THE HIGH COURT OF DELHI AT NEW DELHI

% Judgment reserved on : 02.06.2010
Judgment delivered on: 01.07.2010

\+ **W.P.(C) 6876/2008**

'MARUTI' SUZUKI INDIA LTD ..... Petitioner

versus

ADDITIONAL COMMISSIONER OF INCOME TAX TRANSFER PRICING OFFICER NEW DELHI ..... Respondent

Advocates who appeared in this case:
For the Petitioner : Mr S. Ganesh, Sr Adv. with Mr Arjun Pant
For the Respondent : Mr Sanjeev Sabharwal

CORAM:-
HON'BLE MR JUSTICE BADAR DURREZ AHMED
HON'BLE MR JUSTICE V.K. JAIN

1. Whether Reporters of local papers may be allowed to see the judgment? Yes
2. To be referred to the Reporter or not? Yes
3. Whether the judgment should be reported in Digest? Yes

V.K. JAIN, J.

1. The petitioner before this Court, formerly known as Maruti Udyog Limited (hereinafter referred to as 'Maruti'), is engaged in the business of manufacture and sale of automobiles, besides trading in spares and components of

automotive vehicles. The petitioner launched 'Maruti 800' Car in the year 1983 and has thereafter launched a number of other models, including Omni in the year 1984 and Esteem in the year 1994. The trade mark/logo 'M' is the registered trade mark of the petitioner-company.

2. Since Maruti wanted a licence from Suzuki for its SH model and Suzuki had granted licence to it, for the manufacture and sale of certain other models of Suzuki four-wheel motor vehicles, Maruti, on 4th December, 1992, entered into a License Agreement, with Suzuki Motor Corporation (hereinafter referred to as 'Suzuki') with the approval of Government of India.

3. The Agreement, to the extent, it is relevant for our purpose, provided as under:

> **"1.05 "Licensed Information"**
> "Licensed Information" shall mean any and all technical information whether patented or not, including know-how, trade secrets and other data (including all drawings, prints, machine and material specifications, engineering data and other information, knowledge and advice) which SUZUKI now has or which may come into its possession and control during the term of this Agreement relating to the engineering, design and development, manufacture, quality control, assembly, testing, sale and after-sales service of PRODUCTS and PARTS

and which may be supplied by SUZUKI to 'MARUTI' on or after the Effective Date pursuant to this Agreement as well as before the Effective Date.

LICENSE AND SUZUKI'S OWNERSHIP

2.01 scope of License

(a) SUZUKI has agreed to provide technical collaboration and license necessary to the engineering, design and development, manufacture, assembly, testing, quality control, sale and after sales service of the PRODUCTS and PARTS, subject to the payment of a lump sum specified in Article 6.01(a) and in accordance with Article 3.01 and other terms and conditions contained in this Agreement.

(b) SUZUKI hereby grants to 'MARUTI' during the term of this Agreement, in strict accordance with the terms and subject to the conditions herein set forth, (i) the exclusive right (within the meaning as provided for in Article 5.02 of this Agreement) to use the Licensed Information and Licensed Trademarks for the engineering, design and development, manufacture, assembly, testing, quality control, sale and after-sale service of the PRODUCTS and PARTS within the Territory and (ii) the non-exclusive right to use the same with regard to SH Series only for the sale in such other countries as provided in Article 5.05.

(c) SUZUKI declares that if SUZUKI grants a license for manufacturing the PRODUCTS and/or PARTS to any party other than 'MARUTI', such licensee of SUZUKI will not be given the right to sell the PRODUCTS and or PARTS in any country in Europe.

(d) 'MARUTI' shall have the right to

sub-license the rights granted hereunder to other entities which are directly or indirect6ly owned or controlled by persons of Indian nationality, with the prior written consent of SUZUKI, which SUZUKI will not unreasonably withhold.

PROVISIONS RELATING TO LICENSING TECHNIAL ASSISTANCE

3.01 Supply of Licensed Information

(a) SUZUKI agrees to make available to 'MARUTI' such Licensed Information which SUZUKI has the right and capacity, and is free, to disclose and/or grant license to 'MARUTI' as contemplated by this Agreement. Notwithstanding the foregoing provision in this Article 3.01, SUZUKI shall make available to 'MARUTI' such Licensed Information as, when properly used by 'MARUTI', will be sufficient and complete for the engineering, design and development, manufacture, assembly, testing, quality control, sale and after-sales service of the PRODUCTS and/or PARTS as contemplated by this Agreement.

(b) SUZUKI also agrees to make available to 'MARUTI' upon 'MARUTI"S request such information required for obtaining National Type Approval in the countries where the PRODUCTS and/or PARTS are intended to be exported which is available to SUZUKI without considerable costs and expenses.

3.07 SUZUKI In-Plant Training

SUZUKI agrees, during the term of this Agreement, upon receipt of written request from 'MARUTI' to make available to 'MARUTI' SUZUKI's plant facilities, as designated by SUZUKI, for the purpose of in-plant observation and training of personnel of 'MARUTI'.

3.08 Despatch of SUZUKI's Personnel

(a) SUZUKI agrees, during the term of this Agreement, upon written request from 'MARUTI', to dispatch its personnel to the factories of 'MARUTI' to give technical advice and guidance in the use of the Licensed Information for the engineering, design and development, manufactures, assembly, testing, quality control and sale and after-sales service of PRODUCTS or PARTS.

PURCHASE OF PRODUCTION MACHINERY AND PARTS

4.01 Purchase of Production Machinery

With regard to the production machinery to be purchased by 'MARUTI' for the manufacture and/or assembly of PRODUCTS and PARTS by 'MARUTI', SUZUKI shall render advice and assistance to 'MARUTI' in the selection and purchase of such equipment and machines, at the request of 'MARUTI'.

5.02 Trademark to be Applied to PRODUCTS and PARTS

All PRODUCTS and PARTS manufactures, assembled and sold in Territory by 'MARUTI' pursuant to this Agreement shall bear the trademark of "MARUTI-SUZUKI" and 'MARUTI' shall use and apply the same trademark on containers, packages and wrappings used for and in connection with the sale of such PRODUCTS and PARTS within the Territory. The parties hereto hereby agree to apply for registration in the Territory of the trademark "MARUTI-

SUZUKI" jointly in the name of SUZUKI and 'MARUTI' when the application for such trademark becomes acceptable under the applicable laws of India. 'MARUTI' represents and warrants to SUZUKI that the trademark 'MARUTI' has been registered in the Territory in the name of 'MARUTI' and agrees that it will do everything necessary to maintain such registration in the Territory. 'MARUTI' further agrees to apply forthwith for the registration of the trademark "MARUTI" in those countries where it intends to export certain of the PRODUCTS in accordance with Article 5.05 of this Agreement. No trademark other than the Licensed Trademarks and the above trademark "MARUTI SUZUKI" shall be affixed of stamped by 'MARUTI' on any of the PRODUCTS or PARTS or containers, packages or wrapping for PRODUCTS or PARTS or written consent of SUZUKI thereto. 'MARUTI' may use the notation to indicate that the PRODUCTS and/or PARTS have been manufactures and/or assembled under technical collaboration with SUZUKI, for the purposes of their sale and advertisement.

5.04 <u>Not to Use the Word "SUZUKI" Except as Specifically Authorized</u>

It is understood and agreed that, except as specifically authorized by this Agreement, 'MARUTI' is not authorized to use, nor shall 'MARUTI' use, the word SUZUKI or any word similar thereto or any of the Licensed Trademarks as part of its corporate name, trademark, trade name or commercial designation without the prior written consent of SUZUKI.

5.05 <u>Exports of the SH Series</u>

(a) SUZUKI grants to 'MARUTI' a non-exclusive right to export subject to and in accordance with the terms and conditions in this Agreement, the SH Series and its PARTS manufactured and/or assembled by 'MARUTI' pursuant to this Agreement to all countries except those where SUZUKI has, at the date of this Agreement or any time thereafter, its own manufacturing facilities or a licensee for any four-wheel passenger cars or parts thereof.

(b) For the purpose of export and sale of the SH Series and its PARTS manufactures and/or assembled by 'MARUTI' pursuant to this Agreement, 'MARUTI' shall be free to establish its own distributor and dealership channels in those countries to which 'MARUTI' may export such SH Series and its PARTS in accordance with paragraph (a) of this Article 5.05 and in which neither SUZUKI, nor any of SUZUKI's subsidiaries, nor a SUZUKI'S licensee for any four-wheel motor vehicles or parts thereof having the right of export and sale of such four-wheel motor vehicles or parts to and in such country, has any distributors or dealers.

(e) SUZUKI will, subject to its satisfaction on the quality, price and delivery schedule, promote the export of PARTS made by 'MARUTI' to SUZUKI and/or its overseas manufacturing factories or licensees.

<u>ROYALTIES, PAYMENTS AND REPORTS</u>

6.01 <u>Lump Sum</u>

As part of the consideration of the technical assistance and license with respect to the SH Series set forth in

Exhibit A attached hereto, 'MARUTI' shall pay to SUZUKI lump sum in the sum of Five Hundred Million Japanese Yen (Y 500,000,000/-) in three instalments.

6.02 Running Royalties

(a) 'MARUTI' hereby further agrees and shall be obliged to pay to SUZUKI not later than sixty (60) days after the end of each Royalty Calculation Period, (i) a running royalty in the sum equivalent to two and one half per cent, (2.5%) of the aggregate of the FOB price of SUZUKI of the Deleted Portion of CKD Components ascertained in the manner provided hereinbelow in the same number of units in respect of each model of PRODUCTS as the number of the PRODUCTS shipped by 'MARUTI' during the immediately preceding Royalty Calculation Period (whether for sales in the Territory or for exports) and (ii) a running royalty in the sum equivalent to two per cent (2%) of the aggregate sum (translated into Japanese Yen at the exchange rate or rates (Via exchange rate or rates against the United States dollar where appropriate) between Japanese Yen and Indian rupees or other currencies in which the ex-factory prices referred to below are denominated, publicly quoted by the Bank of Tokyo, Ltd. New Delhi Office, on the date of remittance) of the ex-factory prices (net of excise tax) of 'MARUTI' of the PARTS shipped by 'MARUTI' during the immediately preceding Royalty Calculation Period (whether for sales in the Territory or for exports). In the event that any PRODUCTS and/or PARTS are shipped by 'MARUTI', directly or indirectly, to any country other than the Territory during any Royalty Calculation Period, 'MARUTI' shall, in addition to the above sum of running royalties, pay to SUZUKI not later than sixty (60) days after the end of each Royalty Calculation period, an additional running royalty in the sum equivalent to one half of one per cent (0.5%) of the sum of (i) the aggregate of the FOB price of SUZUKI of the Deleted Portion of CKD Components referred to in (i) above in this paragraph (a) multiplied by a fraction in which the denominator is the FOB sales price of SUZUKI multiplied by the number of units of the PRODUCTS shipped by 'MARUTI' during the said Royalty Calculation Period (whether for sales in the Territory or for exports) and the numerator is the FOB sales price of SUZUKI multiplied by the number of units of the PRODUCTS exported by 'MARUTI' during the same Royalty Calculation Period and (ii) the aggregate sum (translated into Japanese Yen as aforesaid) of the ex-factory sales prices (net of excise tax) of 'MARUTI' of those PARTS exported by 'MARUTI' during such Royalty Calculation Period.

"Deleted Portion of CKD Components" shall mean a part of one unit of the CKD Components within the meaning as described in (1) in article 1.01 which is, together with the CKD Components as described in (2) of Article 1.01, to be assembled into one unit of PRODUCTS or any multiples of such part of the said unit of CKD Components and, in the event that any PRODUCTS which do not incorporate any CKD Components imported by 'MARUTI' from SUZUKI are shipped by 'MARUTI' during any Royalty Calculation Period, shall mean the CKD Components within the meaning as described in (1) in Article 1.01.

4. Prior to 1993, the petitioner was using the logo 'M' on the front of the cars manufactured and sold by it. From 1993 onwards, the petitioner started using the logo 'S', which is the logo of Suzuki, in the front of new models of the cars manufactured and sold by it, though it continued to use the Mark 'Maruti' along with the word 'Suzuki' on the rear side of the vehicles manufactured and sold by it.

5. A reference under Section 92 CA(1) was made by the Assessing Officer of the petitioner, to the Transfer Pricing Officer (hereinafter referred to as 'TPO') for determination of arm's length price for the international transaction undertaken by Maruti with Suzuki in the F.Y.2004-05. A notice dated 27.8.2008 was then issued, by the TPO, to the petitioner with respect to replacement of the front logo 'M', by the logo 'S', in respect of three models, namely, 'Maruti' 800, Esteem and Omni in the year 2004-05, which, according to the TPO, symbolized that the brand logo of Maruti had changed to the brand logo of Suzuki. It was stated in the notice that Maruti having undertaken substantial work towards making the Indian public aware of the brand 'Maruti', that brand had become a premier car brand of the country. According to the

TPO, the change of brand logo from 'Maruti' to 'Suzuki', during the year 2004-05, amounted to sale of the brand 'Maruti' to 'Suzuki'. He noticed that Suzuki had taken substantial amount of royalty, from Maruti, without contributing anything towards brand development and penetration in Indian market. It was further noted that Maruti had incurred expenditure amounting to Rs.4,092 crores on advertisement, marketing and distribution activity, which had helped in creation of 'Maruti' brand logo and due to which Maruti had become the number one car Company in India. Computing the value of the brand at cost plus 8% method, he assessed the value of the brand at Rs.4,420 crores. Maruti was asked to show cause as to why the value of Maruti Brand be no taken at Rs.4,420 crores and why the international transaction be not adjusted on the basis of its deemed sale to Suzuki.

