

## Mumbai ITAT directs AO to follow Sony Ericsson's case for benchmarking of AMP expenditure

**Summary –** The Delhi ITAT in a recent case of BMW India (P.) Ltd., (the Assessee) held that where in determining ALP of AMP expenses and benchmarking, neither assessee nor TPO had followed prescription of judgment in case of Sony Ericsson [231 Taxman 113](#), matter was to be remanded for fresh adjudication

International transaction of 'Receipt of IT support Services' is required to be separately benchmarked, it being distinct from international transactions of purchase, etc.

There being functional differences between 'procurement' and 'training' services and use of separate work force by assessee for their rendition, their aggregation could not be accepted

### Facts

- The assessee was a BMW Group company with 99.99 per cent of its capital being owned by BMW Holdings B.V. Netherland, and balance by BMW AG, Munich, Germany. BMW group was engaged in manufacturing of automobile and motorcycles.
- On reference, the TPO noticed from the assessee's Transfer Pricing study report that BMW India was supposed to ensure that it followed the global guidelines provided by BMW Group in terms of the usage of BMW banners, specifications of release of print advertisement for font size and page layout etc. Considering the above facts and the assessee's exorbitant ratio of AMP expenses/sales, the TPO observed that the incurring of AMP expenses was an international transactions covered under section 92B(1), read with clause (v) of section 92F. He determined the ALP of AMP expenses with a mark-up of 11.105 per cent at Rs. 85.84 crore.
- The assessee remained unsuccessful before the Dispute Resolution Panel (DRP). That is how, the transfer pricing addition of Rs. 85.84 crore came to be made in the final assessment order.
- On assessee's appeal before the Tribunal:

### Held

- It is pertinent to note that the TPO examined and got satisfied with the assessee's profit margin *vis-a-vis* the comparables only *qua* the international transactions of manufacturing/distribution functions. He separately determined the ALP of AMP expenses, *albeit*, without examining the AMP functions carried out by the assessee and the comparables. Manner of determination of the ALP of the distribution activity and AMP activity has been set out by the High Court in *Sony Ericsson Mobile Communications (India) (P.) Ltd. v. CIT* [\[2015\] 231 Taxman 113/55 taxmann.com 240/374 ITR 118 \(Delhi\)](#) to be conducted, firstly, in a bundled manner by considering the distribution and AMP functions performed by the assessee as well as the probable comparables. If probable comparables

having performed both the functions are not available, then to determine the ALP of AMP expenses in a segregated manner. As such, it becomes immensely important to separately examine the distribution and AMP functions undertaken by the assessee as well as probable comparables.

- It is vital to highlight the difference between AMP expenses and AMP functions. Whereas AMP functions are the means by which AMP activity is performed, AMP expenses is the amount spent on the performance of such means (functions). To put it simply, an examination of AMP functions carried out by the assessee and the probable comparables is *sine qua non* in the process of determination of the ALP of the international transaction of AMP spend, either in a segregate or an aggregate manner. What Their Lordships have held is to bundle the distribution activity with the AMP activity, being two separate but connected international transactions, for the purposes of determination of the ALP of both these international transactions in a combined manner. The argument of the assessee that since the profit margin of the comparables is much less than the assessee and hence no separate addition should be made for AMP functions, if taken to a logical conclusion, will make the AMP spend as a non-international transaction, which, is not appropriate in the given facts.
- Once AMP expense has been held to be an international transaction, it is, but, natural that the functions performed by the assessee under such a transaction need to be compared with similar functions performed by a comparable case. If AMP functions performed by the assessee turn out to be different from those performed by a probable comparable company, then, an adjustment is required to be made so as to bring AMP functions performed by the assessee as well as the comparable, at the same pedestal. If we concur with the contention of the assessee that the addition on account transfer pricing adjustment of AMP expenses be deleted without any examination of the AMP functions carried out by the assessee as well as comparables, this will amount to snatching the tag of international transaction from AMP expenses, which admittedly exists in facts and circumstances of the present case.
- What Their Lordships in *Sony Ericsson (supra)* have held is that the distribution activity and AMP expenses are two separate but related international transactions. It is only for the purposes of determining their ALP that these two should be aggregated. The process of such an aggregation does not take away the separate character of the AMP expenses as an international transaction. An analysis and examination of the manufacture/distribution and AMP functions carried out by the assessee must be necessarily done in the first instance, which should be then compared with similar functions performed by some comparables. If the manufacture/distribution and AMP functions performed by the assessee turn out to be different from those performed by probable comparables, then, a suitable adjustment should be made to the profits of the comparable so as to counterbalance the effect of such differences. If however differences exist in such functions, but no adjustment can be made, then, such probable comparable should be dropped from the list of comparables. If, in doing this exercise, there remains no company doing comparable manufacture/distribution and AMP functions, then, both the international transactions are required

to be segregated and then examined on individual basis by finding out probable comparables doing such separate functions similarly. For the international transaction of AMP spend, this can be done by, firstly, seeing the AMP functions actually performed by the assessee and then comparing it with the AMP functions performed by a probable comparable. If both are found out to be similar, then the matter ends and a comparable is found and one can go ahead with determining the ALP of such a transaction.

