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9 August 2013

Suzuki Brand not benefitted by piggybacking on Maruti, Royalty addition deleted

In brief

In a recent ruling in the case of Maruti Suzuki India Limited[1] (the taxpayer or MSIL), the Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) held that:

- The transfer pricing officer (TPO) was not justified in artificially splitting the royalty paid by MSIL to its associated enterprise (AE) (Suzuki Motor Corporation, Japan or SMC) into royalty for use of technology and for use of brand name and in determining the arm's length price of the payment of royalty allegedly towards use of brand name as Nil.
- At the time of entering into the license agreement in 1982, MSIL and SMC were unrelated entities and since the same terms and conditions were in force during the relevant financial year, the payment of royalty should be accepted to be at arm's length price.

Facts

- MSIL, incorporated in 1981, started its business operations in 1982 as a 100% Government of India (GOI) company. SMC, Japan was selected as business partner in 1982 and held 54.21% share in MSIL as on March 31, 2005. It is a licensed manufacturer engaged in the business of manufacturing of passenger cars in India.

[1] M/s Maruti Suzuki India Limited [ITA No. 5237/Del/2011]

- MSIL entered into a license agreement with SMC for manufacture of specified models of cars using the licensed information and licensed trademark. Under the agreement, MSIL made composite royalty payments for the rights and licenses granted by SMC.
- The TPO held that the royalty paid by MSIL was towards use of technology as well as towards use of trademark/brand name and divided the total royalty payments into royalty for use of technology and for use of trademark. For the purpose of splitting the royalty, the TPO took into consideration the research & development expenses and advertisement and marketing expenses incurred by SMC.
- The TPO determined the arm's length price of royalty, allegedly paid for use of brand name, as Nil on the pretext that Suzuki was a weak brand.
- The TPO also made an adjustment in relation to the advertisement, marketing and sales promotion expenses incurred by MSIL, holding the same to have been incurred for promotion of brand owned by the AE.
- These adjustments were confirmed by the Dispute Resolution Panel (DRP).
- Aggrieved, MSIL approached the Tribunal against the order passed by the tax officer.

Taxpayer's contention

- At the time of entering into the license agreement in 1982, MSIL and SMC were unrelated entities and since the same terms and conditions were in force during the relevant financial year, the payment of royalty should be accepted to be at arm's length price.
- The royalty paid by MSIL was an in-severable and composite payment which had been artificially divided by the TPO into payment for use of technology and for use of brand name.
- The license agreement granted a right to MSIL to manufacture and sell specific models of cars using the licensed information and trademark.
- The 'Suzuki' brand is a world renowned brand and is amongst the top 500 global brands.
- In the absence of any arrangement between the taxpayer and its AE, such expenses being incurred by the taxpayer could not be regarded as a 'transaction'.
- The taxpayer was the sole beneficiary of the advertising, marketing and promotion (AMP) expenditure incurred by it, and its conduct in incurring and bearing the cost of such expenditure was consistent with the arm's length price.

Revenue's contention

- The Revenue contended that the brand Suzuki was a 'lesser known' brand and had 'piggybacked on Maruti' to become an established brand and hence there did not arise a need for MSIL to pay any royalty for use of brand to SMC Japan.
- Since the taxpayer was unable to quantify the payment it made to the AE for the brand name, the TPO inferred that it was 'logical' to split the royalty in the ratio of R&D expenses and marketing expenses incurred by SMC. For the purpose of computing the ratio of aforesaid expenses, the TPO considered the consolidated financial statements of SMC.
- Consequently, the TPO divided the royalty in the ratio of 50.58% of use of technology and 49.42% for use of brand name.
- The Revenue also pointed out that no independent entity would be willing to enter into a composite agreement without ascertaining the individual charges

towards the use of technology and the brand.

Tribunal Ruling

- SMC was not in a position to control MSIL in 1982, and as the same terms and conditions were in force during the relevant financial year, the license agreements can be said to be at arm's length.

- The royalty was paid by MSIL to obtain license to manufacture licensed products. Other rights such as right to use the technology, knowhow and trade mark were linked to the core right to manufacture and sell the licensed products.

- The Tribunal accepted the contention of MSIL that the license agreement was a composite/in-severable agreement and relying upon the decision of the Supreme Court in the case of *Vodafone International Holdings B.V. v. UOI (Civil Apeal No. 733 of 2012)*, the Tribunal held that it was not open for the revenue to split a composite agreement.

- The Tribunal also agreed with the taxpayer that entire manufacturing activity and business of MSIL was based and founded on the license agreement without which the business of the MSIL would cease to exist and the entire operations would come to a halt.

- The decision to use the Suzuki brand name was taken by the taxpayer in order to advance its own commercial interest and Suzuki was a renowned international brand.

- The Tribunal accordingly deleted the adjustment made by the TPO on account of payment of royalty by MSIL to SMC.

- On the issue of the adjustment on account of AMP expenses, the Tribunal remanded the matter back to the TPO for adjudication in light of the decision of the Special Bench in the case of *LG Electronics India Limited v. ACIT (ITA No. 5140/Del/2011)*.

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