6. Maruti, in its reply dated 8.9.2008, stated that at no point of time had there been any transfer of 'Maruti' brand or logo by it, to Suzuki, which did not have any right at all to use that logo or trademark. It was submitted by Maruti that a registered trademark could be transferred only by a written instrument of assignment, to be registered with the Registrar of Trademarks, and no such instrument had been executed by it,

at any point of time. It was also brought to the notice of the TPO that Maruti continued to use its brand and logo 'Maruti' on its products and even on the rear side of models Esteem, 'Maruti 800' and 'Omni', the 'Maruti' trademark was being used along with the word 'Suzuki'. It was further submitted that Maruti continued to use the trademark/logo 'Maruti' in all its advertisements, wrappers, letterheads, etc. It was also submitted by Maruti that Suzuki, on account of its large shareholding in the company and because of strong competition from the cars introduced by multinationals in India, had permitted them to use the 'Suzuki' name and logo so that it could face the competition and sustain its market share, which was under severe attack. It was also submitted that Suzuki had not charged any additional consideration for use of their logo on the vehicles manufactured by Maruti and there was no question of any amount of revenue being transferred from the tax net of Indian exchequer to any foreign tax jurisdiction. It was submitted that Maruti had, in fact, earned significantly larger revenue on account of the cooperation extended by Suzuki and that larger revenue was being offered to tax in India.

The jurisdiction of the TPO was thus disputed by

'Maruti' in the reply submitted to him. He was requested to withdraw the notice and drop the proceedings initiated by him.

7. Since Maruti did not get any response to the jurisdictional challenge and the TPO continued to hear the matter on the basis of the notice issued by him, without first giving a ruling on the jurisdiction issue raised by it, this writ petition was filed seeking stay of the proceedings before the TPO.

8. Vide interim order dated 19.9.2008, this Court directed that the proceedings pursuant to the show-cause notice may go on, but, in case any order is passed, that shall not be given effect to.

9. Since the TPO passed a final order on 30th October, 2008, during the pendency of the writ petition and also forwarded it to the Assessing Officer of the petitioner, the writ petition was amended so as to challenge the final order passed by the TPO.

10. In the final order passed by him, the TPO came to the conclusion that the trademark 'Suzuki', which was owned by Suzuki Motor Corporation, had piggybacked on the Maruti trademark, without payment of any compensation by Suzuki to 'Maruti'. He also came to the conclusion that the trademark

'Maruti' had acquired the value of super brand, whereas the trademark 'Suzuki' was a relatively weak brand in Indian market and the promotion of the co-branded trademark 'Maruti Suzuki' had resulted in:

> "(a) Use of "Suzuki" – trademark of the AE
>
> (b) Use of "Maruti" – trademark of the assessee.
>
> (c) Reinforcement of "Suzuki" trademark which was a weak brand as compared to "Maruti" in India.
>
> (d) Impairment of value of "Maruti" trademark due to cobranding process."

11. The TPO noted that Maruti had paid royalty of Rs.198.6 crores to Suzuki in the year 2004-05, whereas no compensation had been paid to it by Suzuki, on account of its trademark having piggybacked on the trademark of Maruti. Since Maruti did not give any bifurcation of the royalty paid to Suzuki towards licence for manufacture and use of trademark, the TPO apportioned 50% of the royalty paid in the year 2004-05, to the use of the trademark, on the basis of findings of piggybacking of 'Maruti' trademark, use of 'Maruti' trademark on co-branded trademark 'Maruti Suzuki', impairment of 'Maruti' trademark and reinforcement of 'Suzuki' trademark, through co-branding process. The arm's length price of royalty

paid by Maruti to Suzuki was held as Nil, using CUP Method. He also held, on the basis of the terms and conditions of the agreement between Maruti and Suzuki that Maruti had developed marketing intangibles for Suzuki in India, at its cost, and it had not been compensated for developing those marketing intangibles for Suzuki. He also concluded that non-routine advertisement expenditure, amounting to Rs.107.22 crores, was also to be adjusted. He, thus, made a total adjustment of Rs.2,06,52,26,920/- and also directed that the Assessing Officer of Maruti shall enhance its total income by that amount, for the assessment year 2005-06.

12. In the Counter Affidavit, the respondent has taken a preliminary objection that the merits of the transfer pricing order cannot be examined in a writ petition, since an alternative remedy is available to the assessee by way of appeal before the Commissioner of Income Tax (Appeals). It has also been submitted that the petition itself is not maintainable as the cause of action i.e., the impugned show cause notice was not acted upon. In the counter affidavit filed by him, the respondent has alleged that after considering the reply of the assessee, the TPO had dropped the idea of making adjustment of Rs 4420 crore on account of deemed sale of 'Maruti'

trademark to Suzuki, as was proposed in the show cause notice. It is further stated that, later on, the TPO had issued a detailed questionnaire clarifying that in this case transfer of economic value of 'Maruti' brand, which was a super brand in India, to Suzuki brand, a well known brand in Japan but less known brand in India, was involved, through replacement of the logo fixed on the cars and co-branding of both the trademarks 'Maruti' and 'Suzuki'. According to the respondent, the TPO never acted upon the show cause notice in making adjustment to the international transactions and that in the fresh queries to the petitioner company with regard to quantum of transfer of economic value, embedded in 'Maruti' trademark, to 'Suzuki' trademark, and justification for making royalty payment to 'Suzuki', he had also raised the issue of non-reimbursement of the expenditure, incurred by the petitioner, on brand promotion of Suzuki. It has also been stated in the counter affidavit that the issues raised in the order sheets of the TPO were replied by the petitioner and were duly considered before taking the decision.

13. On merits, it has been stated that since the petitioner had paid running royalty of Rs 198.6 Crore to Suzuki in the year under consideration, for licence to manufacture and sell

under the cobranded trademark 'Maruti Suzuki' and trademark 'Suzuki' and for after-sale service of such vehicles, the transaction between the parties, which were Associate Enterprises, was an international transaction under Section 92B of the Income Tax Act and therefore, the TPO had examined as to whether the payment of royalty to Suzuki was at arm's length price. According to the respondent, it was evident from the agreement between Maruti and Suzuki that the responsibility to develop markets and promote the trademarks 'Maruti', 'Maruti Suzuki' and 'Suzuki' was on the petitioner/assessee, which had incurred huge expenditure of Rs 204 crore on advertisement, in order to develop a market for the vehicles, which included promotion of the trademark 'Suzuki', co-branded trademark 'Maruti Suzuki' and the trademark 'Maruti', though no part of this expenditure was reimbursed by Suzuki to Maruti. It has been stated that Suzuki had enjoyed all the benefits of such expenditure in the form of dividend income of its share holding in the petitioner company, which was more than 50%, as well as in the form of royalty, which was payable on the basis of sale of vehicles/component, in addition to a lump sum component. The case of the respondent, in the counter affidavit, is that an amount of Rs.99.3 Crore, out of the total royalty of Rs.198.6 crore paid to Suzuki in the year in question, could be attributed to use of co-branded trademark 'Maruti Suzuki' and the trademark 'Suzuki'. The respondent claimed that since the trademark 'Suzuki' as well as the trademark 'Maruti' were used in the co-branded trademark 'Maruti Suzuki', no royalty could be paid by Maruti to Suzuki for use of co-branded trademark because 'Maruti' was a super brand in India whereas 'Suzuki' was a weaker brand in India and co-branding of both the trademarks together had resulted in migration of the economic value embedded in the 'Maruti' trademark to the 'Suzuki' trademark, for which no compensation was paid to the petitioner. It is also claimed by the respondent that no independent entity will undertake brand promotion of another independent party at its own expense, without any compensation from the third party.

14. The first contention raised before us, by the learned senior counsel for the petitioner, is that while passing the final order dated 30.10.2008 the TPO has completely abandoned the grounds set out in the notice issued by him on 27th August, 2008 for initiating transfer pricing proceedings against the petitioner and no other notice was thereafter issued to the

petitioner. On perusing the show-cause notice, we find that the only ground given in the show-cause notice dated 27.8.2008 was that change of the brand logo 'M' of Maruti to Suzuki during the year 2004-05 amounted to sale of the brand 'Maruti' to Suzuki. It was for this reason that the TPO asked Maruti to show-cause as to why the entire amount spent by it on promoting the brand 'Maruti' during the period 1989 to 2004-05 be not taken as the value of 'Maruti' brand which was deemed to have been sold by Maruti to Suzuki. There was absolutely no allegation in the show-cause notice that the trademark Suzuki had piggybacked on the trademark Maruti. There was no averment in the show-cause notice that Maruti had paid royalty of Rs.198.6 crores to Suzuki, during the year 2004-05, for licence to manufacture and licence to use the trademark 'Suzuki'. In fact, there was no averment in the show-cause notice that 'Maruti' had paid some royalty to Suzuki for use of co-branded trademark 'Maruti Suzuki', that there had been impairment in the value of the trademark 'Maruti' or that the use of co-branded trademark had resulted in reinforcement of the trademark 'Suzuki'. There was no reference at all to the joint trademark in the show-cause notice issued by the TPO. Maruti was not asked to show cause as to why the arm's length price in respect of the royalty paid by it to Suzuki be not determined taking into consideration piggybacking on the 'Maruti' trademark, and use of 'Suzuki' trademark in the co-branded trademark. In fact, the show-cause notice was based on the sole premise that Maruti had sold its trademark which it had built at the cost of Rs.4,092 crores, to Suzuki, and that there was a deemed sale of that trademark by Maruti to Suzuki.

15. The show-cause notice did not contain any proposal by the TPO to adjust what he termed as expenditure beyond the bright line limit or non-routine advertisement expenditure on the ground that the advertisement expenditure, was in fact incurred on promoting the brand of Suzuki.

16. A perusal of the terms and conditions contained in the agreement between Maruti and Suzuki clearly shows that Maruti has not transferred its brand or logo to Suzuki. No right was given to Suzuki to use either the brand or the logo of Maruti. It is only Maruti which was given the right to use the brand name and logo of Suzuki on its products. The order of the TPO also does not show any use of the brand name 'Maruti' or logo 'M' by Suzuki. It is an admitted position that the petitioner continues to use the name 'Maruti' on all its

products, including passenger vehicles and spare parts, as also in the advertisements and other promotional activities undertaken by it. Moreover, the brand name or logo of 'Maruti' has not been transferred to Suzuki nor has the same been used by Suzuki either in India or in any other country.

17. In terms of clause 5.02 of the Agreement, all products and parts manufactured, assembled and sold in India by Maruti, pursuant to the Agreement, are required to bear the trademark 'Maruti Suzuki' and Maruti is also required to use and apply the same trademark on containers, packaging and wrappings used for and in connection with the sale of such parts and products in India. Thus, not only does the petitioner continue to use the name 'Maruti', it is under a contractual obligation to Suzuki to continue to use that name in conjunction with the name Suzuki. It is true that there is use of the name 'Maruti' in the co-brand 'Maruti Suzuki', on the products manufactured and sold by Maruti in India, as well as on their containers, packaging, wrapping etc. But, Suzuki, even if it so wants, cannot use the joint trademark "Maruti' Suzuki' either on its products or on the containers packaging, wrapping etc., which may be used by it in connection with its products. There is a provision in the Agreement for

registration of the trademark 'Maruti Suzuki' in the names of the Maruti and Suzuki but, admittedly, no such registration has actually taken place. Whenever such a registration takes place, it can possibly be said that benefit of the name 'Maruti' on account of its use in the joint trademark 'Maruti Suzuki' does accrue to Suzuki but, then, the benefit of the name 'Suzuki' in the joint trademark will also simultaneously accrue to Maruti. We need not dwell further into this aspect of the matter, since no such registration has taken place so far.

18. It, therefore, cannot be disputed that the TPO has failed to make out any case of sale of the brand name 'Maruti' or logo 'M' by the petitioner to Suzuki. The ownership and use of the trademark as well as the logo continues to vest in the petitioner company. In fact the TPO himself noted in para 7.11.3 of the order dated 30.10.2008 that it was nowhere the intention to convey that Maruti had transferred its brand to Suzuki and that the same was being used by Suzuki also. Hence, there is no escape from the conclusion that the case as set up in the show-cause notice was abandoned by the TPO, while passing the final order. In fact, the respondent himself has taken the stand that the show cause notice dated August 27, 2008 was not acted upon and the TPO had made out an

altogether new case, far removed from the basis on which the original notice was given by him.

19. The learned counsel for the respondent drew our attention to the proceedings dated 6.10.2008, 13.08.2008 and 16.10.2008 whereby the petitioner was asked to give the following information and contended that by seeking this information the TPO had clearly conveyed to the assessee, the basis and the grounds on which adjustment was made by him in the final order dated 30.10.2008:-

> **13.08.2008**
> "iv) Assessee is not a legal owner of "S" Trademark. This trade mark is owned by A.E. How this trade mark "S" was an a number of products of the assessee. The advertisement and other related expenditures are incurred for promoters of Trade Mark of which assessee had no legal right. Therefore the promotional efforts of Assessee has generated and embedded economic value in "S" in which was an unknown trade mark in India AR requested to explain why para 6.38 of OEDC guidelines should not be applied in the present case.
>
> v) Further the embedded economic value in Trade Mark "M" had been extinguished in favour of AE's Trade mark "S". Therefore, the marketing intangible inbuilt in trade Mark "M" had been extinguished in favour of trademark of "S". AR asked to file final submission if any on the above mentioned issue. The case adjourned for final hearing for

> 16.10.2008 at 11 A.M. on request of ARS.
>
> **16.10.2008**
> The case was discussed at length with AR's on all aspect relating to brand promotion, marketing intangibles, royalty payment modelwise and industry analysis too."

