$~

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

Judgment Reserved on: 22.11.2023

% *Judgment Pronounced on: 13.12.2023*

\+ **ITA 7/2023 & CM APPL. 920/2023**

PR. COMMISSIONER OF INCOME TAX – 8 ..... Appellant

Through: Mr Zoheb Hossain, Senior Standing Counsel along with Mr Sanjeev Menon, Standing Counsel.

versus

M/S SONY INDIA PVT. LTD. ..... Respondent

Through: Mr Nageswar Rao, Mr Parth, and Ms Maher Verma, Advs.

CORAM:
HON'BLE MR. JUSTICE RAJIV SHAKDHER
HON'BLE MR. JUSTICE GIRISH KATHPALIA

[Physical Hearing/Hybrid Hearing (as per request)]

RAJIV SHAKDHER, J.:

Prefatory facts:

1. This appeal concerns Assessment Year (AY) 2007-08. *Via* the instant appeal, the appellant/revenue seeks to assail the order dated 21.12.2018 passed by the Income Tax Appellate Tribunal [hereafter referred to as "the Tribunal"].

2. Although a perusal of the appeal discloses that three (3) questions are proposed on behalf of the appellant/revenue, in substance, they veer around one (1) issue, which is, whether the reimbursement of advertising, marketing and promotion expenses (AMP), incurred by the respondent/assessee on

behalf of its Associated Enterprise (AE), was at arm's length. In other words, whether any upward adjustment was required to be carried out in the amount received by the respondent/assessee from its AE.

2.1 The inter-related issue that arose for consideration was whether the Transfer Pricing Officer (TPO) ought to have used the bright line test (BLT) in computing the arm's length price (ALP) concerning AMP activities carried out by the respondent/assessee.

3. The aforementioned issues arise for consideration against the backdrop of the following broad facts and circumstances.

3.1 In and about November 1994, the respondent/assessee was incorporated as a wholly-owned subsidiary of Sony Corporation, Japan (SCJ). SCJ held shares in the respondent/assessee *via* its subsidiaries, Sony Holding (Asia) B.V., Netherlands, and Sony Gulf FZE, Dubai.

3.2 Initially, the respondent/assessee was into manufacturing, assembling, importing, and distributing various colour televisions, audio recording media equipment, information technology products, software, and general audio products.

3.3 However, with effect from 01.07.2004, the respondent/assessee shut down its manufacturing activities.

3.4 Thereafter, on 01.04.2005, the respondent/assessee entered into an advertisement agreement with Sony Electronics Asia Pacific Pte. Ltd.

4. The respondent/assessee filed its return of income (ROI), for AY

2007-08, on 30.10.2007. In the ROI for AY 2007-08, the respondent/assessee declared its income as Rs. 82,58,38,988/-. This return was processed under Section 143(1) of the Income-tax Act, 1961 [hereafter referred to as "Act"].

4.1 The respondent's/assessee's return was, thereafter, picked up for scrutiny, and accordingly, notices under Sections 143(2) and 142(1) of the Act were issued.

4.2 In the course of assessment proceedings, a reference was made to the TPO, under Section 92CA of the Act, for the determination of ALP.

4.3 The TPO issued a notice, dated 22.09.2010, calling upon the respondent/assessee to show cause as to why international transactions concerning reimbursement of advertisement expenses should not be benchmarked under the provisions of Section 92C of the Act. The thrust of the show cause notice was that the respondent/assessee, which was primarily engaged in the distribution of imported audio and visual products in the Indian market, was incurring AMP expenses on behalf of its AE.

4.4 As per the TPO, although the respondent/assessee had incurred Rs. 119,54,43,600/- towards brand promotion and developing marketing intangibles for its AE, it was reimbursed only Rs. 72,63,324/-.

4.5 In response to the notice, the respondent/assessee filed a reply dated 11.10.2010.

4.6 Ultimately, the TPO passed an order, dated 25.10.2010, whereby, Rs. 65,34,38,272/- was added to the taxable income of respondent/assessee,

having regard to the amount by which AMP expenses incurred by the respondent/assessee exceeded the amount, as determined by applying the BLT dicta.

5. The Assessing Officer (AO), thus, passed a draft assessment order in line with the adjustment made by the TPO. Against the TPO's order, the respondent/assessee preferred objections with the Dispute Resolution Panel (DRP), which were rejected *via* order dated 27.09.2011.

