

MASTER CLASS ON MARKETING INTANGIBLES

IFA Academy, Noida, 19th January 2019

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1. Marketing intangibles are trademarks and trade names that aid in the commercial exploitation of a product or service, distribution channels, customer lists etc.

2. Lately, it has become an important issue in global transfer pricing community.

**MARKETING
INTANGIBLES
Concept & Issue**

3. Indian Revenue has been identifying excessive AMP expenses by applying the bright line test.

4. AMP expense in excess of “bright-line” is considered as TP adjustment, faced by many taxpayers, alleging contribution by taxpayer is towards strengthening AE owned brands.

EVOLUTION

2002

- US tax court in DHL case propounds Bright Line Test (BLT)

2010

- TPOs invoke BLT; Delhi HC supports BLT in Maruti Suzuki; signals beginning of AMP litigation; subsequently SC delicates HC order non est factum.

2012

- Definition of 'intangible' broadened with retrospective effect.

2013

- Majority view of ITAT Special Bench in LG Electronics supports BLT.

2014

- Coordinate benches follow Special Bench decision.

2015

- Delhi HC upholds AMP expense as an international transaction but rejects BLT in Sony Ericsson lead case.

2016

- Delhi HC distinguishes its earlier order holding AMP is not international transaction in Maruti Suzuki case.

Controversy in a Nutshell

- ▶ BLT (Bright Line Test) applied with segregation of routine & non-routine expenses.
- ▶ Non-routine would form part of excessive AMP.
- ▶ Distinguishing functions: Manufacturing (full risk, licensed, contract) & distribution (full, limited & stripped risk) models.
- ▶ AMP proposition should be recovered from foreign AE brand building services rendered by AE.
- ▶ Conflict where Revenue contends that developing brand is prerogative of legal owner and AMP spends (by subsidiaries) reflect services to brand owner.

Recent Development - PepsiCo India

- ▶ AMP does not result in International Transaction.
- ▶ Even FAR doesn't reveal any AMP benefit to foreign AE.
- ▶ Sponsorship of cricket constitute taxpayer's business promotion.
- ▶ Finding that AMP expenditure was not at the behest of foreign AE – no mutual understanding.
- ▶ Rejection of Revenue's argument that AMP results in brand building.

Recent Development - PepsiCo India

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- ▶ Value of brand created in India relevant only when the foreign AE decides to sell the brand (DHL Principle).
- ▶ Legal owner of brand did not charge Royalty.
- ▶ PepsiCo India as full-fledged manufacturer reaps the profit from the Indian operation (Reliance on AP 8-10).
- ▶ Rejects PSM Benchmarking approach, TPO approach at the threshold as erroneous.
- ▶ Frowns upon DRP's approach of other method terming it as distorted BLT.

Assessment Experience

- ▶ BLT continues to be adopted.
- ▶ Barring Delhi jurisdiction, no exclusion of sales promotion expenses for determination of BLT.
- ▶ Adoption of MSS companies for markup of AMP as a service.
- ▶ Imperfect adoption of PSM based on ad-hoc basis (profits of comparables taken as reference point for allocating excess profit or profit before AMP expense or AMP allowed based on formulary apportionment).
- ▶ Revenue has inferred a transaction as a DEMPE (developing, enhancing, maintaining, protecting and exploiting) function, but not improved its position on methodology.*

** Lately, the Revenue Department has started issuing protective tax demand notices in addition to already pending Transfer Pricing issues.*

APA Experience

- ▶ AMP support seen as an international transaction.
- ▶ Adhoc rejection of TNMM / RPM methodologies.
- ▶ AMP admitted as international transaction on without prejudice basis – Critical assumption.
- ▶ Couple of examples: Excess AMP as determined under BLT set off against royalty and net margin established. Outcomes lead to capped royalty and minimum net operating margin.
- ▶ AMP as a percentage of sales correlated with operating margin. Excess AMP to be reimbursed.
- ▶ AMP admitted for MAP/ BAPA; however, international transaction will have to be admitted. No precedents, although US has agreed to accept.

International Position on AMP

- ▶ OECD Transfer Pricing (TP) Guidelines
 - ▶ Chapter VI of the guidelines on intangibles provides clarity on the approach to be followed for identification of intangibles, their ownership (legal or economic), approach for the comparability and selection of transfer pricing method for determination of the arm's length price.
 - ▶ The 2017 revision introduces Hard-to-Value Intangibles (HTVI) & DEMPE transactions.
- ▶ UN TP manual deals with allocation of cost of market penetration, expansion and maintenance strategies.

Possible Approaches

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- ▶ AMP intensity adjustment – Luxottica case reflects difference.
- ▶ Luxottica case has parallels with adjustment for capacity utilization (Petro Araldite case, as affirmed by Bombay HC).
- ▶ In Luxottica, excess AMP was loaded on the comparables on the cost side and revenue side.

