senior counsel for the Assessee contested the above submissions. He referred in detail to the clauses of both the LTAA and the EA and submitted that they were two separate agreements. He pointed out that it was only after two decades of working out the technical collaboration agreement that HMCL agreed to permit export by the Assessee of the Hero Honda brand of vehicles to territories where HMCL and its subsidiaries operated. He pointed out that Article 3 of the LTAA dated 2nd June, 2004 anticipated a separate EA whereby the Assessee would be permitted to sell the products outside India. The consideration was clearly spelt out in the EA viz., the ceding of territories for the Assessee to sell and use the existing distribution network of HMCL and its subsidiaries in those territories without extra payment.

15. Mr. Vohra further submitted that the Assessee continued to pay the

amounts under the LTAA in relation to the vehicles exported. This was separate from the export commission. Further, HMCL could continue to export Honda vehicles to those territories through its subsidiaries. The Assessee was permitted to export the Hero Honda brand of vehicles. He submitted that it was not permissible to re-characterise the transaction of export commission as one involving payment of royalty. He finally submitted that the impugned order of the ITAT called for no interference and did not give rise to any substantial question of law on this issue.

Is export commission in fact 'royalty'?

16. The submissions on behalf of the Revenue hinge on having to treat the LTAA and EA as forming part of the same scheme of agreements, one in continuation of the other and which achieve the same result i.e., payments by the Assessee to the AE i.e., HMCL. However, when the entire history of the collaboration between the Assessee and HMCL is viewed, then the picture becomes clear. As rightly noted by the ITAT, the technical know-how was licensed by HMCL to the Assessee since 1984. This was continued in 1995 and then in 2004 by the LTAA dated 2nd June, 2004. The EA which was entered into on 21st June, 2004 could not therefore be said to be contemporaneous.

17. Secondly, the specific clauses in the EA further bring out the nature of the transaction involved therein. The payment of the export commission was not without consideration. It permitted the Assessee to export specified two wheelers manufactured under the Hero Honda brand to the specified countries. Further, the Assessee did not have to pay for using the existing

distribution and sales networks in those territories. The attempt at re-characterising the transaction as one involving payment of royalty overlooks the fact that the payment under the LTAA is treated by the Assessee itself as royalty. Such royalty is in effect paid even on the export consignments. Also, to view this as only benefitting the AE is to overlook the fact that not only has the Assessee benefitted in various ways as noted before, but it has also earned during the AY in question profits of Rs. 13.05 crores from exports.

18. In the above factual background and the specific wording of the clauses of both the LTAA and the EA, it is not possible to accept the contention that the export commission was in fact the monetisation of the negative covenant of the LTAA viz., abstaining from exporting to territories outside India. This argument at its best is ingenious but far removed from what the transaction in fact is. The consideration for the EA is clearly spelt out. Consequently, there was no question of there having to be an principal-agent relationship to justify the payment of the export commission. The amount spent on that score by the Assessee was for the benefit of its business and in fact resulted in a benefit.

19. In *Commissioner of Income Tax v. Shiv Raj Gupta* (*supra*), two agreements were entered into on the same day, one for the sale of shares for around Rs. 55.83 lakhs and another – a 'non-compete' agreement – for a consideration of over Rs. 6 crores. In the circumstances of that case, it was held that the non-compete agreement was a colourable device and the consideration received thereunder was brought to tax. The facts in the

present case are different. As already noted, the two agreements i.e., the LTAA and EA were distinct and independent. The Revenue has not been able to show that the EA was a colourable device and that the export commission was a disguised royalty payment. It was not a payment for technical services either.

20. In this context, the Court concurs with the following findings of the ITAT:

“Therefore, by export agreement, the assessee has not been transferred or permitted to use any patent, invention, model, design or secret formula. Similarly, HMCL, by way of export agreement, has not rendered any managerial, technical or consultancy services. In view of the above, we hold that export commission was neither royalty nor fee for technical services and, therefore, the assessee was not required to deduct tax at source on the payment of export fee. Once the assessee was not required to deduct the tax at source, it cannot be said that the assessee failed to deduct tax at source so as to apply Section 40(a)(ia).”

Conclusion

21. For all of the above reasons, the Court concludes that the payment of export commission by the Assessee to HMCL was not in the nature of payment of royalty or fee for technical services attracting disallowance under Section 40 (a) (i) of the Act. No substantial question of law arises from the said issue. The appeal is, accordingly, dismissed.

S.MURALIDHAR, J

ANIL KUMAR CHAWLA, J

MAY 08, 2017

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