6. Consequentially, the AO passed a final assessment order on 10.10.2011, as per the directions of the DRP.

7. The record shows that the respondent/assessee preferred an appeal to the Tribunal against the directions issued by the DRP. The Tribunal, *vide* order dated 07.06.2013, remitted the matter to the TPO/AO for determination of AMP expenses, *albeit*, after taking into account a proper comparable, and granting a hearing to the authorized representative of the respondent/assessee.

8. The record discloses that cross-appeals were preferred to this court against the order of the Tribunal. These appeals were disposed of by a coordinate bench of this court *via* an order dated 23.07.2018. One of the questions raised in the appeal preferred by the respondent/assessee concerned AMP expenses. The said question reads as follows:

> "*Whether the advertising and marketing expenditure incurred by the appellant/assessee can be treated as international transaction and made subject matter of adjustment in arm's length pricing?*"

8.1 The operative directions, by the coordinate bench, *qua* the

aforementioned question are extracted hereafter:

> "*3. After hearing the parties we are inclined to set aside the order passed by the Tribunal in view of decision* ***in Sony Ericson Mobile Communication India Private Limited v. CIT****, (2015) 374 ITR 118 (Del).*
>
> *4. Accordingly, the question is answered in terms of the decision in* ***Sony Ericson Mobile Communication (supra)*** *with an order of remit to the Tribunal to decide the issue afresh in light of the direction given in the aforesaid decision.*
>
> *5. We may record that counsel for the assessee has submitted that there have been subsequent decisions by this Court and other High Courts which the assessee would like to rely upon. It is open for assessee to rely upon the said ratios. Equally, Revenue will be entitled to defend their stand.*
>
> *6. Counsel for the Revenue submits as the order of the Tribunal has been set aside, Revenue would raise all pleas and contentions when the appeals are taken up for hearing. It will be open to the Revenue to rely upon judgments and ratios which they feel are in their favour. Counsel for the assessee states that he would have no objection but would contest the contention of the Revenue on merits.*"

8.2 Accordingly, the order impugned in the said cross-appeals was set aside, and the matter was remitted to the Tribunal for fresh decision, bearing in mind the directions contained in ***Sony Ericsson Mobile Communications India Pvt. Ltd. v. CIT-III***, (2015) 55 taxmann.com 240 (Delhi).

9. On remand, the Tribunal allowed the appeal of the respondent/assessee.

10. Being aggrieved, the appellant/revenue has preferred the instant appeal.

Submissions by counsels:

11. Arguments on behalf of the appellant/revenue were addressed by Mr

Sanjeev Menon, whereas, submissions on behalf of the respondent/assessee were advanced by Mr Nageshwar Rao.

12. We may note that although an opportunity was granted to both parties to file written submissions, the appellant/revenue has not availed of the opportunity.

13. The submissions advanced by Mr Sanjeev Menon can be, broadly, paraphrased as follows:

(i) The 'Sony' brand is promoted by the respondent/assessee in India. The respondent/assessee has incurred huge expenses for the promotion and development of the brand and has, therefore, created a marketing intangible for its AE. Therefore, the TPO was right in holding that the effort made by the respondent/assessee *qua* its AE needed to be adequately compensated. Because of the advent of modern technology, brand promotion in India has a cross-border impact, and thus, the benefit to the AE is direct and immediate, contrary to the view held by the Tribunal.

(ii) Merely because the TPO accepted other international transactions by applying the transactional net margin method (TNMM), it cannot be said that the respondent/assessee was not required to be compensated for promoting the brand owned by its AE.

(iii) A person/entity at arm's length would expect remuneration/compensation commensurate with the effort put in for promoting and marketing the brand of its AE. Therefore, the remuneration/compensation paid for such effort should factor in not only the entrepreneurial effort but also the cost of funds utilized, and the opportunity

cost involved in incurring such marketing expenses. If regard is had to such aspects, then the markup of 7.01%, applied by the TPO, would appear to be quite reasonable.

(iv) The Tribunal failed to appreciate that the import of 'electronic' goods was distinct and independent of AMP activity. The AMP activity was not incidental or in any way, irreversibly bundled with the import of goods. Thus, the ALP for AMP expenses could have been arrived at by separately benchmarking AMP services.

(v) The Tribunal erred in accepting comparables selected by the respondent/assessee even when the said comparables had been rejected for good reasons by the TPO.

