IN THE HIGH COURT OF DELHI AT NEW DELHI

% Judgment delivered on: 06.02.2025

\+ **ITA 472/2018**

COMMISSIONER OF INCOME TAX .....Appellant

Versus

BENETTON INDIA PVT. LTD. .....Respondent

\+ **ITA 1318/2018**

COMMISSIONER OF INCOME TAX .....Appellant

Versus

BENETTON INDIA PVT.LTD. .....Respondent

\+ **ITA 1319/2018**

COMMISSIONER OF INCOME TAX .....Appellant

Versus

BENETTON INDIA PVT.LTD. ....Respondent

Advocates who appeared in this case:

For the Appellant: Mr. Shlok Chandra, SSC with Ms. Madhvi Shukla, Ms. Naincy Jain, JSCs and Mr. Sushant Pandey, Advocate.

For the Respondent: Mr. Himanshu S. Sinha, Mr. Prashant Meharchandani, Mr. Vibhu Jain & Mr. Jainender Singh Kataria, Advocates.

CORAM
HON'BLE MR JUSTICE VIBHU BAKHRU
HON'BLE MS JUSTICE SWARANA KANTA SHARMA

JUDGMENT

VIBHU BAKHRU, J.

1. The Revenue has filed the above-captioned appeals under Section 260A of the Income Tax Act, 1961 (hereafter *the Act*) impugning the orders passed by the Income Tax Appellate Tribunal (hereafter *ITAT*) in respect of the assessment years (AYs) 2007-08, 2008-09 and 2009-10.

2. The learned ITAT had rejected the Revenue's appeal (ITA No.457/Del/2013) in respect of the AY 2007-08 as well as the Revenue's appeal (ITA No.458/Del/2013) in respect of the AY 2008-09, by a common order dated 10.07.2017. The above-captioned appeals, being ITA 1318/2018 and 1319/2018, impugn the said common order dated 10.07.2017 in respect of AY 2007-08 and AY 2008-09.

3. In ITA No.478/2018, the Revenue impugns an order dated 27.10.2017 passed by the learned ITAT rejecting the Revenue's appeal being ITA No.4229/Del/2014, in respect of AY 2009-10. The learned ITAT had rejected the said appeal following its earlier order in respect of AYs 2007-08 and 2008-09, being the order dated 10.07.2017 impugned in ITA No.1318/2018 and 1319/2018.

4. The learned counsel for the parties submit that the issue involved in the present appeals is common and therefore the appeals were taken up together.

5. It is material to note that by an order dated 04.04.2024, this court had framed the following common question of law for consideration in the above-captioned appeals:

> "Whether on the facts and in the circumstances of the case, the ITAT perversely and unlawfully deleted the additions made for purported reimbursement of expatriate salaries and payment for royalty, by failing to make an independent finding and determination on the "double deduction" nature of the claim for such purported expenses along with "reimbursement of software expenses" with near identical details, use, functions and purposes purportedly served?"

6. The counsel are *ad idem* that ITA No.1318/2018 be treated as the lead matter for deciding the aforementioned question of law. Accordingly, we shall refer to the facts as obtaining in ITA No.1318/2018 for addressing the aforementioned question.

THE FACTUAL CONTEXT

7. The respondent company (hereafter *the Assessee*) is a wholly owned subsidiary of Benetton International NV, Netherlands, which in turn is a subsidiary of Benetton Group SPA Italy. The Assessee is engaged in the business of production and sale of readymade garments under the brand name "Benetton". It also assists Benind S.P.A in

sourcing garments and other finished products from third party vendors in India.

8. The Assessee filed its income tax return for AY 2007-08 declaring its income as Nil after setting off brought forward loss of ₹89,17,139/- for AY 2002-03 and 2003-04. The said return was initially processed under Section 143(1) of the Act but thereafter was picked up for scrutiny. The Assessing Officer (hereafter *the AO*) noticed that the Assessee had entered into international transactions with associated enterprises (hereafter *AEs*) within the meaning of Section 92B of the Act and therefore, referred the Assessee's case to the Transfer Pricing Officer (hereafter *the TPO*) in terms of the provisions of Section 92CA(1) of the Act for determining the arm's length price (ALP) in relation to the international transactions.