20. We are unable to accept the contention that the above referred information sought by TPO could be an adequate substitute for the notice required to be issued to the petitioner company. When the show cause notice issued to the petitioner company is based solely on the premise that the trademark 'Maruti' had been transferred by the petitioner company to Suzuki and the TPO does not convey, to the noticee that he had abandoned the show cause notice issued by him and was now proceeding on an altogether different ground for the purpose of making adjustments to its income, seeking an information of this nature, without expressly conveying the grounds for the proposed adjustment cannot be said to be an appropriate substitute for the show cause notice required to be issued to the petitioner company. The case made out by the TPO in the final order dated 30.10.2008 is that since the joint trademark 'Maruti Suzuki' included the word Suzuki belonging to the Associate Enterprises, that trademark had piggybacked on the Maruti trademark of the petitioner company, without

payment of any compensation by Suzuki to Maruti. We cannot discern such a ground from the above referred proceedings. There is absolutely no reference to the joint trademark 'Maruti Suzuki' in the above referred proceedings, which relate only to the logo 'S'. These proceedings do not indicate that on account of use of the joint trademark 'Maruti Suzuki', the value of the trademark 'Maruti' had been impaired and the value of the trademark Suzuki had gone up. Though it was stated in the proceedings that advertisements and other related expenditure was incurred for promotion of trademark on which the assessee had no legal right, it was not stated that these expenditures were incurred on promoting the joint trademark 'Maruti Suzuki' or that they were not in line with the expenses that are incurred by comparable independent enterprises. It appears that while recording these proceedings, the TPO had only the logos, 'S' of Suzuki and 'M' of 'Maruti', in his mind and he was not referring to the joint trademark 'Maruti Suzuki' being used at the rear of the vehicles being manufactured, sold and serviced by Maruti.

21. The purpose of a show cause notice being to enable the assessee to meet the grounds, on which the arm's length price paid by him was sought to be rejected and adjustment

was proposed to be made to its income, the grounds to be conveyed to the assessee needed to be clear, cogent, specific and unambiguous. In **Uma Nath Pandey & Others Vs. State of UP & Another**: (2009) 12 SCC 40, Supreme Court, inter alia observed as under:

> "Notice is the first limb of this principle. It must be precise and unambiguous. It should appraise the party determinatively the case he has to meet. Time given for the purpose should be adequate so as to enable him to make his representation. In the absence of a notice of the kind and such reasonable opportunity, the order passed becomes wholly vitiated. Thus, it is but essential that a party should be put on notice of the case before any adverse order is passed against him."

In **Biecco Lawrie Limited & Another Vs. State of West Bengal & Another**: (2009) 10 SCC 32, Supreme Court, inter alia, observed as under:

> "One of the essential ingredients of fair hearing is that a person should be served with a proper notice, i.e., a person has a right to notice. Notice should be clear and precise so as to give the other party adequate information of the case he has to meet and make an effective defence. Denial of notice and opportunity to respond result in making the administrative decision as vitiated. The adequacy of notice is a relative term and must be decided with reference to each case. But generally a notice to be adequate must contain the following: (a)

> time, place and nature of hearing; (b) legal authority under which hearing is to be held; (c) statement of specific charges which a person has to meet."

Since the query of the TPO as recorded in the above referred proceedings, was confined to use of logo, there was no occasion for the assessee company to assume, on the basis of these proceedings that it was required to justify the use of joint trademark 'Maruti Suzuki' on its products, and in their marketing, promotion and advertising, without any compensation from Suzuki.

22. Section 92CA of Income Tax Act, 1961 (hereinafter referred to as the Act) provides that where the assessee has entered into an international transaction and the Assessing Officer considers it necessary or expedient to do so he may, with the previous approval of the Commissioner, refer computation of arm's length price, in relation to the said international transaction, under Section 92C, to the TPO. Since the reference to the TPO is not mandatory, ordinarily the Assessing Officer would make reference to TPO in those cases, where he is not in agreement with the price disclosed by the assessee or where, on account of the complex nature of the transaction, he feels that the arm's length price needs to be

determined by the TPO. When such a reference is made, the TPO is statutorily required to serve a notice on the assessee requiring him to produce or cause to be produced any evidence on which the assessee may rely in support of the computation, made by him, of the arm's length price, in relation to the international transaction in question. Unless the assessee knows what are the grounds which impelled the TPO to discard the price disclosed by him and to propose an adjustment in its income, while determining arm's length price in relation to the international transaction made by it, it is not possible for him to meet those grounds and satisfy the TPO that the price agreed by it for the transaction in question was the right arm's length price and there was no justification to make any adjustment in its income. The assessee can produce the relevant information and documents before the TPO only if he knows the precise case which he is expected to meet before the TPO. It is meaningless to give opportunities of leading evidence to the assessee, without first letting him know, what he is expected to meet. In case the TPO, feels the necessity of making adjustments to the income of the assessee only after he has considered the evidence produced before him, by the assessee, in support of the price agreed by him for transaction in question, he needs to disclose to the assessee, at that very stage, the ground on which wants to make the adjustment to his income, and then give him adequate opportunity to reply to those grounds and lead evidence in support thereof.

23. Our attention has not been drawn to any proceedings conveying to the assessee, that (i) the TPO proposed to make adjustment to its income on the grounds that on account of use of the name 'Suzuki' in the joint trademark 'Maruti Suzuki', (ii) some benefit had accrued to Suzuki in the form of building and strengthening of its brand 'Suzuki' and (iii) that the TPO felt that the advantage, which accrued to 'Suzuki' had neutralized the benefit which 'Maruti' had obtained by use of the trademark and name of Suzuki, on its products and accordingly, he proposed to make adjustment in its income. Our attention has not been drawn to any proceedings requiring the petitioner-company to produce evidence justifying use of the joint trademark 'Maruti Suzuki' without payment of any compensation by Suzuki to Maruti, while entailing payment of running royalty to Suzuki, by Maruti, for use of the technical assistance from Suzuki, along with permission to use its trademark 'Suzuki'. No proceeding, conveying to the assessee, that the expenses incurred by it on advertising and promotion

of its products and parts were higher than what a comparable independent enterprise would have incurred and such higher expenditure on promotion, marketing and advertising had resulted in strengthening and building the trademark of 'Suzuki' in India and that the TPO proposed to make adjustment in its income accordingly, has been brought to our notice. Similarly, no proceedings requiring the petitioner Company to justify the expenditure incurred on advertisement and promotion of its products under the joint trademark 'Maruti Suzuki' has been brought to our notice.

24. As held by this Court in **Moserbaer India Limited & Others Vs. Additional Commissioner of Income Tax & Another**, (2009) 316 ITR 1 (Delhi), the provision of sub-Section (3) of Section 92CA casts a duty on the TPO to afford an opportunity of an oral hearing to the assessee. Oral hearing would be meaningless, unless the assessee knows the grounds on which adjustment to its income is proposed to be made by the TPO while determining arm's length price in respect of international transaction made by it. We would like to note here at the cost of repetition that no notice other than the notice dated 27.8.2008 was given to the petitioner by the TPO. The notice dated 27.8.2008 having admittedly been abandoned

and not acted upon, it was obligatory for the TPO to either issue a fresh notice requiring the assessee to produce such evidence as it might be having in its possession, to justify payment of royalty for use of the joint trademark 'Maruti Suzuki' on all its products and their containers, packaging etc as well as such evidence as it might have in its possession, to justify the expenditure incurred on advertisement and promotion of its products under the joint brand name 'Maruti Suzuki'. This notice ought to have been issued at the very threshold of the proceedings initiated by the TPO. In any case, the bare minimum that was expected from TPO, for compliance of the statutory requirement of giving notice envisaged in sub-Section (2) of Section 92CA, and to comply with the principles of natural justice which are necessarily required to be observed, before passing an order entailing civil consequences, was to record the grounds on which the adjustment was proposed to be made by him, in the income of the petitioner Company, in a precise, clear and unambiguous language, in the proceedings recorded by him, get it signed from the authorized representative of the assessee, give it an opportunity to file a reply to those grounds and to produce such evidence as it might have in its possession to show that no such adjustment is called for in its case. If the procedure adopted by the TPO does not meet even this minimum requirement, it cannot be said to be a fair and reasonable procedure required to be followed by an authority exercising quasi-judicial and/or administrative powers, entailing serious consequences for the assessee in the form of not only additional tax liability on account of addition to the income but also on account of the penalty that may be imposed upon it under Section 271 of the Act, Explanation 7 to which specifically provides that in the case of the assessee who has entered into an international transaction, in the event of any amount being allowed or disallowed in the process of computation of its income under sub-Section (4) of Section 92C, will be deemed to represent the income, in respect of which particulars have been concealed, or inaccurate particulars have been furnished, unless the assessee proves that the price charged or paid in such transaction was computed in accordance with the provision contained in Section 92C and the manner prescribed under that Section, in good faith and with due diligence. Thus, the adjustment made by the TPO in the arm's length price could be regarded as concealment of particulars of income or furnishing inaccurate particulars under Section 271(1)(c) of the Act. Therefore, the order passed by the TPO visiting Maruti with civil consequences, having wide ramifications for it, it was necessary for him to follow the expected norms in the matter of issuing show-cause notice and giving opportunity to produce evidence, followed by opportunity of oral hearing to the assessee Company.

25. It was submitted by the learned counsel for the respondent that in case this Court is of the view that requisite notice has not been given to the petitioner Company, the matter can be remanded to the TPO for passing a fresh order after giving the requisite notice and opportunity to produce evidence, followed by oral hearing. On the other hand, it was contended by the learned counsel for the petitioner that since no case for any adjustment to the income of the petitioner is made out even from the facts brought out in the order of the TPO, the proceedings initiated by him ought to be quashed. It was further submitted by him that since the order passed by the TPO has been justified in the counter-affidavit filed by the respondent, no useful purpose will be served from remitting the matter back to the TPO, who is likely only to reiterate the order passed by him. In support of his contention, the learned

counsel for the petitioner has referred to **State of Andhra Pradesh Vs. P.V.Hanumantha Rao(Dead) through LRs & Another** (2003) 10 SCC 121, where the Supreme Court, inter alia held that though remedy of writ petition available in the High Court is not against the decision of the subordinate court, tribunal or authority but is against the decision making process, if the court, tribunal or authority deciding the case, in the decision making process, ignored vital evidence and thereby arrived at erroneous conclusion or has misconstrued the provisions of the relevant Act or misunderstood the scope of its jurisdiction, the Constitutional power of the High Court under Articles 226 & 227 can be invoked to set right such error and prevent gross injustice to the complaining party.

26. The Supreme Court in the case of P.V.Hanumantha Rao(supra), inter alia, observed as under:

> "This Court has recognized the right of the High Court to interfere with orders of subordinate courts and tribunals where (1) there is an error manifest and apparent on the face of the proceedings such as when it is based on clear misreading or utter disregard of the provisions of law, and (2) a grave injustice or gross failure of justice has occasioned thereby."

In **Sawarn Singh Vs. State of Punjab** (1976) 2 SCC

868, Supreme Court, inter alia, observed as under:

> "In regard to a finding of fact recorded by an inferior tribunal, a writ of certiorari can be issued only if in recording such a finding, the tribunal has acted, on evidence which is legally inadmissible, or has refused to admit admissible evidence, or if the finding is not supported by any evidence at all, because in such cases the error amounts to an error of law."

He has also referred to **Paradip Port Trust Vs. Sales Tax Officer & Others**, (1998) 4 SCC 90, where the writ petitions involved interpretation of the words "transfer of the right to use any goods" used in sub-clause (d) of clause (29-A) of Article 366 of the Constitution. It was held by the Supreme Court that since the writ petition involved interpretation of a Constitutional provision and taxability of the transactions in respect of which sales tax had been assessed by the Sales Tax Officer, the High Court should have entertained the writ petition and should have considered the question therein requiring the appellant to avail the remedy of appeal under the Sales Tax Act.

27. On the other hand, the learned counsel for the respondent, Mr. Sanjeev Sabharwal has referred to the decision of the Supreme Court in **State of Andhra Pradesh Vs. Chitra Venkatarao**, 1976 SCR (1) 521, where in the context of the

power of the High Court in relation to departmental inquiries against the Government servants, it was held that findings of fact reached by an inferior court or tribunal, as a result of appreciation of evidence, are not to be re-opened or questioned in writ proceedings. It was further held that in regard to a finding of fact recorded by a tribunal, a writ can be issued if it is shown that the tribunal had refused to admit admissible evidence or had admitted material or erroneous evidence which had influenced the impugned findings. It was also held that if a finding is based on no evidence that would be regarded as an error of law which can be corrected by a writ of certiorari but if there is some evidence which may reasonably support the conclusion, its adequacy or sufficiency and the inference of fact drawn are within the exclusive jurisdiction of the tribunal.

28. It would be appropriate for us to examine the order passed by the TPO in the light of statutory provisions relating to transfer pricing methods, in order to decide whether to altogether quash the proceedings or to remit the matter back to the TPO for a fresh decision.

29. Section 92 of the Act, which was the only Section to deal with cross-border transaction at the time of introduction of the Finance Bill, 2001 provided for adjustment to the profits

of a resident, arising from the business carried on between him and a non-resident, if it appeared to the Assessing officer, that owing to the close connection between them, the course of business was so arranged, so as to provide less than expected profit to the resident. Rule 11 prescribed under that Section provided a method to estimate a reasonable profit in such cases. As stated in CBDT Circular No. 14/2001, this provision, however, was of a general nature and limited in its scope, since it did not allow adjustment of income in case of the non-resident and referred to a close connection which was not defined and was vague. That Section provided for adjustment of profits rather the adjustment of prices and it was felt that the rule prescribed for estimating profits was not scientific and did not apply to individual transaction such as payment of royalty, which were not part of a regular business carried on between a resident or a non-resident.