14. Mr Nageshwar Rao, on the other hand, resisted the appeal, both because there was a huge delay in re-filing the appeal and on merits:

(i) It was pointed out that the delay in re-filing, which was 423 days, was neither bonafide nor unintentional. It was emphasized by Mr Rao that the reasons given in the application for condonation of delay in re-filing were vague and insufficient.

(ii) On merits, it was submitted that from the list of international transactions extracted by the TPO, the single largest transaction for the import of goods amounted to Rs. 1445 crores. It was stated that these goods were sold in India for a gross value of Rs. 2340 crores, resulting in a net margin of 3.29% after adjusting AMP expenses, amounting to Rs. 119,54,43,600/-. As compared to the net margin earned by the respondent/assessee, the comparable companies/entities selected by the

TPO, during the same period, earned a margin of 2.09%.

(iii) The TPO had rejected the respondent's/assessee's contention that he ought to adopt the aggregated benchmark analysis. The TPO, instead, applied the BLT to determine ALP, contrary to the judgment of this court rendered in the ***Sony Ericsson Mobile Communications India*** case.

(iv) The TPO's findings are contradictory in as much as, on the one hand, he notes that the money expended on AMP has resulted in increasing the sales of the respondent/assessee in India, while on the other, he concludes that the increase in sales has benefited the AE. The TPO, contrary to business realities, observed that the high AMP spend had resulted in lowering the respondent's/assessee's profitability.

(v) Erroneously, the TPO rejected the respondent's/assessee's contention that the better net margin earned by it, as compared to the companies/entities selected by the TPO for employing the BLT tool, only demonstrated that the distribution business satisfied the ALP test.

(vi) The DRP committed the same error as the TPO in approving the employment of the BLT tool, in the determination of ALP. This error was compounded as the DRP summarily rejected the respondent's/assessee's assertion that the AMP expenses already stood covered in the compensation model agreed to between itself and its AE. Given the findings of fact returned by the Tribunal and the position of law, as enunciated by the court in the ***Sony Ericsson Mobile Communications*** case, no interference was called for with the impugned order.

Reasons and Analysis:

15. Having heard the learned counsel for the parties, and examined the record, the only issue, as noted at the outset, which arises for consideration, is whether the respondent/assessee was adequately compensated for expenses incurred for AMP activities carried out in India.

16. Before one answers the issue, one way or the other, one must bear in mind the following undisputed facts which obtain in the instant case:

(i) First, the respondent/assessee had shut down its manufacturing activity in India with effect from 01.07.2004.

(ii) Second, in the period in issue, i.e., FY 2006-07 (AY 2007-08), there was no advertising agreement obtaining between the respondent/assessee and its AE. The last agreement was entered into on 01.04.2005, which apparently, had come to an end.

(iii) Third, the TPO had used comparables furnished by the respondent/assessee for employing the BLT tool, in ascertaining the ALP *qua* AMP activities.

(iv) Fourth, concededly, the respondent's/assessee's net operating margin was 3.29%, whereas, the arithmetic mean of the net operating margin of comparables chosen by the TPO was 2.09%.

(v) Fifth, the TPO had accepted other international transactions under the TNM method employed by the respondent/assessee, except for AMP activities.

17. Given the aforesaid facts, what emerges is that, in the period in issue, the respondent/assessee was only in the business of import and distribution of Sony products. The amount spent on AMP activities by the respondent/assessee in the relevant FY was Rs. 119,54,43,600/-.

17.1 The compensation for this expense was, according to the Tribunal, received by the respondent/assessee in terms of higher profitability for the product sold.

17.2 Furthermore, even according to the TPO, the AMP expenditure incurred by the respondent/assessee resulted in increased sales in India for products, *albeit* developed by the AE but sold by the respondent/assessee.

18. The fact that the comparables chosen by the TPO had a net margin lower than that registered by the respondent/assessee would persuade us to hold that no upward adjustment concerning AMP expenses ought to have been made.

19. Lastly, the application of the BLT tool, by the TPO, in determining ALP, injected the order issued by him, which was incidentally approved by the DRP, with a legal error. [See ***Sony Ericsson Mobile Communications India*** case].

Conclusion:

20. Thus, for the foregoing reasons, we are not inclined to interfere with the impugned order passed by the Tribunal, as no substantial question of law arises for our consideration.

21. The appeal is disposed of in the aforesaid terms.

22. The application for condonation of delay in re-filing is rendered infructuous.

22.1 The application is, accordingly, closed.

(RAJIV SHAKDHER)
JUDGE

(GIRISH KATHPALIA)
JUDGE

DECEMBER 13, 2023