ITAT remanded matter as revenue sharing though christened as royalty yet wasn't royalty

Summary – The Kolkata ITAT in a recent case of Labvantage Solutions (P.) Ltd., (the Assessee) held that where assessee had pleaded that payment though nomenclatured as royalty, was not royalty as such, but was only a payment made towards revenue sharing arrangement entered into with its AE, since this aspect was not considered by Assessing Officer, matter deserved to be remanded back to file of TPO for de novo adjudication

Where comparable was engaged in IT, ITES and sale of products for which segmental information was not available, no comparison could be made for want of segmental data

Forex gain/loss is to be treated as operating income while computing PLI

Facts

- LVS US was engaged in development, marketing of Laboratory Information Management Systems (LIMS) Software, testing and customer configuration services. LVS India was engaged in the development and customization of LIMS for its AE. Further, LVS India was also engaged in the resale of packaged software, namely 'Sapphire' of AE in the domestic market and with respect to the said distribution activity, the AE charged royalty based on software packages sold by the assessee.
- The assessee had paid royalty to its AE on the license sales made by it to the third party customers as well as on the maintenance revenue generated from such licenses earlier sold to third party customers and argued that since such payment was integral to the operations of assessee, and in the nature of operating expenses, such transaction was aggregated with the provision of software design and development services transaction and benchmarked using TNMM as the MAM.
- The TPO separately determined the arm's length price of the royalty paid, by using TNMM while determining the amount of adjustment on a proportionate basis and made an adjustment on account of payment of royalty by completely disregarding the business and pricing model of the assessee and thereby challenging the commercial wisdom of the assessee in making such payments while passing the order.
- On appeal:

Held

- The assessee had pleaded that the payment though nomenclatured as royalty , was not royalty as such, but was only a payment made towards revenue sharing arrangement entered into with its AE. Though this fact was also mentioned in the assessment year 2010-11, no finding with regard to this aspect was given by the Tribunal and relief was granted to the assessee on the benefit test and benchmarking of royalty done by the assessee based on CUP method. No finding whatsoever had been given by the lower authorities on the said argument of the assessee that payment of 40 per

cent is made to AE pursuant to revenue sharing arrangement, though nomenclatured as royalty. In other words, the lower authorities had completely proceeded on the point that the payment made is only towards royalty. The assessee also pointed out that the assessee to be on the safer side, had also subjected the payment of 40 per cent to AE to withholding tax treating the same as royalty to avoid possible disallowance of the same under section 40(a)(i) read with section 195. This has got no bearing on the determination of ALP of the subject mentioned payment in the scheme of transfer pricing. Since the assessee had stated that what is paid is only share of AE pursuant to revenue sharing arrangement and not royalty, this aspect deserves to be remanded back to the file of the TPO for *de novo* adjudication. Accordingly, this issue of disallowance of payment of royalty is remanded to the file of TPO/Assessing Officer for *de novo* adjudication with a direction to TPO to benchmark the subject mentioned payment *vis-a-vis* the comparables afresh.