30. The trigger behind introducing the Transfer Pricing Regime in the Act, as discerned from the Finance Minister's in his Speech, while introducing the Finance Bill, 2001, was the presence of multinational enterprises in India and their ability to allocate profits in different jurisdictions by controlling prices in intra-group transactions. As stated in the Memorandum

explaining the provisions of the Finance Bill, 2001, it was felt that the profits, derived by the enterprises belonging to the same multinational groups, carrying on business in India, could be controlled by the multinationals, by manipulating the prices charged and paid in such intra group transactions, thereby leading to erosion of tax revenue in India. A statutory framework, therefore, was sought to be incorporated in the Act, so as to compute reasonable, fair and equitable profits and tax of such multinational enterprises in India. The mechanism devised to achieve this objective was to compute income from the international transactions, having regard to arm's length price, keeping and maintaining all information and documents, by persons entering into international transactions and furnishing a report from an accountant by persons entering into such transactions. Towards this purpose, the terms 'arm's length', 'enterprise', 'Associated Enterprise' and 'international transactions' were defined in the Act.

31. Section 92 to 92(F) of the Act apply to entities which are defined as "enterprise" in Section 92(F)(iii) of the Act. The definition given in the Act is wide and the attempt is to cover almost every type of business or activity in which the multinationals are normally engaged. The provisions cover

assets, tangible as well as intangible, services, investments, loans and shares/securities. The paramount objective behind enactment of these provisions is that the entities which are connected to each other on account of shareholding or managerial control etc. and thereby are in a position to influence the business decisions of Indian entities, including the payments made to or received by them from the non-resident entity, are not able to shift payment of taxes from India to other countries, by shifting the income which genuinely belongs to the Indian entity, to the non-resident entity, which is not taxed in India.

32. The arm's length principle of transfer pricing is based on the premise that the amount charged by one related party to another for a product must be the same as if the parties were not related. An arm's length price in respect of a foreign transaction, therefore, is the price which that transaction would obtain in the open market. Determination of arm's length price, when dealing with proprietary goods and services or intangible can be a much more complicated matter, as compared to determining such price in case of products such as commodities. A controlled transaction normally would meet the arm's length standard, if the results of the transaction, are

consistent with the results that would have been obtained, if an uncontrolled entity was engaged in the same transaction, under the same circumstances. It may not always be possible to come across identical transactions and, therefore, the TPO, in such cases, would need to refer to comparable transactions made under comparable circumstances.

33. Section 92 A of the Act, which defines 'associated enterprise', to the extent it is relevant, reads as under:

> **92A.** (1) For the purposes of this section and sections 92, 92B, 92C, 92D, 92E and 92F, "associated enterprise", in relation to another enterprise, means an enterprise—
> (a) which participates, directly or indirectly, or though one or more intermediaries, in the management or control or capital of the other enterprise; or
> (b) in respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.
> (2) For the purposes of sub-section (1), two enterprises shall be deemed to be associated enterprises if, at any time during the previous year;--
> (a) one enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in the other enterprise; or

> (b) any person or enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in each of such enterprises; or
>
> (c) ……….
>
> (d) ……….
>
> (e) more than half of the board of directors or members of the governing board, or one or more executive directors or executive members of the governing board of one enterprise, are appointed by the other enterprise; or
>
> (f) more than half of the board of directors or members of the governing board, or one or more executive directors or executive members of the governing board, of each of the two enterprises are appointed by the same person or persons; or
>
> (g) ………

34. It was expressly admitted before us, by the learned senior counsel appearing for the petitioner, that Suzuki was an 'Associated Enterprise' in relation to the petitioner Company on account of managerial participation and control as well as on account of 50% or more of the equity of the Maruti being owned by Suzuki.

35. 'International transaction' is defined in Section 92B of the Act and to the extent it is relevant, the provision reads as under:

> **92B.** (1) For the purposes of this section and sections 92, 92C, 92D and 92E, "international transaction' means a transaction between two or more

> associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises, and shall include a mutual agreement or arrangement between two or more associated cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to ay one or more of such enterprises.

An international transaction, therefore, is essentially a cross-border transaction, between Associated Enterprises, in any sort of property, whether tangible or intangible or any provision of services, lending of money etc. The transaction in question is definitely covered in the above referred definition, since not only does it include sale of tangible properties such as parts and components and licensing of trademark by Suzuki to Maruti, it also had a bearing on the profits and losses of both the entities. If there was a mutual arrangement between Maruti and Suzuki relating to their respective costs and expenses in connection with the services provided by Suzuki to Maruti or by both the entities mutually to each other, that also would come within this definition.

36. Section 92 of the Act, to the extent it is relevant, reads

as under:

> “(1) Any income arising from an international transaction shall be computed having regard to the arm’s length price.
>
> (2) Where in an international transaction, two or more associated enterprises enter into a mutual agreement or arrangement for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises, the cost or expense allocated or apportioned to, or, as the case may be, contributed by, any such enterprise shall be determined having regard to the arm’s length price of such benefit, service or facility, as the case may be.”

37. Section 92C, to the extent it is relevant, reads as under:

> **92C.** (1) The arm’s length price in relation to an international transaction shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associate3d persons or functions performed by such persons or such other relevant facts as the Board may prescribe, namely:-
>
> (a) comparable uncontrolled price method:

38. Section 92F(ii) defines arm’s length price, which reads

as under:

> **92F.** ....
> (ii) "arm's length price" means a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions;

39. The intention behind the new provisions is to ensure that the profits taxable in India are not understated nor are the losses in India overstated, by declaring lower receipts or higher outgoings than those which would have been declared by persons entering into similar transaction with unrelated parties, under the same or similar circumstances. The basic intention underlying the new provisions is to prevent shifting of profit by manipulating international transactions, thereby reducing the country's tax base.

40. Rules 10 to 10A, inter alia, provide for the factors which are to be considered in selecting the most appropriate method to determine the arm's length price in respect of an international transaction, the major consideration in this regard being the availability and reliability of data necessary for application of the method, the extent and reliability of assumption required to be made and the degree of comparability existing between the international transaction

and the uncontrolled transaction.

41. Under the new provision, the primary onus is on the tax payer to determine an arm's length price in accordance with the rules and to substantiate the same with prescribed documentation. Where such onus is discharged by the assessee and the data used for determining the arm's length price is reliable and correct, there should normally be no intervention by the Assessing officer. Ordinarily, it is only where the assessee has not discharged the onus placed on him or he has not determined the price of the international transaction in question in terms of sub-section (1) and (2) of Section 92 of the Act or the data used by him is not reliable, correct or appropriate or the TPO finds evidence which discredits the data used by the assessee or the methodology applied by him in arriving at arm's length price of the international transaction in question, that the arm's length price declared by the assessee should be rejected and re-determined in terms of Section 92-C of the Act.

42. On the functions to be performed by Suzuki and Maruti, the TPO in the final order passed by him inter alia noted as under:-

Functions Performed by SMC in

relation to Indian Operations
...SMC provides MUL with all the technical information and know-how in connection with the manufacture, assembly, testing, quality control, sales and after sales service of passenger cars. The technical know-how provided to MUL includes all designs, drawings, standards, machine and material specifications, prints, engineering data and other information, knowledge and advice, etc.

Complex Manufacturing
SMC is responsible for the manufacturing and supply of complex components to MUL, which the Indian entity cannot manufacture/procure locally. It also purchases components from third party for subsequent resale to affiliates.

Core Marketing and Global Brand Management
SMC is responsible for core marketing and relationship management with its customers. It also undertakes brand building exercises and marketing. Further, it provides valuable marketing support to MUL in India.

Technical Assistance, Vendor Development, etc.
In summary, SMC is engaged in complex R&D and manufacturing, as well as core marketing and brand building which are key contributors to the overall vale generated in any business operations...

Functions Performed by MUL
Further, in case of exports to Europe, Suzuki Europe SA (a 100% Belgium subsidiary of SMC Japan) assists MUL in coordinating and promoting the Indian

entity's sale in Europe to various Suzuki distributors…

…SMC provides information about markets to MUL, although the final decision to enter a market or not it taken by MUL. The local marketing, advertising, etc. is undertaken by the overseas distributor, although MUL provides support to the distributors for such marketing efforts. In some cases SMC also organizes events and road-shows showcasing both SMC & MUL's products. MUL reimburses the promotional expenses incurred by SMC for displaying MUL's products. It is however worth noting that the Suzuki **brand is well recognized worldwide, which helps MUL in entering any export market**.

Intangibles

SMC owns significant intangibles like designs, drawings, patents, trademarks know-how, technical information, research findings, proprietary techniques, standards, etc. that are used by MUL.

MUL only employs the intangibles provided by SMC and also uses the trademark "Suzuki" owned by SMC. It does not undertake any significant R&D that leads to development of non routine intangibles. MUL owns the engineering results and production experience undertaken by it over the years.

Technology Risk

SMC is responsible for constant upgradation of technology of products and processes. It therefore, bears significant risk on this account.

Research & Development

R&D is primarily the responsibility of

> SMC and hence it bears all the risks associated with this activity.
>
> **Research and Development Expenditure by Maruti**
> ...assessee had undertaken substantial R&D work for product development, localization of product enhancement and customization of the technology of the assessee. Therefore, assessee was licensed, manufactured and as a license manufacture it had undertaken substantial research and development work.
> 5.4.7 Admittedly, the assessee had borne the cost of advertisement of Rs 20 Million undertaken to promote Suzuki branded vehicle in European countries i.e., the expenditure was incurred to promote the brand of AE in European countries. However, the assessee was neither reimbursement the cost of advertisement nor was paid any service charge. **It is important to clarify here that even on export sale of these Suzuki branded vehicles, the assessee had paid royalty to the AE**. These facts lead us to an irresistible conclusion that on the manufacturing and export of Suzuki branded vehicles where the assessee was reduced to merely a contract manufacture it had borne the cost of advertisement and paid royalty to the AE SMC. No independent uncontrolled contract manufacture would ever absorb the cost of another entity.

43. After examining the terms and conditions of the agreement, the TPO inter alia observed as under:-

> 5.4.12 The above extracted terms and conditions of the agreement have proved

the following facts:
(a) The assessee has paid royalty to the AE, Suzuki Motor Corporation (in short SMC) for licence for the **manufacture, sale and after sale** service of Motor vehicles manufactured by it.
(b) The agreement stipulates use of 'Suzuki' and "Suzuki" trade mark only for export of Suzuki branded motor vehicles (refer Exhibit B and clause 5.05 above extracted agreement).
(c) Under licence agreement dated 3rd June 1992 between the assessee and the AE, SMC for YE-2 model, the assessee was required to use Suzuki logo on front side of the car.
(d) The agreement stipulates for use of trade mark "Maruti-Suzuki" for domestic sales.
(e) Clause 3.02 and 3.03 stipulate that improvement and modification of product, and part by the assessee shall be treated as licenced information i.e., legal ownership of technology intangible will get transferred to the AE, SMC and the assessee shall be compensated for such improvement and modification. It is matter of record that the assessee head made localization, improvement, modification and upgradation of technology provided by the AE as discussed in para 5.4.5 of this order by incurring huge expenditure on Research and Development activities. However, in reality the AE has never compensated the assessee for such improvement and modification contrary to this it had charged royalty on continuous basis from assessee even on modified and upgraded technology. This view is fortified by a fact that the AE has been charging running royalty at certain percentage of the export and domestic sale (refer article 6 of the

agreement)
(f) For technical advice personnel of SUZUKI to be paid hefty fee. All taxes to be borne by the MARUTI. Normally in the case of licensed manufacturing, it is the responsibility of licensor to provide this facility as it is already included in lumpsum royalty and free running royalty.
(g) Research and development and product enhancement without any compensation in India.
(h) As per clause 5.01 of the agreement which reads as under, the assessee was responsible to develop, promote and expand the sale of product and part of the AE within India.
"**MARUTI shall use its best efforts to develop, promote and expand the sale of PRODUCTS and PARTS within the territory"**.
(extracted from para 5.01 of the licence agreement dated 09.01.2001 between AE and the assessee)
(i) The agreement has restricted the assessee's business opportunity by prohibiting into manufacture, sale and export product or parts of other competitors (refer 5.01(a) and 5.03 of the agreement).
(j) **The clause 5.02 stipulates that all products and parts manufactured in India shall bear trademark of "MARUTI-SUZUKI" whether for sale in territory or for export. It is important to clarify here that 'MARUTI' or 'M' are registered trade mark of the AE, SMC. The assessee vide letter dated 22.08.2008 has informed that "MARUTI-SUZUKI" is not a registered combined trade mark**. This puts a question mark on the right of the assessee to receive royalty for trade mark

particularly when the trade mark MARUTI as used in co-branded trade mark was registered trade mark of the assessee.

(k) This agreement is only related to licensed trademark of SUZUKI and it do not provide any protection and compensation to super trademark of MARUTI even though as per agreement both the trade mark were used together under cobranded trade mark.

(l) The brand development was the responsibility of the Maruti without any compensation. Rather royalty paid for promoting the little known "Suzuki" owned by the AE.

44. As regards payment of Royalty to 'Suzuki', the TPO inter alia observed as under:-

> 7.9 Next pertinent issue for examination is to know the reason for changing "M" and "Maruti" logo on the various model cars manufactured in India to "S" or "Suzuki" logo over a period of time. The reasons is obvious i.e., to replace super brand logo having smaller brand value in India on various known models of cars manufactured by the assessee because these car models were widely recognized as value car by Indian customer. ***In other words "Suzuki" and "S" trade mark had piggybacked the trademark of the assessee "MARUTI" or "M" which was developed as super brand over period of two decades at huge economic cost of assessee without any compensation to the assessee***. Now issue here for consideration is whether any prudent third party will allow piggybacking of his established brand without any compensation? Answer

stares at one face i.e., a big NO. Every prudent businessman will impair its marketing intangible only after charging a right compensation. The assessee had allowed piggybacking for no commercial reasons that is why it is under transfer pricing scrutiny.