9. The learned TPO passed an order dated 26.10.2010 under Section 92CA(3) of the Act recommending an adjustment of ₹9,65,58,146/- on account of "reimbursement of expenses to AEs" and "payment of royalty".

10. The AO passed a draft assessment order dated 14.12.2010 under Section 144C(1) of the Act, *inter alia*, proposing additions of ₹9,65,58,146/- as directed by the TPO. In addition, the AO also proposed additions of ₹24,89,021/- on account of doubtful current assets and advances, and ₹30,31,188/- on account of lease registration charges.

11. The Assessee furnished a letter dated 17.01.2011 informing the AO of its decision not to file any objections before the Dispute Resolution Panel (hereafter *DRP*) against the draft assessment order. The AO passed the final assessment order dated 28.01.2011 assessing the Assessee's income at ₹11,09,95,494/-, which included the additions as proposed under the draft assessment order dated 14.12.2010.

12. The Assessee successfully assailed the assessment order before the Commissioner of Income Tax (Appeals) [hereafter *CIT(A)*] and by an order dated 21.11.2012, the learned CIT(A) deleted the adjustment of ₹5,93,90,122/- on account of reimbursement of salaries paid to expatriates and ₹3,71,68,024/- on account of payment of royalty.

13. Additionally, the learned CIT(A) also deleted the lease registration charges amounting to ₹30,31,188/-.

14. The Revenue preferred an appeal [being ITA 457/Del/2013] impugning the deletions made by the learned CIT(A) in respect of reimbursement of expenses towards expatriate salaries, royalty, and lease rental charges. The same were dismissed by the learned ITAT *vide* the impugned order dated 10.07.2017.

RIVAL CONTENTIONS

15. Mr Chandra, the learned counsel appearing for the Revenue contended that the learned ITAT had erred in not returning any independent findings and determination as to the deletion of additions made by the learned CIT(A) and had merely approved the said decision.

He also contended that the decision of the learned ITAT is perverse. It was earnestly contended that the Assessee had failed to establish that it had derived any benefit from the expatriates, whose salaries were claimed to have been reimbursed and therefore, the decision of the learned TPO in finding that the ALP of such services was Nil could not be faulted. It was contended that the learned TPO had rightly found that the functions performed by the expatriates in question were in regard to functions to be performed by the AEs and therefore, the Assessee could not be expected to pay any amount for the same. It was also contended that the Assessee had not derived any benefit in respect of the amounts paid as royalty and therefore, the ALP was rightly determined as Nil.

16. It is material to note that no submissions were advanced by Mr Chandra on account of any double deduction.

17. The learned counsel for the Assessee countered the aforesaid submissions.

18. He submitted that there was no issue regarding software expenses as the Revenue had not raised any specific ground to challenge the deletion of expenses paid towards the provision of software.

19. The learned counsel for the Assessee further contended that the payment towards reimbursement of salaries to expatriates was subsumed in the benchmarking of ALP for the commission received by the Assessee and the reimbursement of salaries of expatriates would not require to be benchmarked separately.

ANALYSIS

20. As the question of law as framed indicates, the controversy centers around the international transactions relating to "reimbursement of expatriate salaries"; "payment of royalty" and "reimbursement of software expenses".

21. During the previous year, relevant to AY 2007-08, the Assessee had undertaken various international transactions. The same included reimbursement of cost of expatriates to its AEs, which was disclosed as ₹5,93,90,122/- as well as the payment of royalty of an amount of ₹3,71,98,024/-. The order dated 26.10.2010 passed by the learned TPO also mentions other international transactions. However, the same are not subject matter of the present appeal.

22. The reimbursement of salaries of expatriates disclosed at ₹5,93,90,122/- erroneously included reimbursement of software charges amounting to ₹35,39,400/-. The Assessee acknowledges that it had received information technology support services from its AE, Bentec S.p.A., however, had not reported the transaction regarding reimbursement of software cost separately in its Form No.3CEB. Concededly, the said costs were erroneously clubbed and included within the amount disclosed as costs relating to reimbursement of salaries paid to expatriates.

23. It is material to note that the Assessee did not separately disclose the amounts paid for information technology support services to Bentec S.p.A. during the previous year relevant to AY 2008-09 as well.