- If the AMP functions performed by the two entities are found to be different, then adjustment is required to be made in the case of a probable comparable, so as to make it uniform with the assessee. The assessee may have possibly done, say, four different AMP functions as against the probable comparable having done, say, only three. In such a scenario, again the adjustment will be warranted. In another situation, the AMP functions performed by the assessee and probable comparable may be similar but with varying standards, which will also call for an adjustment. Crux of the matter is that the AMP functions performed by the assessee must be similar to those done by the comparables, in the same manner as such functions are compared in any other international transaction. However, in computing ALP of AMP spend, the adjustment or set off, if any, available from the distribution function, should be made.
- Essence of the judgment in the case of *Sony Ericsson Mobile (supra)* is that the two international transactions of Distribution and AMP should be examined on the touchstone of transfer pricing provisions, but on an aggregate basis. Determining the ALP of two transactions in an aggregate manner postulates making a comparison of both the functions of manufacture/distribution and AMP carried out by the assessee with the comparables, so that surplus from the manufacture/distribution activity could be adjusted against the deficit, if any, in the AMP activity. The High Court has nowhere laid down that the AMP functions performed by the assessee should not be compared with those performed by the comparable parties. On the contrary, it turned down the contention raised by the assessee urging for not treating AMP as a separate function. Thus, it is manifest that comparison of AMP functions is vital which cannot be dispensed with. The alternative prescription of the judgment is that if ALP of both the transactions of Distribution and AMP cannot be determined in a combined manner, then the ALP of AMP functions should be separately done. The stand of the assessee urging the consideration of profit on an entity level without making comparison of AMP functions done by the assessee as well as the comparable, will render this alternative approach incapable of compliance. Canvassing such a view amounts to treating AMP spend as a non-international transaction, which is patently incapable of acceptance.
- If the legal position is summarized from the judgment in *Sony Ericsson (supra)* that the distribution and AMP functions are two separate international activities, which need to be compared with uncontrolled transactions. Because of their inter-twinning, it is only for the purposes of determining their ALP that both these transactions can be aggregated in first instance, so that the surplus from one could be adjusted against the deficit from the other in an overall approach. It does not mean that because of aggregation, the AMP expense transaction sheds its character of a separate

international transaction and, hence, the AMP functions should not be matched with the AMP functions carried out by probable comparables. If suitable comparables can be found having performed both distribution and AMP functions, then, their ALP should be determined on aggregate basis. If, however, there is some difference in the distribution or AMP functions performed by the assessee *vis-a-vis* the probable comparables, then an attempt should first be made to iron out such difference by making a suitable adjustment to the profit margin of comparables. If such an adjustment is not possible, then such probable comparable should be eliminated. If, by making a comparative analysis of the distribution and AMP functions jointly, there remains no comparable case performing such distribution and AMP functions, then, the international transaction of AMP should be segregated and their ALP be determined separately by applying a suitable method. However, in so determining the ALP of such an international transaction of AMP expenses on separate basis, a proper set off, if any, available from the distribution activity, should be allowed.

- Adverting to the facts of the present case, the assessee did not separately report the international transaction of AMP expenses. Even under the transfer pricing analysis done by it on entity level, there is no identification of AMP functions, what to talk of comparing such functions with the other comparables in a combined or separate approach. The TPO treated the AMP spend as a separate international transaction. He segregated routine AMP expenses incurred by the assessee for his business from the non-routine AMP expenses by treating such non-routine AMP expenses leading to the creation of marketing intangible for its AE. Then he applied a mark-up of 11.05 per cent to determine the ALP of this transaction. There is no attempt to find out the mark-up of comparables by analyzing the AMP functions carried out by the assessee *vis-à-vis* the comparables. To put it straight, neither the assessee nor the TPO have followed the prescription of the judgment in the case of *Sony Ericsson (supra)* for benchmarking.
- Further, no detail of the AMP functions performed by the assessee is available on record. Similarly, there is no reference in the order of the TPO to any AMP functions performed by comparables. In fact, no such analysis or comparison has been undertaken by the TPO. The assessee has also failed to bring any material divulging the AMP functions performed by the assessee as well as comparables. As such, it is not possible to determine the ALP of AMP expenses at the end of the instant High Court, either in a combined or a separate approach.
- Since the orders of the authorities below are not in conformity with the ratio laid down in *Sony Ericsson (supra)* as discussed above and further necessary details for doing this exercise are also not available, the impugned order is to be set aside and the matter is to be send back to the file of the TPO/Assessing Officer for determining the ALP of the international transaction of AMP spend afresh in accordance with the manner laid down by the High Court in *Sony Ericsson Mobile (supra)*.