7.10 …In this case it is undisputed fact that 'MARUTI' or "M" trade mark has more brand value as compare to "Suzuki" trade mark in Indian market. In other words "Suzuki" trade mark has lesser brand value as compared to 'Maruti' trade mark. In this context the cobranding has achieved two fold objectives of the AE which had acquired controlling interest in the assessee company since financial year 2003-2004; one to reinforcement of brand value of trade mark "SUZUKI" which was relatively a weaker brand as compared to Maruti and impairment of brand value of "MARUTI" which started migrating to "Suzuki" trade mark through cobranding process. ***However, the AE had charged royalty of Rs.99.03 crores from the assessee for use of its "Suzuki" brand in cobranded trade market but the assessee was not compensated either for use of its trade mark on cobranded trade mark or for impairment of its trade mark and simultaneous reinforcement of "Suzuki" trademark.***

Concept of Marketing Intangible and its Application to the Facts of the case of the Assessee

7.13.1 …While precise meaning of a "marketing intangible" is rather unclear from a tax and legal perspective generally the term "marketing intangible" can be meant to include trade names,

> trademarks and trade dress, logos, the local market position of a company and/or its product, know-how that surrounds a trademark such as the knowledge of distribution channels and customer relationship and trade secrets. OECD has made an attempt to differentiate between "marketing intangibles" such as trademarks, trade names, customer lists and distribution channels from "trade intangible" such as manufacturing know-how and trade secrets...

45. He also relied upon paragraph 6.4 of OECD's "Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations" edition 2001, which inter alia reads as under:-

> 6.4... Marketing intangibles include trademarks and tradenames that aid in the commercial exploitation of a product or service, customer lists, distribution channels, and unique names, symbols, or pictures that have an important promotional value for the product concerned...

46. He also took support from the following OECD guidelines:

> 6.36 Difficult transfer pricing problems can arise when marketing activities are undertaken by enterprises that do now own the trademarks or trade names that they are promotional (such as a distributors of branded goods). In such a case, it is necessary to determine how the marketer should be compensated for

those activities. The issue of whether the marketer should be compensated as a service provider, i.e., for providing promotional services, or whether there are any cases in which the marketer should share in any additional return attributable to the marketing intangibles. A related question is how the return attributable to the marketing intangibles can be identified.

6.37 As regards the first issue – whether the marketer is entitled to a return on the marketing intangibles above a normal return on marketing activities – the analysis requires an assessment of the obligations and rights implied by the agreement between the parties. It will often be the case that the return on marketing activities will be sufficient and appropriate. One relatively clear case is where a distributor acts merely as an agent, being reimbursed for its promotional expenditures by the owner of the marketing intangibles. In that case, the distributor would be and entitled to compensation appropriate to its agency activities alone and would not be entitled to share in any return attributable to the marketing intangible.

6.38 Where the distributor actually bears the cost of its marketing activities (i.e., there is no arrangement for the owner to reimburse the expenditures), the issue is the extent to which the distributor is able to share in potential benefits from those activities. In general, the arm's length dealings the ability of a party that is not the legal owner of a marketing intangible to obtain the future benefits of a marketing activities that increase the value of that intangible will depend principally on the substance of the rights of the party. For example, a distributor

> may have the ability to obtain benefits from its investments in developing the value of a trademark from its turnover and market share where it has a long term contract of sole distribution may bear extraordinary marketing expenditures beyond what an independent distributor in such a case might obtain an additional return from the owner of a trademark, perhaps through a decrease in the purchase price of the product or a reduction in royalty rate.

47. Referring to a case pertaining to the DHL incorporated and its subsidiaries, he inter alia noted as under:-

> 7.13.4... Here the trial Judge espoused his "bright line" test which notes that, while every license or distributor is expected to spend a certain amount of cost to exploit the items of intangible property to which it is provided, it is when the investment crosses the 'bright line' of routine expenditure into the realm of non routine that, economic ownership likely in form of a marketing intangible is created.

48. The TPO recorded the following finding with respect to payment of royalty:-

> 8.1.4 It is evident from findings of the facts recorded in above para 8.1.2 and 8.1.3 that both the processes of piggybacking of "Maruti" trade mark by the "Suzuki" brand of the AE in a big way from F.Y.2003-04. Impairment of "Maruti" or "M" brand has started because "Maruti" was super brand in India as compared to "Suzuki" trademark

and was developed by incurring several thousand crores of expenditure on advertisement and marketing for a period of two decades. ***The process of reinforcement of value of "Suzuki" brand has started because "Suzuki" being a very low value brand in Indian market was used along with "Maruti trade mark in cobranding process. This resulted in migration of intangible embedded in "Maruti" brand to "Suzuki" brand due to association of both the brands together.***

8.1.5 The assessee ignoring the migration of intangible embedded in "Maruti" brand to the low value brand "Suzuki" of the AE through the process of piggybacking and co-branding had agreed to pay the AE a royalty for sale of car using cobranded logo or "Suzuki" logo.

8.1.6. The assessee for non economic reason even ignored an important fact that the cobranding of both the trademarks as stipulated in the agreement extracted earlier in this order involves use of "Maruti" trade mark owned by the assessee without any corresponding compensation. In nutshell the assessee paid royalty of Rs.99.3 crores for use of Suzuki logo on cobranded trade mark but had not recovered any value for allowing use and association of its trade mark "Maruti" with a weak brand of "Suzuki" in India during cobranding process. The assessee has also ignored the vital issue of replacement of "M" logo with "S" logo on existing model of cars. The cobranding of "Maruti-Suzuki" resulted in reinforcement of value of "Suzuki" brand and simultaneous impairment of "Maruti" trademark for which it had received no

> compensation but had incurred huge expenditure of several thousand crores to develop "Maruti" or "M" as super brand. Contrary to this the assessee agreed to pay brand royalty for use of "Suzuki" trade mark as part of cobranded trademark.

49. The arm's length price in respect of payment of royalty was determined as under:-

> **Determination of arm's length price of royalty payment licence to sale and after sale service**
> 8.1.8 I am of the considered view that "SUZUKI" trade mark of the AE had piggybacked "Maruti" trade mark of the assessee without any compensation to the assessee accordingly no royalty could be paid for use of both the trade mark of the assessee and the AE which had resulted in impairment of brand value of "MARUTI" and reinforcement of brand value of "SUZUKI" of the assessee. Accordingly, royalty should be paid to the assessee instead of royalty payment of Rs.99.3 crores to the AE. I have also noted from facts as noted in above para 8.1.7 of this order that on the basis of FAR analysis no royalty was attributable to the AE for licence to sale and other sale services as all the economic cost and risk pertaining to market development was borne the assessee not by the AE.
> ...In my considered view payment of royalty of Rs. 99.3 crores to the AE by the assessee is an internal CUP which suggests that Maruti should get at least 99.3 crore from Suzuki as a royalty for co-branding, brand promotion and for bearing all the risks. Though, the royalty for Maruti trademark should be much

> more than Rs.99.3 crore, however, on conservative basis I am holding that as a co-brand partner, Maruti should have also got Rs.99.3 crore from the AE for allowing them to use “Maruti” trademark on cobranded trademark, for impairment of the value of “Maruti” trademark and for reinforcing the brand value of “Suzuki” trademark in India during cobranding process. On the basis of above analysis, I am of considered view that royalty of Rs.99.3 crores was due to the assessee for use of Maruti trade mark in cobranded trade mark but it had not received royalty ***accordingly the payment of royalty of Rs.99.3 crores to the AE for use of Suzuki brand is not at arm’s length, which is held as ‘Nil’ (adjustment of 99.3 crores)***.

50. As regards promotional and marketing expenditure incurred by Maruti, the TPO inter alia observed as under:-

> It is a matter of record that the assessee had incurred huge expenditure of Rs 204 crores on advertisement for promotion of brand development and other marketing intangibles for the AE. The brand development included promotion of trade mark of “SUZUKI” and “MARUTI-SUZUKI”. The other marketing intangibles include product and part promotion, development of dealers and after sale service network, quality control etc. The assessee had assumed all the functions and risk for development of marketing intangible for the AE in India and to some extent in European countries as per agreement extracted in preceding part of this order. However, the agreement does not stipulate any compensation to the assessee for these

> economic cost and risk. For these reasons, I am of the firm view that transfer pricing of market intangible is also an important issue in this case besides benchmarking royalty.

51. The TPO rejected the contention of the petitioner that since it had right to use 'S' trademark in future, the benefit of self advertisement/marketing expenses enured directly to it. While maintaining that para 6.38 of OECD guidelines was not applicable, the petitioner submitted before the TPO that in case of long terms contract for the use of intangibles, the return of such developer, from the marketing activity, would be embedded in the turnover/market share, where such developer is exclusively operating in the market and in such a case the benefit would meet the arm's length test, if the developer's benefits are similar to what an independent comparable would obtain in such similar situation. It was further submitted by the petitioner that in case there are extraordinary marketing expenses, beyond what an independent distributor with similar rights might incur, an additional return, from the owner of the trademark, should be received either through decrease in the purchase price of the products or through a reduction in the royalty rate. It was also pointed out by the petitioner that its average growth of sales for past 13 years was approximately

18% and that its high growth and the turnover showed that it had benefitted from the marketing efforts made by it and consequently in terms of para 6.38 of OECD guidelines, the return from promotional activities carried out by Maruti was captured in its turnover and margins. It was submitted that its advertisement and marketing expenses were in line with the industry. It computed the industry average of comparables at 1.8%, and same was the computation in respect of the petitioner for the period of 13 years. It was further submitted that the royalty to sales ratio of the petitioner in the past 13 years was in the range of 0.8% to 1.47%, whereas as per RBI policy royalty could be upto 5% of the domestic sales and 8% of export sales. The case setup before the TPO was that the petitioner had received a huge subsidy in the royalty paid to Suzuki and no additional benefit was passed on to Suzuki, by Maruti, by using the trademark 'S'.

52. The contention of the petitioner that use of 'S' trademark had assisted it in maintaining its market share in the face of stiff competition from multinational brand was not accepted by the TPO on the ground that Maruti was a 'super' trademark and there was no change in the market share of the petitioner even after the use of Suzuki.

53. The TPO further observed as under:-

> "(v)(a) Assessee had incurred advertisement expenses, marketing and distribution expenses for promotion of "SUZUKI" trade mark of the AE in India and abroad. The distribution and the marketing expenditure were also incurred to development of marketing intangible. The advertisement expenses incurred for advertisement on the print and electronic media has resulted in global promotion through satellite television broadcasting. The assessee had advertised "SUZUKI" brand owned by the associated enterprise. Therefore, the advertisement carried building of the AE. Therefore, the advertisement expenses incurred by the assessee would be compared with the advertisement expenses of the comparables selected by the assessee in the transfer pricing report. Therefore, the contention of the assessee that the cost benefit analysis should be based on the analysis of independent comparables is accepted. The arm's length expenditure would be based on the advertisement expenditure incurred by the independent comparables companies identified by the assessee in the transfer pricing report.
>
> (b) The contention of the assessee is accepted that if there are extraordinary marketing expenses beyond what an independent enterprise might incurred, an additional return from the owner of trade mark should be received either through decrease in the purchase price of the products or through a reduction in the royalty rate. I am in full agreement with the concept advanced by the assessee. As stated above if the advertisement expenses incurred by the assessee are above the level of

> advertisement expenses incurred by the independent entity then the additional amount should be recovered from the associated enterprise. This is a well established concept and in line with the OEDC and also supported by bright line concept. Therefore, this approach would be adopted for determination of arm's length price of the international transactions undertaken by the assessee.

54. The comparables chosen by the TPO were Hindustan Motors Limited, Mahindra and Mahindra Limited and TATA Motors Limited. He found that average growth rate of the comparables on the basis of multiple year data was 19.54%, whereas the average growth rate of the petitioner was 14%. He, therefore, rejected the contention that extra promotional efforts had resulted in higher growth to petitioner in comparison to independent comparable companies.

55. As regards import of components by Maruti from Suzuki, vis-à-vis cost of local components, it was submitted by the petitioner before the TPO that the prices at which Indian vendors supplied some of the components to Maruti, could not be considered to be uncontrolled prices or prices which could be comparable with prices at which various parts and components were supplied by Suzuki to Maruti, since Indian vendors did not have any intellectual property rights in respect

of patents, designs, copy rights, etc, which were essential for the manufacture and supply of the said parts, whereas all these intellectual property rights are vested in Suzuki and were licensed to Maruti, with a power to grant sub-license to Indian Vendors, in order to enable the procurement of those parts, components, etc. from them and therefore, the prices charged by Suzuki would necessarily be inclusive of the value of intellectual property rights vested in Suzuki. It was also pointed out that in respect of many parts and components even the input materials of the required specifications were procured and made available to the Indian suppliers by Maruti at its own cost and consequently, Indian vendors did not have to incur any expense for the purchase or procurement of those parts and components nor did they have to employ any working capital for maintaining their inventory. It was submitted that the prices of the patented parts particularly those which were imported from abroad were extremely high, mainly because of the value of the intellectual property right embodied in the parts and components. It was further submitted that the manufacturing and other costs, incurred by Suzuki were far more than the costs incurred by any manufacturer in India and, therefore, the prices charged by the

Indian vendor could not be compared with the prices of Suzuki. The TPO, however, rejected the contention of the petitioner that it had received subsidy in the form of less royalty payment.