24. The learned TPO had not considered the issue regarding charges for information technology support services. The order dated 26.10.2010 passed by the TPO proceeds on the basis that the entire amount as disclosed was paid as costs of expatriates.

25. However, on an appeal preferred before the learned CIT(A), the fact that the amount of ₹35,39,400/- was paid towards information and technology services received from Bentec S.p.A. was duly disclosed and noted. The CIT(A) also made certain observations on merits in this regard. The relevant extract of the order dated 21.11.2012 passed by the CIT(A) is reproduced below:

> "Further, it is a move point whether the TPO should have brought any 'CUP' data in such a situation. The fact that various softwares are used by the appellant is not denied by the TPO. In view of this, I hold that the addition made in this regard is not sustainable since they are not based on any facts or evidences. TPO/ AO is directed to delete the addition made in this regard"

26. The Revenue preferred an appeal before the learned ITAT but it did not raise any specific ground regarding payment of charges for information technology related services not being on arm's length basis. The grounds of appeal regarding the deletion of amount of ₹9,65,58,146/- made on account of ALP adjustment are set out below:

"Whether the Ld. CIT(A) has erred in law and on facts in deleting the addition made on account of arm's length price of International Transaction amounting to Rs.9,65,58,146/- ignoring the facts that.

(a) The assessee has not been able to prove the benefits that it had derived from the services purportedly provided by the Expats. No independent entity would pay for such services without any cost benefit analysis.

(b) The assessee has not furnished any evidence as to the cost benefit analysis with regards to the independent local employees. No third party would like to avail services without any cost benefit analysis with regard to Expats vs. independent employees.

(c) No documentation has been produced by the assessee to support its claim for the receipt of services.

(d) The benchmarking done by the assessee was not in accordance with the law and therefore CUP method was required to be applied in this case.

(e) The OECD guidelines state, "Ideally, in order to arrive at the most precise approximation of arm's length principle should be applied on a transaction-by transaction basis."

(j) For the purpose of this section and section 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 release of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on profits income losses or assets of such enterprises and shall include a mutual agreement or arrangement

> between two or more associated enterprises for the allocation or apportionment of or any contribution to, any cost or expense incurred or to be incurred in connection with benefit service or facility provide to anyone more of such enterprises."

27. It is material to note that it was the Assessee's case that it had received information technology support services from its AE, Bentec S.p.A., which was mainly "computer assistance designing technique", that was used by the Assessee for its manufacturing activities. It was asserted that the said payments for reimbursement of costs were without any mark up. The Assessee's submission as recorded in the order dated 21.11.2012 passed by the learned CIT(A) is set out below:

> "5.5. Software Costs:
>
> Submission of the appellant is summarized as below:
>
> Benetton India receives Information technology support services from BentecSpA. The support services are mainly in the nature of assistance in Computer Assistance Designing Technique which Benetton India uses in its own manufacturing process. This includes various software services like –
>
> • CAD (Computer Aided Design System): This software helps in cutting the fabric in a planned and systematic manner and enables maximum utilization of fabric, keeping wastage to a bare minimal. By the use of this software the fabric consumption of Benetton India optimizes significantly.
>
> • Orchidie & Iris: This software helps in downloading design sheets and technical specifications of a particular garment like its size, fabric description, color options, stitching details etc which helps Benetton India in local manufacturing.
>
> • Rtbenet: This software helps in order booking applications. Details of samples and materials which are required by

> Benetton India are uploaded in the server with the help of this software.
>
> • Citrix: This software provides better connectivity between Benetton India's & Benetton Italy's server. This enables smooth transfer of bulk files such as technical design sheets, technical specifications etc.
>
> For this purpose, Benetton India paid INR 3,539,400 and INR 6,029,205 for AY 2007-08 and AY 2008-09.
>
> According to the submission, the TPO erroneously considered this transaction as part of the software services transaction and considered the arm's length price of the same to be "Nil". Since no specific contention has been raised by the TPO, the arguments raised in earlier paragraphs, to the extent applicable, shall apply."

28. The learned ITAT did not had any occasion to address the issue regarding determination of the ALP of reimbursement of software expenses because no specific ground in this regard was raised by the Revenue. The impugned order, thus, proceeded on the basis that the dispute regarding determination of ALP in respect of international transactions was confined to payment of royalty (₹3,71,98,024/-) and expatriate costs (₹5,93,90,122/-).