Possible Approaches

- ▶ In Petro Araldite case, the level of fixed costs to sales was scaled to the level of comparables.
- ▶ Default approach should be AMP function as a service.
- ▶ PSM only in exceptional circumstances:
 - ❑ Valuable and non-routine contributions by the distributor
 - ❑ Residual profit split for strictly non-routine functions (R&D, branding and marketing)
 - ❑ Group TP policy supports application of PSM

Policy Proposals

- ▶ Characterization of distributor is key – if economic ownership of brand building lies with the distributor, risk and reward is aligned, no AMP adjustment is called for.
- ▶ Sales promotion not to form part of AMP – Clear definition of point of sale, promotion expenses such as discounts, rebates, commissions.
- ▶ Distribution channel expenses to not form part of AMP.
- ▶ Determine intensity of AMP by functional analysis. Australia ATO guidance on distributors is a useful tool. Quantum of AMP expense relative to comparables is a risk-assessment tool, but not a conclusive test.

Policy Proposals

- ▶ Indicators of DEMPE functions performed by local distributors:
 - Decision making by Indian distributor in relation to brand strategy.
 - Appointment of brand ambassador for promotion of Brand vs. Product.
 - Sponsorships for brand promotion.
- ▶ Evaluate compensation model of the distributor to comprehend if AMP is factored in the returns.

Glossary - Case Laws & other references

- ▶ L.G. Electronics India (P.) Ltd. v. Assistant Commissioner of Income-tax, Circle - 3, Noida - [2013] 22 ITR(T) 1 (Delhi - Trib.) (SB)
- ▶ Maruti Suzuki India Ltd. v. Commissioner of Income-tax - [2016] 381 ITR 117 (Delhi)
- ▶ Sony Ericsson Mobile Communications India (P.) Ltd. v. Commissioner of Income-tax -III - [2015] 374 ITR 118 (Delhi)
- ▶ Commissioner of Income-tax -LTU v. Whirlpool of India Ltd. - [2016] 381 ITR 154 (Delhi)
- ▶ Bausch & Lomb Eyecare (India) (P.) Ltd. v. Additional Commisssoner of Income-tax - [2016] 381 ITR 227 (Delhi)
- ▶ Daiichi Sankyo Company Ltd. v. Jayaram Chigurupati - 2010 (6) MANU/SC/0454/2010
- ▶ Sassoon J. David & Co. Pvt. Ltd. v. Commissioner of Income-tax - [1979] 1 Taxman 485 (SC)
- ▶ PepsiCo India Holdings (P.) Ltd. v. Additional Commissioner of Income Tax, Range - 1, Chandigarh - [2018] 100 taxmann.com 159 (Delhi - Trib.)
- ▶ OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, July 2010
- ▶ OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, July 2017
- ▶ Actions 8-10 of the BEPS Action Plan (“Aligning Transfer Pricing Outcomes with Value Creation”)

Glossary - Case Laws & other references

- ▶ Commissioner of Income-tax v. Ahmedbhai Umarbhai & Co. - [1950] 18 ITR 472 (SC)
- ▶ Mazagaon Dock Ltd v. Commissioner of Income-tax & Excess Profits Tax - [1958] 34 ITR 368 (SC)
- ▶ BMW India (P.) Ltd. v. Deputy Commissioner of Income-tax, Circle-1 (I) Gurgaon - [2017] 88 taxmann.com 26 (Delhi - Trib.)
- ▶ Commissioner of Income-tax v. Kusum Products Ltd. - [1993] 71 Taxman 611 (Calcutta)
- ▶ Volkswagen India (P.) Ltd. v. Additional Commissioner of Income-tax, TDS, Range, Pune - [2017] 81 taxmann.com 8 (Pune - Trib.)
- ▶ Deputy Commissioner of Income-tax-6(3) v. Mattel Toys (India) (P.) Ltd. - [2016] 72 taxmann.com 86 (Mumbai - Trib.)
- ▶ Ranbaxy Laboratories Ltd. v. Assistant Commissioner of Income-tax, Range-15, New Delhi - [2016] 68 taxmann.com 322 (Delhi - Trib.)
- ▶ Sony Mobile Communications (India) (P.) Ltd. v. Additional Commissioner of Income-tax, Range-9, New Delhi - [2018] 96 taxmann.com 312 (Delhi - Trib.)
- ▶ Guide on marketing intangibles, International Transfer Pricing, Australian Tax Office - www.ato.gov.au
- ▶ US IRS regulations under § 1.482 - <https://www.irs.gov/>

Acknowledgment

IFA acknowledges the contribution of CA Karishma Patarphekar, CA Suchint Majumdar, Advocate Joseph K. Antony, TaxSutra & Deloitte publication on Advertisement, Marketing and Promotion (a concept paper).

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