56. In order to compare the advertisement, marketing and promotion expenses incurred by the petitioner, with similar expenditure incurred by other automobile companies, the TPO compared the advertisement costs of three other companies Hindustan Motors Limited, Mahindra and Mahindra Limited and TATA Motors Limited. He noticed that there was no advertisement costs of Hindustan Motors and TATA Motors Limited whereas it was 0.876% of net sales in the case of Mahindra and Mahindra Limited. He found that that advertisement/net sales ratio in the case of Maruti was 1.843 as against 0.876% of Mahindra and Mahindra Limited.

57. Under the Agreement, Suzuki had agreed to provide technical collaboration and licence necessary to the engineering, design and development, manufacture, assembly, testing, quality control, sale and after sale service of the products and parts. Suzuki also granted, to Maruti, exclusive right to use licensed information and licensed trademarks for the engineering, design and development, manufacture,

assembly, testing, quality control, sale and after sale service of the products and parts within the territory of India. Suzuki agreed to provide requisite information, to Maruti, for obtaining National Type approval, in the countries where the products and/or parts were intended to be exported and which was available to Suzuki without considerable costs and expenses. Suzuki was also under an obligation to sell, to Maruti, parts which were identified as 'Suzuki procured parts'. Suzuki also agreed to provide inplant training to Maruti personnel, at the plant facilities of Suzuki, for the purpose of inplant observation and training. Nothing was to be paid by Maruti for inplant observation and training. Suzuki further agreed to dispatch its personnel to the factory of Maruti, to give technical advice and guidance in the use of licensed information for the engineering, design and development, manufacture, assembly, testing, quality control, sale and after sale service of the products and parts, subject to reimbursement of travel expenses etc. by Maruti. Suzuki also agreed to render advice and assistance to Maruti in the selection and purchase of equipments and machines. Suzuki also granted to Maruti, exclusive right to use the trademarks 'Suzuki' and 'Suzuki CCI', which were owned by Suzuki, during the period of licensed information, for the engineering, design and development, manufacture, assembly, testing, quality control, sale and after sale service of the products and parts within India. Suzuki further agreed that it will not give right to sell the models of Suzuki four wheel motor vehicles listed in Ex. 'A', attached to the Agreement, as well as such other serial models of Suzuki four wheel motor vehicles, as might be agreed between the parties from time to time thereafter, with respect to the aforesaid two models, in any country in Europe. Maruti was also given right to sub-licence the rights granted to it under the agreement, to other entities which were directly or indirectly owned or controlled by persons of Indian nationality, with prior written consent of Suzuki, which Suzuki was not to unreasonably withhold. Suzuki was also agreed to use the name 'Suzuki' in the joint trademark 'Maruti Suzuki', which was to be used and applied on all the products and parts manufactured, assembled and sold in India by Maruti as also on the containers, packaging and wrapping, used for and in connection with sale of automobiles and their parts by Maruti in India. The licensed information and use of licensed trademark was provided by Suzuki on payment of running royalty besides a one-time lumpsum payment in terms of clause 6.01(a) of the Agreement.

58. The case of the petitioner is that de-licensing of the passenger car industry by Government of India had resulted in entry of a number of overseas players, such as General Motors, Hyundai, Honda, Ford and Daewoo Motors, etc. in the automobile industry, which led to a huge increase in the competition and posed a great threat to the petitioner, which till then, had no competition in the market in respect of its products. It, therefore, felt a need to project itself as an international brand, so as to counter the competition. When multinationals enter the domestic market with a wide range of products manufactured, using latest technology and having advanced features hitherto not available on the products manufactured in India, and those multinationals also command vast material resources, including quality products sold under brand names which are internationally reputed and well-known and are also in a position to offer quality after-sale service, coupled with parts and components of superior quality, it is quite natural that buyers of such products particularly those who look for quality products, may give preference to them over domestic products which do not match the range and quality of the products offered by these multinationals. We need to appreciate that international

brands are not built in a day and are the result of tremendous expenditure incurred upon research, development, manufacturing and brand building, and the buyer would normally believe that the quality of these products is superior to that of domestic products, which justifies a higher price for them. It, therefore, becomes necessary for the domestic entity, engaged in the manufacture and sale of such products to counter the products of these multinationals in the best manner it can and one such widely used method is to go in for technical and/or financial collaboration with a foreign company, products of which are perceived to be of superior quality and international standards.

59. The TPO himself noted that the Indian automobile industry had seen a number foreign entries, since de-licensing of auto industry and the entry of foreign majors had made the Indian markets more competitive. He also noted that before entry of foreign multinationals Indian car manufacturers lacked in technology, but, with the entry of multinationals, superior and latest technology was being made available in the domestic industry. He also noted that Indian auto manufacturers were likely to face increased competition and risk losing market share to global players, such as General

Motors, Toyota and Honda, which were eroding the market share of Indian players. As regards Suzuki, he noted that this Company employed the most modern factory equipments and technologies and its various activities were continually aimed at enhancing productivity, strict quality control, etc. He also noted that it had developed and it possessed technical knowhow and technologies for manufacture of a wide range of passenger cars, parts and components, besides owning patent trademarks etc. as well as valuable intangible like technical expertise, proprietary technologies, as well as the information and skill required for manufacture, sale, distribution and marketing of automobiles. It was also noted by the TPO that Suzuki possessed a strong and established network to operate as a global organization serving 187 countries across the world and this network was also used by Maruti to export components to European markets.

60. Admittedly, Suzuki was already providing technical assistance to Maruti for its various operations, including manufacturing, product testing, vendor development, etc. Hence, when Maruti felt the heat of competition from the foreign players who entered the Indian Market, it was quite natural on its part to look towards Suzuki, for technical

upgradation and advancement, besides seeking use of the brand name 'Suzuki' which admittedly was an international brand of repute. If a domestic manufacturer feels that besides technical upgradation and technical assistance, use of a foreign brand name was necessary for it to ward off the competition, posed to its products from the entry of other players in the market, no fault can be found with the domestic entity entering into an agreement, of the nature Maruti entered with Suzuki on 12th December, 1992. In fact, the agreement, admittedly, was entered into with the prior approval of Government of India which shows that Government of India was satisfied of the need of Maruti to enter into such an agreement on payment of royalty in terms thereof. In fact, even the TPO has not said that Maruti did not require the technical collaboration and assistance, which Suzuki provided to it, under the agreement. Maruti, therefore, was justified in entering into an agreement of this nature with Suzuki.

61. If a domestic entity irrespective of whether it is an independent entity or an Associate Enterprise of a foreign entity, feels that the use of a foreign brand name and/or its logo is likely to be beneficial to it, by enabling it to ward off the competition from other players, garner a larger market share or

maintain its existing market share despite increase in competition on account of entry of foreign players, there can be no dispute about the domestic entity taking a business decision to use a foreign brand and/or logo on its products, on payment of royalty to the owner of the foreign brand/logo. The exposure to the foreign brand/logo, on account of its use on the products of the domestic entity, is only incidental in such cases, the primary objective being to bring benefit to the domestic entity by using a reputed brand name/logo on its products. In that case, it cannot be said that since the foreign brand and/or logo will be used by the domestic entity, the owner of the brand/logo should also make payment to the domestic entity for carrying the foreign brand/logo on its products. What is important to note is that it is the domestic entity which wants the use of foreign branch/logo on its products as well as on their promotion, marketing and development, so that it may cash upon the reputation associated with the foreign brand/logo, by selling its products under that name/logo. So long as the payment of royalty for use of the foreign brand/logo by a domestic entity is within the limits, if any, prescribed by law in this regard, there can be no reasonable objection to such a payment and it is not open to the Income Tax Authorities to claim payment to the domestic entity merely for using the foreign brand/logo on the domestic products.

62. However, when such an agreed payment is made by an entity which is an Associate Enterprise within the meaning of Section 92A of Income Tax, the transaction between the Indian entity and the foreign entity needs to be based on arm's length price to be paid in terms of Section 92C of the Act. Since Suzuki, admittedly, is an Associate Enterprise of Maruti within the meaning of Section 92A of Income Tax, it must satisfy the TPO that the price paid by it to Suzuki was determined by it, following the most appropriate method out of the methods laid down in Section 92C(1) of the Act.

63. The TPO has not tried to find out what royalty, if any, a comparable independent Indian entity would have paid for the benefits derived by Maruti from Suzuki under the Agreement dated 12.12.1992. The case of Maruti before the TPO was that infact, it had got a subsidy from Suzuki in payment of royalty, since RBI guidelines permitted payment of royalty upto 5% of the turnover. The TPO, however, rejected the contention without trying to make an effort to find out how much royalty, fixed and running, would a comparable

independent domestic entity have paid in consideration of an agreement of this nature. This becomes important since according to the petitioner even if some benefit on account of promotion and brand building of the brand 'Suzuki' accrued to, Suzuki, in the form of marketing intangibles, that was more than offset by the subsidy which Suzuki granted to Maruti by accepting a lesser royalty.

64. It was noted by the TPO that Maruti had undertaken substantial research and development work for developing, localizing and customizing its products, without any compensation to it in this regard from Suzuki. In his view, normally, such development work, in the case of a licensed manufacturer, is undertaken by the entity which is the licence provider. Since the benefit from the research and development work for localization and customization, etc. would have accrued solely to the benefit of Maruti without bringing any benefit to Suzuki, we are unable to agree that Suzuki should have compensated Maruti in this regard. As per clause 3.02 of the Agreement, an improvement discovered or acquired by Maruti with respect to products or parts was to be treated as licensed information and Maruti was required to give full information, know-how, etc. in this regard to Suzuki. Maruti

was to be paid, by Suzuki, if such information provided a significant commercial value to Suzuki. According to the TPO, despite localization, improvements and modifications made by Maruti, it was never compensated by Suzuki in this regard. There is no finding by the TPO that the improvements and modifications made by Maruti benefitted Suzuki in any manner or were of commercial value to it, which it could exploit in other markets. Hence, it cannot be said that Suzuki ought to have paid to Maruti in respect of such improvements and modifications.

65. Admittedly, Suzuki has been supplying various parts and components to Maruti. We do not know whether the price being charged by Suzuki from Maruti for those components and parts is a fair price or not. If Maruti has been paying more than what a comparable independent entity would pay for such parts and components, the benefit which accrues to Suzuki on account of excess payment needs to be taken into consideration while determining arm's length price in respect of the rights and obligations of the two contracting parties, under the Agreement dated 12.12.1992. If Suzuki has been charging less than the amount, which a comparable independent entity would have paid to it for those parts and

components, that would be considered as a subsidy by Suzuki to Maruti and will be taken into consideration while determining arm's length price under the composite Agreement dated 12.12.1992. We hasten to add here that the TPO would not be justified in determining the fair price in respect of components and parts being supplied by Suzuki to Maruti solely on the basis of the price charged by domestic auto part manufacturers from Maruti, since the case of Maruti has been that Suzuki owns intellectual property rights in respect of the parts and components supplied by it to Maruti, whereas Indian venders did not have any such rights which are essential for the manufacture and supply of those parts. It was also pointed out to the TPO that Suzuki had licensed those intellectual property rights to Maruti, with power to grant sub-licence to Indian vendors and in respect of parts and components even the input material of required specifications were procured and made available to Indian suppliers by Maruti at its own cost. Consequently, the Indian suppliers did not even have to employ any working capital for maintaining their inventory. The correct approach to determine the fair price of such parts and components would be either to ascertain the price at which such components and parts were being exported by Suzuki outside Japan or the price at which they were being sold in Suzuki's domestic market. The other alternative can be to ascertain the price which a comparable independent domestic entity would have paid for importing such parts from Suzuki or from some other comparable foreign manufacturer of repute. Of course, necessary adjustments will have to be made by the TPO wherever required in this regard. Unless the TPO determines the price which an independent Indian entity would have paid for the benefits derived from Suzuki in the form of marketing intangibles, it may not be possible to determine a fair arm's length price, that should have been paid under the agreement between Suzuki and Maruti.

66. According to the TPO, Maruti did not tell him how much royalty, out of the total royalty of Rs.198.6 crores paid by it to Suzuki in the year 1994-95, was towards use of the trademark/logo of Suzuki. No data was collected by the TPO in respect of the royalty paid by other entities entering into similar transactions. We feel that the requisite data could be available, since there were other entities selling vehicles under foreign brand names, such as Honda and Hyundai. The TPO could easily have called for relevant information from these

companies. Even if no such data in respect of companies operating in the Indian market was available, it could have been obtained data from overseas companies, which were similarly situated and could be compared to Maruti. What he did was to take half of the royalty payment as payment for use of brand name and logo of Suzuki, without having any material before him justifying such an apportionment. The decision of the TPO in this regard, therefore, is absolutely arbitrary and wholly without any basis or rationale. The case of the petitioner is that since it had agreed to pay a composite running royalty to Suzuki, it is not in a position to say how much out of that amount is attributable to the use of the name and logo of Suzuki including the name Suzuki in the joint trademark 'Maruti Suzuki' on its products. In fact, it may not be possible, even for the TPO, to identify an objective and reliable methodology, to compute the economic value of such marketing intangibles, in money terms. He needs to keep in mind that such composite agreements being like package deals, it may not be possible to individually quantify the monetary value of each benefit obtained and obligation incurred under such an agreement. He, therefore, must ascertain the price which a comparable independent entity would have paid for a transaction of this nature. Only then he could have known whether Suzuki had given any subsidy to Maruti in payment of royalty as claimed by the petitioner, or it had got more than what it ought to have got. The TPO, therefore, was necessarily required to determine what a comparable independent domestic entity would have paid to Suzuki for the rights and obligation of the nature incurred by Maruti and Suzuki under the Agreement dated 12.12.1992. We, therefore, feel that the approach adopted by the TPO in the matter was erroneous and unsustainable.