29. It is material to note that in the present appeal as well, no specific ground relating to the reimbursement of costs for provision of information technology services, which were erroneously included as a part of the costs relating to expatriates (₹5,93,90,122/-), has been raised.

30. In view of the above, the issue regarding determination of ALP or the payments made for information technology related services, does not *sensu stricto* arise.

Reimbursement of Expatriate Costs

31. The Assessee had furnished its transfer pricing report, *inter alia,* stating that during the financial year 2006-07 certain employees of foreign AEs were seconded to the Assessee to assist it in its day-to-day activities. The salaries and perquisite costs of such employees were credited directly by the AEs in the bank accounts of the said employees. However, since the functions performed by the said employees were directly for the benefit of the Assessee, it had reimbursed the costs to its AE. It was asserted that no mark up was charged by AEs and therefore, the transactions should be regarded on arm's length basis.

32. The Assessee was called upon to disclose the details of the services performed by the expatriate employees and the same was furnished by the Assessee. The order dated 26.10.2010 passed by the TPO includes a tabular statement setting out the name of the employees and their role. The said tabular statement is set out below:

> "5.2 On the basis of submissions of the assessee it is ascertained that the Expatriates Cost of Rs. 59,390,122/- has been debited to Legal and Professional expenses. Vide this office letter dated 01.09.2010 the assessee was asked to furnish the details of services performed by the expats. The assessee vide its letter dated 23.09.2010 has furnished the following reply:

No.	Name of the employee	Profile	Major Role
1	EttoreCadamore	International Sourcing Head	Supervision of the sourcing activities carried out by Benetton India

2	Renzo Gardin	Production Head	Supervision of the manufacturing facilities in India
3	Andreini Giuseppe	Buying and Visual Media Head	Supervision of design and display of Benetton stores in India.”

33. The TPO had determined the ALP for the transaction relating to reimbursement of expatriate costs at Nil as the TPO was of the view that the expatriate employees were performing the functions for the benefit of the AE and not for the benefit of the Assessee.

34. The TPO also noted the functions performed by the Assessee in respect of receipt of commission for its sourcing activities. The relevant extract of the order dated 26.10.2010, which sets out the extract from the Assessee’s TP report in this regard is set out below:

> “**4.4 Receipt of Commission for sourcing activities**
>
> 4.4.1 Nature and terms of the international transaction identified
>
> During FY 2006-07, Benetton India assisted Benind S.P. A in acquiring garments and other finished products from third part)’ vendors in India. With respect to the above mentioned transaction, Benetton India's role was limited to procuring and sourcing of merchandise for its AE and for this function Benetton India charged commission amounting to INR116,766,163 during the year.
>
> 4**.4.2 Functions performed**
>
> **4.4.2.1 Product development**
>
> Based on the requirements of Benina S.P.A. Benetton India analyzes the products that can be sourced front India and communicates the same to Benind S.P.A. In case Benind S.P.A decides to procure such products from India. Benind S.P.A provides the product designs for

the upcoming collection to be launched in near future, which would be manufactured by the independent manufacturers in India.

4.4.2.2 Purchasing activities/ supplier identification

Benetton India assists Benind S.P.A in identifying potential suppliers of apparels in India. This involves identifying and evaluating a vendor's manufacturing facility and practices using standard policies and procedures of Benetton Group. BenindS.RAalso provides the vendor with die standard specifications of garments including detailing, stitching coordinates and designs.

4.4.2.3 Contracting with suppliers

All decisions regarding purchase and issuance of purchase orders are made by Benind S.P.A. Further, Benind S.P.A enters into contracts directly with the suppliers. Benetton India merely acts as an interface between Benind S.P.A and the suppliers by obtaining price quotes from the suppliers, communicating the purchase prices to the suppliers etc. Benetton India does not obtain title to the goods exported from India. Such goods are exported by the vendors directly to Benetton Group entities located outside India,

4.4.2.4 Quality control

Benetton India ensures that the products manufactured by the vendors are according to the specifications and global quality standards prescribed by the Benetton Group.

