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

Date of Decision: 07.11.2017

\+ ITA 882/2017

COMMISSIONER OF INCOME TAX (LTU) ..... Appellant

versus

M/S ESPN SOFTWARE INDIA LTD. ..... Respondent

\+ ITA 890/2017 & CM No.37958/2017

COMMISSIONER OF INCOME TAX (LTU) ..... Appellant

versus

M/S ESPN SOFTWARE INDIA LTD. ..... Respondent

\+ ITA 891/2017

COMMISSIONER OF INCOME TAX (LTU) ..... Appellant

versus

ESPN SOFTWARE INDIA LTD. ..... Respondent

Present: Mr. Rahul Chaudhary, Sr. Standing Counsel with Mr. Sanjay Kumar, Jr. Standing Counsel for appellant.
Mr. Porus Kaka, Sr. Adv. with Mr. Divesh Chawla & Mr. Prakash Kumar, Advs. for respondent.

CORAM:
HON'BLE MR. JUSTICE S. RAVINDRA BHAT
HON'BLE MR. JUSTICE SANJEEV SACHDEVA

S. RAVINDRA BHAT, J. (ORAL)

1. The question of law urged by the Revenue is that the ITAT fell into error in clubbing of two distinct revenue streams i.e. sale of air time with distribution business, advertisements, sale business, etc. The TPO was of the opinion that both sets of businesses were separate and distinct and could not have been clubbed. The assessee had urged that the clubbing of these transactions for Arm's Length Price (ALP) determination had been permitted in the past. It relied upon common features to contend that whereas in sale of airtime, it was bulk sale of the product/service to the concerned customer, i.e. the air time user, distribution too involves sale through a network. The TPO's rejection of the aggregation, for ALP determination was appealed against.

2. The CIT (A) was of the opinion that both segments were appropriately clubbed for the purposes of benchmarking international transactions and cited two reasons. Firstly, that were closely related and that popularity of a channel had bearing on the subscription as well as sale of airtime for advertisement. It was felt that both businesses mutually reinforced each other. If the channel fails to air popular sporting activities, the advertisement sale would correspondingly be impacted adversely. The second element which persuaded the CIT (A) to accept the assessee's contention was that both segments employed the same set of assets and that separately benchmarking them would take it away from reality. Furthermore, the ITAT felt that it was not possible to merge comparables for profits having regard to these practical considerations, the CIT upheld the

assessee's decision to aggregation of the sets of transactions for the purpose of ALP determination and worked out an operating profit margin of 7.82%.

3. In appeal, the Revenue emphasized that in earlier years the advertisement sales segment had reflected a profit but that in the year under consideration the assessee had recorded losses. This was used as evidence to say that clubbing of the two transactions or rather their aggregation, distorted the picture. The other argument made was that the assessee overstated the purchase price of advertisement inventory which had been clearly added by the AO as the assessee had adjusted the losses incurred against profit distribution. Thus apparently, deliberately merging two audited separate business segment, i.e., distribution business segment and sale of air time advertisement sale segment. The ITAT rejected the Revenue's submissions. The findings of the ITAT pertinently are as follows:

> *"20. …… In the present case, it is noticed that activities of distribution of channels and advertisement air time inventory allotment are inter-related because higher the subscriber base of channel, the greater are chances of the aired advertisement being viewed by a large target audience because the advertisers want the widest possible coverage to their messages and both the activities i.e. subscription and advertisement air time drive towards the same end of promotion of channels. As regards to the objection of the TPO/AO that there was a loss in the advertisement air time inventory business in the year under consideration while in the earlier year there was profit, the ld. Counsel for the assessee explained that in the earlier years the assessee was acting only as a commission agent for its AE and*

solicited advertisements in the Indian market for its AE for that purpose the assessee was getting a fixed percentage of commission while for the year under consideration and in the succeeding years, the assessee shifted to the distribution model in pursuant to the change in the foreign exchange regulations of the RBI vide Circular No. 76 which relaxed the condition of export earnings by advertisers in Foreign Television Channels and the assessee, without prior approval from RBI, could have brought air time on a bulk basis and allot the same directly to third parties i.e. advertisement agencies etc. It is also noticed that Ministry of Information and Broadcasting formulated several guidelines vide Downlinking Guidelines Number 13/2/2002-BP&L/BC-IV dated 11.11.2005. The said guidelines were as under:

> ***"1.3** The applicant company must either own the channel it wants downlinked for public viewing, or must enjoy, for the territory of India, exclusive marketing/distribution rights for the same, inclusive of the rights to the advertising and subscription revenues for the channel and must submit adequate proof at the time of application.*
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> ***1.4** In case the applicant company has exclusive marketing / distribution rights, it should also have the authority to conclude contracts on behalf of the channel for advertisements, subscription and programme content."*

21. In view of the aforesaid guidelines, if the assessee decided to relinquish advertisement air time inventory rights on account of losses, it would also have to relinquish the subscription rights to the channel which have resulted in profits. Therefore, the assessee was required to aggregate both the activities i.e. channel subscription and air time sale segment. Accordingly, the assessee aggregated both the activities for the purpose of

arm's length analysis. It is also noticed that the advertisement air time revenue earned by the assessee has a direct correlation with the number of cricket events which is evident from the chart furnished by the assessee, reproduced in the former part of this order. On perusal of the said chart, it would be clear that when the cricket events were more in the FYs 2007-08 and 2009-10. The OP/sales ratio jumped to 9.18% and 6.85% respectively from the negative ratio of 0.78% in the FY 2004-05 when the cricket events were less. In the present case, by changing the business model, the assessee was getting more control over the distribution of function and it was a part of the business strategy of the assessee. It is also noticed that OECD guidelines clearly states that closely linked transaction should have been aggregated and evaluated together in this regard. It is relevant to refer OECD guidelines which read as under:

> *"Ideally, in order to arrive at the most precise approximation of arm's length conditions, the arm's length principle should be applied on a transaction-by-transaction basis. However, there are often situations where separate transactions are so closely linked or continuous that they cannot be evaluated adequately on a separate basis."*

4. On the basis of the above observations and after taking due note of the OECD Transfer Pricing Guidelines – as well as the US Transfer Pricing Regulations, the ITAT upheld the Appellate Commissioner's findings that the transactions in question ought to be analyzed in conjunction i.e. after aggregation for arm's length purposes. The ITAT also found that the assessee had structured itself in a manner that its profit was maximized as a whole rather than independently as regards these two activities.

5. This Court has considered the submissions of the Revenue – which largely reiterated what was urged before the Tribunal.

6. The Court is of the opinion that the ITAT's decision cannot be faulted. The rejection of the RBI guidelines and the TPO's omission given due weight to the down linking guidelines were a relevant factor, which in our opinion, the CIT(A) and the ITAT correctly noted to reverse the original findings. It is a settled proposition that whether to segregate or not segregate two transactions, is entirely a fact dependent exercise that cannot *per se* be treated as a question of law. In the present case, the reasons which impelled the lower authorities i.e. the CIT (A) and the ITAT to uphold the assessee's plea with regard to aggregation for ALP purposes, are reasonable and cannot be interfered with.

The appeals are therefore dismissed.

S. RAVINDRA BHAT, J

SANJEEV SACHDEVA, J

NOVEMBER 07, 2017
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