67. We see no justification for the TPO insisting upon payment by Suzuki to Maruti, merely on account of use of the name and/or logo of Suzuki on the products and parts manufactured and sold by Maruti. It is Maruti which felt the necessity of use of Suzuki's brand name and logo and that necessity was recognized by the Government of India, by approving the agreement between Maruti and Suzuki. We cannot agree with the TPO that Maruti had become a super brand and, therefore, the petitioner Company did not need to use Suzuki brand name and logo on its products. As noted earlier, on account of liberalization of the economy and de-licensing of the automobile industry, a number of foreign

automobile majors had entered India or were contemplating entering the Indian market. Maruti, therefore, was not unjustified in concluding that it was necessary for it to enter into an agreement of this nature with Suzuki, so that it could meet the increased competition, posed to it on account of entry of these foreign majors, by using the brand name and logo of Suzuki on its products, besides obtaining the technical upgradation, augmentation and assistance from Suzuki. We cannot be oblivious of the fact that Suzuki being an international player, particularly in the segment of small cars, it was in a position to offer newer and better models to Maruti and use of the brand name and logo of Suzuki, therefore, was likely to be beneficial for the business interests of the petitioner. In any case, we can find no objection to the business decision taken by Maruti in this regard.

68. It would be noteworthy here that it was not obligatory for Maruti to use the logo of Suzuki on the products manufactured and sold by it in India, though Maruti in its discretion could use that logo, on those products as well.

69. As noted earlier, all products manufactured and sold by Maruti in India, including the parts manufactured and sold by it, were necessarily required to use the joint brand name

'Maruti Suzuki'. If a domestic entity, it is discretion, uses a foreign trademark and/or logo or a trademark, which is a combination of its domestic brand name and the brand name of a foreign entity, that by itself would not necessarily entail any payment from the foreign entity to the Indian entity, so long as benefit of such a joint brand name accrues to the Indian entity alone. In fact, such an arrangement would be mutually beneficial to both the entities, since it, while allowing the domestic entity to use a foreign brand name, also enables it to use its domestic brand, alongwith the foreign brand. As a result, from the point of view of the domestic entity, it does not have to kill its own brand, since it may at sometime in future feel no necessity of using the foreign brand in conjunction with its domestic brand and may save payment of royalty by discontinuing the use of the foreign brand. From the point of view of the foreign entity, it permits it to retain the exclusivity of its brand and its products, by distinguishing them from the products manufactured and sold by the domestic entity. Had Maruti been having a discretion to use the joint brand name 'Maruti Suzuki', so long as it felt that the use of the joint brand name was beneficial to it on account of association of a reputed foreign brand name with its domestic brand, that, in our view, would not necessarily have entailed payment from Suzuki to Maruti for use of the name 'Suzuki' in the joint trademark. In that case, it would have been open for Maruti to use the joint brand name only if and to the extent it felt that the use was in its business interests and was likely to prove beneficial to it. The benefits from the use of the joint trademark, including the expenditure incurred on its marketing, promotion and advertisement would then have accrued solely for the benefit of Maruti and the benefit to Suzuki on account of use of the name 'Suzuki' in the joint trademark would only be incidental, for which no payment will ordinarily be payable to Maruti.

70. If we accept the contention that a foreign entity must necessarily pay to the domestic entity, which is an Associate Enterprise, on account of use of its trademark and logo even where using such trademark/logo is not obligatory for the Indian entity, that would result in the owner of every foreign trademark undertaking making payment to the domestic entity approaching it for use of its trademark and/or logo for the purpose of taking advantage of that reputed, trademark and/or logo on its products. This will result in a situation where, on the one hand, the Indian entity is paying to the foreign entity for use of its trademark/logo, and, on the other hand, it is

simultaneously getting paid for carrying that trademark or logo on its products though it is the Indian entity and not the foreign entity which wants the use of the foreign trademark on the products manufactured and sold in India. If that happens, the owners of foreign trademarks may not be willing to permit use of their trademarks/logos by a domestic entities on the products manufactured and sold in India, unless they are more keen than the domestic entities in this regard.

71. The TPO took the view that the value of the trademark 'Maruti' which, by the time Maruti entered into this agreement with Suzuki, had become a super brand, got diminished and correspondingly the value of the brand 'Suzuki' which was hithereto unknown in India appreciated on account of Maruti deciding to use the logo 'S' in place of the logo 'M' and use of the brand name 'Maruti Suzuki' in place of brand name 'Maruti' on the advertisements and promotions undertaken by Maruti. We, however, do not find ourselves to be in agreement with the TPO in this regard. As noted earlier, despite Maruti being a well-known brand of passenger car in the domestic market and only a few people in India being aware of the brand name 'Suzuki' at the time of Maruti entering into the agreement with Suzuki, the fact remains that on account of the

increased competition, consequent upon the entry of multinationals selling vehicles under reputed and well established brand names, Maruti felt that it did require to use a reputed international brand name/logo in order to meet the competition. It is quite probable that had Maruti not used the name and logo of Suzuki, it might not have been able to face the competition given by these major auto players and would have lost its market share to them. Maruti instead of using the brand trademark of Suzuki, agreed to sell its products under a joint trademark which enabled it to preserve and promote its own brand while simultaneously taking advantage of the reputation associated with the name and logo of Suzuki, which admittedly was a reputed international brand in the automobile industry. In the joint trademark also the name Maruti comes before the name 'Suzuki', thereby giving an edge to the domestic trademark. In fact, the benefit from association of a reputed foreign name and logo may in such a case outweigh the loss, if any, in the value of the domestic brand. The test again, to our minds, would be as to what a comparable independent entity placed in the position of Maruti would have done in this regard. There was no material before the TPO from which it could be inferred that Maruti would have been able to achieve the growth which it was able to achieve even if it had not used the name 'Suzuki' in the joint trademark or had not used the logo of Suzuki.

72. But, under the Agreement dated 12.12.1992 Maruti is under a contractual obligation to use the joint trademark 'Maruti Suzuki' on all the vehicles as well as the parts manufactured and/or sold by Maruti in India. We fail to understand any logic behind Suzuki insisting upon compulsory use of this joint trademark by Maruti, on all its products and parts, rather than leaving such use to the discretion of Maruti, except that Suzuki wanted to popularize its name in India at the cost of Maruti. Compulsory use of the trademark even when the domestic entity does not require it indicates benefit to the non-resident entity in the form of brand building in the domestic market by its display and use on the product as well as its packaging.

73. At some point of time, a domestic entity may continue to need the technical assistance but may not need the foreign brand name. There can be no justification for insisting upon the use of a joint trademark using a foreign brand name unless the owner of the foreign brand feels that he stands to gain by such compulsory use of its name by the Indian entity. In our

opinion, if the agreement between two entities which are not independent entities, carries an obligation to use a joint trademark, either some appropriate payment needs to be made or appropriate rebate in the charges payable to it needs to be given by the foreign entity to the Indian entity, for being obliged to carry the name of the foreign entity on all its products even if it does not see any advantage from carrying that name on its products. Of course, the Department cannot insist upon such a payment in case the parties entering into the contract are independent parties. The reason why we justify such a payment by the foreign entity to the Indian entity is that, in our opinion, it is quite possible for the foreign entity on account of the managerial/financial control it exercises over the Indian entity, to force an obligation of this nature on the Indian entity. On the other hand, there is no such possibility when the two contracting parties are independent entities, without one having any managerial or financial control over the other.

74. We are unable to agree that there can be no possible benefit to 'Suzuki' on account of compulsory use of the joint trademark 'Maruti Suzuki' on all the parts and products manufactured and sold by Maruti in India. Once, the name

'Suzuki' becomes widely known in the domestic market, nothing prevents Suzuki from refusing to extend its agreement with Maruti or to independently enter the Indian market for manufacture and/or sale of similar products under its own brand name. It is true that Suzuki holds majority share holding in Maruti, but, it is not the only shareholder in Maruti and, therefore, necessarily has to share the profits in the form of dividend and/or bonus shares etc. with the other shareholders. Moreover, Maruti is taxed in India under Indian laws whereas Suzuki is taxed in Japan under Japanese laws. Hence, there can always be incentive for Suzuki to go solo and manufacture and/or sell four wheel automobiles in India under its own brand name, so that it does not share its income with any other person and does not pay tax under the Indian laws. Though Suzuki has not as yet entered India of its own, nothing prevents it from doing so, if it so decides, at a future date. The tax rate in a foreign country may be low or the exemptions and deductions permissible under the laws of the foreign country may be more than permitted under the Indian laws.

75. As noted earlier, it may not always be possible for the TPO to devise an objective and fair method to assess the monetary value of the benefit obtained by 'Suzuki' in the form

of marketing intangibles, which would include the benefit on account of compulsory use of the joint trademark 'Maruti Suzuki' on all the parts and products manufactured and sold by 'Maruti' in India. In such a case, what the TPO has to do is to determine the arm's length price in respect of benefits obtained and obligations incurred by both the parties under the composite agreement dated 12th December 1992, by finding out what payment, if any, a comparable independent domestic entity would have made in respect of an agreement of this nature.

76. As regards the expenditure incurred by a domestic entity, on promotion, marketing and advertising of its parts and products carrying a foreign trademark/logo, we are of the view that it is not obligatory for the owner of a foreign trademark to make payment to the domestic entity, using the foreign trademark/logo while promoting, marketing and advertising its products, merely because the promotions and advertising of the product carried the foreign brand/logo on it. As noted earlier, if a domestic entity feels the need to use a foreign brand/logo on its products and accordingly uses that brand/logo, with the permission of the owner of the brand/logo, while promoting and advertising its products, it

does so in the belief that use of a reputed international brand and/or its logo, while promoting and advertising its products, is likely, to prove beneficial to it, in the form of a larger revenue and/or larger profit, by encashing upon the reputation enjoyed by that international brand/logo amongst the buyers of its products. The intention in such a case is not to benefit the non-resident owner of that brand/logo but is to promote its own product using that name. Unless the domestic entity uses the foreign brand/logo while promoting and advertising its products, the buyer is not likely to give it the preference and premium which that foreign brand commands in the market. The benefit which the owner of the foreign brand/logo gets in the form of increased awareness and goodwill of its brand in the domestic market being purely, incidental and necessarily implicit in the promotion, marketing and advertisement of the Indian product sold under that brand name/logo, no payment is expected to be made by the owner of the brand/logo to its domestic user unless specifically agreed by him. It is on account of need of the domestic manufacturer and not on account of the need of the owner of the brand, that the brand/logo is used on the products manufactured and sold in the domestic market. Even where a foreign brand/logo is used by a domestic entity, which is an Associate Enterprise of a non-resident entity, while promoting and advertising its products, no payment is required to be made by the non-resident entity to the Indian entity unless it is shown that the expenses incurred by the Indian entity towards marketing, promotion and advertisement of its product, using the brand/logo of the foreign entity on the promotions and advertisement, etc. are more than what a comparable independent entity would have incurred. Only in that case it can be presumed that the additional expenses incurred by the domestic entity were aimed at benefitting of non-resident entity and were influenced by it on account of managerial and/or financial control, which it exercised on the domestic entity.

77. There is no justification for apportioning the advertising and promotion expenses between a domestic entity and the foreign entity, even if they happen to be Associate Enterprises, merely on account of use of the name and/or logo of the foreign entity in the promotional and marketing activities, unless it is shown that the expenditure incurred on such activities was disproportionate and the benefit which accrued to the foreign entity in the form of increased awareness of its brand in the domestic market was not merely

incidental. Mere use of a foreign brand, name and/or logo by an Associate Enterprise in the advertising and promotional activities undertaken by it, therefore, does not by itself entail payment by the owner of the foreign brand name and logo, and the question would always be as to whether a comparable independent entity would have incurred such expenditure or not.

78. The use of the joint trademark has to be viewed in the context that any promotion or advertising of the product would also necessarily carry that joint trademark thereby bringing benefit in the form of marketing intangible to the foreign entity. There will be no justification for apportionment of the cost incurred on promotion and marketing where the use of such a joint trademark is discretionary and not obligatory or where the expenses incurred on marketing promotion and advertising do not exceed the expenditure which a comparable independent entity is expected to incur under these heads. But, this would become relevant where the use of a joint trademark of this nature is obligatory and the expenses incurred by the domestic entity on promotion and advertising exceed the normal expenses, which an independent entity would incur in this regard.

79. As noted earlier, in this case the TPO, compared the advertisement, marketing and promotion expenses incurred by Maruti with the expenses incurred by three other automobile units Hindustan Motors Limited, Mahindra and Mahindra Limited and TATA Motors Limited. Since no expenses on advertisement were incurred by Hindustan Motors and TATA Motors during the relevant period and the expenses incurred by Mahindra and Mahindra were 0.876% of net sales as against expenses of 1.834% incurred by 'Maruti', the TPO found no justification for the expenditure incurred by 'Maruti' in this regard and was of the view that half of these expenses should be payable by 'Suzuki' to 'Maruti'. In our view the comparables chosen and the method adopted by the TPO in this regard was faulty and unjustified. The order passed by the TPO does not show that Mahindra and Mahindra was manufacturing and selling passenger cars in India during the year 2004-05. On the other hand, 'Maruti' admittedly, was primarily engaged in the business of manufacturing and selling passenger cars in that year. To the extent we know, Mahindra and Mahindra was manufacturing and selling Tractors and some SUVs/MUVs during the relevant year. Though probably 'Maruti' was also manufacturing and selling MUVs during the

year 1994-95 the bulk of its sales came from passenger cars and not from the MUVs. For this reason alone, the expenses incurred by Mahindra and Mahindra on advertising, promotion and marketing, etc. cannot be compared with the expenses incurred by 'Maruti' under these heads. The order of TPO does not disclose the level and extent of promotion and advertisement required for the products manufactured and sold by Mahindra and Mahindra. Hence, the expenditure incurred by it on marketing, promotion and advertising of its products cannot at all be compared with that on the products manufactured and sold by 'Maruti' in India. As far as tractors are concerned, they require very limited marketing and advertising and that too only amongst farmers. The SUVs/MUVs also do not require that much promotion and marketing as is required for passenger cars. Another material aspect in this regard is that the expenditure incurred on promotion, marketing and advertising would also depend upon the territories in which such activities are undertaken and the mediums used for the purpose of promotion and advertising. The advertising for passenger cars needs to be highly visible and extensive, using not only the print media but also the electronic media, which is far more costly than print media.

Also the expenditure on marketing, promotion and advertising would depend upon the number of new products launched in the market. Promotion and advertising of an existing products requires much less expenditure, as compared to that of a newly launched products which need extensive coverage so as to make a potential buyer aware of the introduction of the new product in the market. It is, therefore, necessary for the TPO to carefully choose the comparables before undertaking the exercise to compare the expenditure incurred by an Associate Enterprise under these heads with the expenditure incurred by an independent domestic unit for similar purpose. We find from a perusal of the order of the TPO that Maruti had suggested the name of Honda SIEL and Hyundai Motors for this purpose. But, the TPO, without any reasonable ground, did not compare the expenditure incurred by these companies on marketing, promotion and advertising of their respective products with those incurred by Maruti under these heads. The TPO declined to consider Honda SIEL and Hyundai Motors and comparables on the ground that these companies had substantial related period transactions. He, however, did not elaborate what those related period transactions were and how they would have distorted the comparison if taken as independent comparables. In any case, if the TPO did not find HONDA SIEL and Hyundai Motors to be appropriate comparables, he ought to have looked for other entities which could be really compared with Maruti considering the nature of its business, the number of the products launched by it in the market, the territories serviced by it and the turnover and profit achieved by it. There should be functional similarity in the companies chosen for the purpose of comparison. If he was unable to find suitable comparables in the domestic market, he could have looked for comparables in overseas market. But, unless he was able to identify suitable comparables, it was not open to him to conclude that the expenses incurred by Maruti on promotion, marketing and advertising of its products were more than what an independent comparable entity would have incurred and, therefore, exceeded the bright line limit. The appropriate method for the TPO would have been to take all automobile companies manufacturing and selling vehicles in domestic market, eliminate those which were incomparable, adopting a methodological approach, and then carry out comparison with those which were really comparable independent entities. Adjustments wherever needed could then be made, considering individual profiles of those entities.

80. The TPO rejected the contention of Maruti that it had benefited from the marketing efforts made by it since it had achieved average growth @ 18% per annum in last 13 years and that the industry average of comparables on advertising was 1.8% which was also the computation in respect of the petitioner for the past 13 years. The growth percentage has to be viewed in the right perspective. If a company selling 10,000 vehicles in a year increases its sale by say 5,000 vehicles, it would mean 50% growth in its revenue. On the other hand, if a company manufacturing 1 lakh vehicles achieved growth of 25,000 vehicles, percentage of its growth would be lower than that of the company selling 10,000 vehicles per year, though if viewed in terms of number of vehicles, the larger company has achieved much more growth than the small company. Therefore, the comparison of growth is to be seen only amongst comparable companies. Taking Hindustan Motors Limited, Mahindra & Mahindra Limited and Tata Motors as comparables in this regard, the TPO found that average growth rate of these companies was 19.4%, whereas the average growth rate of the petitioner was 14% and, accordingly, he rejected the contention of the petitioner that extra promotional

effort had resulted in higher growth to the petitioner, in comparison to independent comparable companies. As noted earlier by us, Mahindra & Mahindra Limited, Tata Motors Limited and Hindustan Motors Limited cannot be said to be comparables since Hindustan Motors Limited and Tata Motors Limited had not incurred any expenditure on marketing, promotion and advertising during the year in question whereas Mahindra & Mahindra did not have any business in passenger car market in the relevant year. Moreover, Hindustan Motors Limited, as far as we know, was selling only Ambassador Cars and that too in very limited numbers, mostly to Government Departments, which required no extra effort Tata Motors Limited is primarily engaged in the business of manufacture and selling of trucks and buses during the relevant year. It was selling only one or two models of passenger cars in the domestic market and since the vehicle manufactured by it catered to an altogether different segment, their sale in the domestic market hardly required any promotion or advertisement. The TPO, in the absence of any comparison with an appropriate entity, could not have outrightly rejected the contention of the petitioner that it had benefited from substantial expenditure incurred by it in marketing, promotion and advertising, in the form of higher growth in its turnover. The case set up by the petitioner in this regard needs to be considered in the light of the fact that on account of the de-licensing of the automobile industry a number of foreign players had entered the domestic market and they were quite enthusiastic about penetrating the Indian market and grabbing a major chunk of the domestic market. They were also extensively promoting and advertising their products. They were international giants, backed by international brands of repute and strong financial muscle, on account of their deep pockets. They were in a position to incur huge expenditure on marketing, promotion and advertising of their products, even at the cost of incurring huge losses in the initial years of their operations in India. It would have been difficult for Maruti to maintain its market share and achieve further growth, had it not countered the efforts of these automotive giants by incurring adequate expenditure on marketing, promotion and advertising of its products. However, the TPO has not even gone into these aspects of the matter and has not made any sincere effort to arrive at expenditure which an independent comparable entity, placed in the position of Maruti, would have incurred on marketing, promotion and advertising of its products. Though the TPO accepted the contention of the petitioner that the cost benefit analysis should be based on the analysis of independent comparables and the arm's length expenditure should be based upon the advertising expenditure incurred by the independent comparables, he miserably failed to identify and select the entities which could be said to be really comparable to Maruti. Hence, the order passed by him being based on no evidence at all cannot be sustained.

81. OCED guidelines on which reliance was placed by the TPO, provide that in order to ascertain whether the marketer is entitled to pass a normal return, it would be necessary to assess the obligations and rights implied by the agreement between the parties. The guidelines acknowledge that the marketer could be reimbursed in various forms for the promotion expenditure incurred by it. In the case of a distributor, such reimbursement could come in the form of higher distribution margin or exclusive or long-term distribution rights. Maruti, admittedly, was not a distributor for the products manufactured by Suzuki. It was a licensed manufacturer of these products and had entered into a long-term agreement with Suzuki. Therefore, it was justified in incurring substantial expenditure on marketing, promotion

and advertising of its products even under the joint trademark 'Maruti Suzuki' and using the logo of Suzuki. Since the products promoted and advertised by Maruti were being manufactured and sold solely by it and Suzuki had no right to sell any product under the joint trademark 'Maruti Suzuki', the benefits from the expenditure incurred on marketing, promotion and advertising of Maruti products under the joint trademark 'Maruti Suzuki' would accrue to Maruti and the status of Maruti is, therefore, not comparable to that of a distributor or a licensed seller.

82. Even if it is found that Maruti had incurred expenditure on marketing, promotion and advertising of its products, which was more than what a comparable independent entity, placed in the position of Maruti would have incurred, that by itself will not entail payment from Suzuki to Maruti if it is shown that under the terms and conditions of the composite agreement dated 12.12.1992, or some other arrangement, Maruti obtained some concession or subsidy from Suzuki, in one form or the other which can offset the extra expenditure incurred by Maruti on marketing, promotion and advertising of its products. As we said earlier, the TPO has to take an overall view of all the rights obtained and

obligations incurred by Maruti, vis-à-vis, Suzuki and then determine appropriate arm's length price in respect of the international transactions which Maruti had with Suzuki.

83. Since we have come to the conclusion that the order passed by the TPO making adjustments to the income of the petitioner company is based on no evidence which amounts to an error of law by him, the procedure followed by him was faulty, the approach adopted by him was erroneous and the order passed by him is arbitrary and irrational, it will be open to this Court to set aside the order passed by him, in exercise of writ jurisdiction under Article 226 of the Constitution. Also, the Transfer Pricing Provisions being rather new to the tax regime in India and with the entry of more and more multinationals in our country, these provisions are likely to come up frequently for application by the TPOs as well as the Assessing Officers, we deem it appropriate to clarify those aspects of the transfer pricing provisions which come up for our consideration in this case, so that they are able to appreciate the scope of their powers under Transfer Pricing Provisions of the Act as well as the procedure to be followed and approach to be adopted by them while processing such cases.

84. **CONCLUSIONS**

i. The onus is on the assessee to satisfy the AO/TPO that the arm's length price computed by it, was in consonance with the provisions contained in Section 92 of the Act. The AO/TPO can reject the price computed by the Assessee and determine it only where he finds that the assessee has not discharged the onus placed on it or he finds that the data used by the assessee is unreliable, incorrect or inappropriate or he finds evidence, which discredits the data used and/or the methodology applied by the assessee.

ii. The TPO/AO, before he determines arm's length price in relation to the income from an international transaction, needs to give appropriate notice to the assessee, giving him an opportunity to produce evidence in support of the arm's length price computed by him. In case the TPO/AO proposes to make adjustments to the income of the assessee by revising the arm's length price computed by him, he needs to give a notice to the assessee, conveying the grounds on which the adjustment is proposed to be made, followed by an opportunity to reply to that notice and produce evidence to controvert the grounds, on which the adjustment is proposed.

iii. If an independent domestic entity uses a foreign trademark and/or logo on its products or on their containers, packaging, etc., manufactured and/or sold in India, no payment to the foreign entity in this regard is necessary, unless agreed by it, irrespective of whether the use of the foreign trademark and/or logo is obligatory or discretionary.

iv. If a domestic entity, which is an Associate Enterprise of a foreign entity within the meaning of Section 92A of the Act, uses a foreign trademark and/or logo on its products or on their containers, packaging, etc., manufactured and/or sold in India, no payment to the foreign entity on account of such user, is necessary, in case the use of the foreign trademark and/or logo is discretionary for the domestic entity. However, the income arising from such international transaction(s) needs to be determined at arm's length price, in terms of Section 92C of the Act.

v. If the domestic entity which is an Associate Enterprise of the foreign entity within the meaning of Section 92A of the Income Tax Act is mandatorily required to use the foreign trademark and/or logo on its products and/or their containers, packaging, etc., appropriate payment in this regard should be made by the foreign entity to the domestic entity, on account of the benefit it derives in the form of marketing intangibles, obtained by it from such mandatory use of its trademark and/or logo.

vi. Even in the cases where payment in terms of clause (v) above is to be made by the foreign entity, to the domestic entity, the arm's length price in respect of the income, from the international transaction between the two entities, needs to be determined, taking into consideration all the rights obtained and obligations incurred by the parties under the international transaction in question, including the value of marketing intangibles obtained by the foreign entity on account of compulsory use of its trademark and/or logo by the domestic entity. Suitable adjustments in this regards will have to be made considering the individual profiles of these entities and other facts and circumstances justifying such adjustments.

vii. The expenditure incurred by an independent domestic entity on advertising, promotion and marketing of its products using a foreign trademark/logo does not require any payment or compensation by the owner of the foreign trademark/logo to the domestic entity on account of use of the foreign trademark/logo in the promotion, advertising and marketing undertaken by it, unless agreed by the domestic entity.

viii. The expenditure incurred by a domestic entity, which is an Associate Enterprise of a foreign entity, on advertising, promotion and marketing of its products using a foreign trademark/logo does not require any payment or compensation by the owner of the foreign trademark/logo to the domestic entity on account of use of the foreign trademark/logo in the promotion, advertising and marketing undertaken by it, so long as the expenses incurred by the domestic entity do not exceed the expenses which a similarly situated and comparable independent domestic entity would have incurred.

ix. If the expenses incurred by a domestic entity which is the Associate Enterprise of foreign entity, using a foreign brand trademark and/or logo while advertising, marketing and promoting its products, are more than what a similarly situated and comparable independent domestic entity would have incurred, the foreign entity needs to suitable compensate the domestic entity in respect of the advantage obtained by it in the form of brand building and increased awareness of its brand in the domestic market.

x. In case the foreign entity is liable to compensate in terms of clause (ix) above, the TPO needs to determine the arm's length price in respect of the international transaction made by the domestic entity, with the foreign entity, which is its Associate Enterprise within the meaning of Section 92A of the Act, taking into consideration all the rights obtained and obligations incurred by the two entities, including the advantage obtained by the foreign entity.

xi. In order to ascertain whether the expenses incurred by the domestic entity, which is an Associate Enterprise of a foreign entity, on the marketing, promotion and advertising of its products using the brand trademark/logo of the foreign entity, are more than what a similarly situated and comparable independent domestic entity would have incurred, or not, it would be necessary to identify appropriate comparables for the purpose of comparison of their expenditure with the expenditure incurred by the domestic entity in this regard. Suitable adjustments will have to be made considering the individual profiles of these entities and other facts and circumstances justifying such adjustments.

85. For the reasons given in the preceding paragraphs, the impugned order dated 30.10.2008 is hereby set aside and the TPO is directed to determine appropriate arm's length price in respect of the international transactions entered into by the petitioner Maruti Suzuki India Limited with Suzuki Motor Corporation, Japan, in terms of the provisions contained in Section 92C of the Income Tax Act and in the light of the observations made and the view taken by us in this order. The TPO shall determine the arm's length price within three months of the passing of this order.

(V.K. JAIN)
JUDGE

(BADAR DURREZ AHMED)
JUDGE

JULY 01, 2010
RS/Ag