4.4.2.5 Logistics

Benenon India is responsible for ensuring timely shipments of goods front India. The function becomes all the more critical in view of the fact that the AEs have pre decided schedules for launch of such products in the upcoming collection of Benetton Group."

35. The TPO reasoned that the vendor identification was a function to be performed by the AE and therefore, the sourcing head (Ettore Cadamore) was performing the functions for the AE and not for the Assessee. The TPO also noted that the Assessee was not assigned any functions regarding training of local employees. On the aforesaid basis,

the TPO held that the ALP of the international transactions regarding the reimbursement of expatriate costs of the international sourcing head was Nil.

36. Insofar as other two expatriate employees (Production Head and Visual Media Head) are concerned, the Assessee had explained that the Production Head had helped the Assessee in reducing downtime, increasing production efficiency, reducing manufacturing costs and in training employees. The Visual Media Head had supervised the design and display of Benetton Stores in India and had assisted the Assessee in designing stores, which give them an international look and thus, enhance the shopping experience of customers.

37. The TPO had disbelieved that the Production Head and the Visual Media Head had rendered any services to the Assessee as it had failed to furnish any contemporary documents to the substantiate the same.

38. Next, the TPO faulted the Assessee for not furnishing any evidence to show the amounts paid in respect of each of the expatriate employees or establish the cost benefit analysis of the expatriate employees.

39. The learned CIT(A) rejected the TP adjustment directed by the TPO. The CIT(A) held that the Assessee had established that the transactions were on an arm's length basis as it had adopted the cost-plus method as the most appropriate method. The Assessee had also established that no markup was charged. The CIT(A) held that the TPO

had erred in concluding that vendor identification was a function of the AE and not of the Assessee. The CIT(A) found that there was no basis to state that Ettore Cadamore, Sourcing Head was working for the AE and not for the Assessee. The relevant extract of the said CIT(A)'s decision is set out below:

> "5.6. I have considered the submission of the appellant as well as the order of the TPO. It is important to analyze the onus of proof in the facts and circumstances of this case. Appellant is a company engaged in the business of high fashion garment manufacturing & sales and sourcing material from India. It markets internationally known branded garment of "United Colours of Benetton". It caters to the high end customers - those who have deep pockets to satisfy their whims and fancies. It has seconded employees on its rolls - 3 employees in AY 2006-07 and 5 employees in AY 2007-08. They were paid by the parent company. TPO did not introduce any evidence to state that these employees did not work in India. Appellant produced the evidence that they were in India during the relevant period. Tax was deducted at source on the salary paid to these employees.
>
> The evidence of their presence in India was produced in the form of Passport - Visa copies and TDS details. In the documentation present before the TPO, the appellant has stated that they have used cost plus method as the most appropriate method. No mark up was charged by the AE as this was a reimbursement of cost of the employees seconded to the appellant.
>
> On the other hand, in the sourcing segment the appellant has received arm's length compensation from its AE which was held to be as such by the TPO. Some of the employees were working in this segment. Therefore, the TP documentation stated that the transaction is at ALP since it is only a cost-to-cost transaction with respect to the employee's salaries. By doing this, I am of the opinion that the appellant had discharged the onus of establishing ALP of the transaction.

In order to dislodge the claim of the appellant, TPO has to bring on record evidence. The only thing which the TPO has brought out is that the "vendor identification" was the function of the AE and therefore, if anybody else - to be more specific if appellant - does this function with the help of seconded employees, then those employees were working not for the appellant but for AE. This was the argument for the denial of the claim of the 'appellant' with respect to Ettore Cadamore who worked in India for AY 2006-07. It is not clear how TPO came to this conclusion that vendor identification is the function of the AE. Appellant had employed him for sourcing the materials. The relevant extracts of the functional analysis documented in the Appellant's Transfer Pricing Documentation, which has been relied upon by the TPO, are as follows:

"*During FY 2006-07, Benetton India assisted Benind SPA in acquiring garments and other finished products from third party vendors in India. With respect to the above mentioned transaction, Benetton Indians role was limited to procuring and sourcing of merchandise for its AE and. for this function Benetton India charged commission amounting to INR 116,766,163 during the year.....*

Purchasing activities/ supplier identification

Benetton India, assists Benind S.P.A in. identifying potential suppliers or apparels in India. This involves identifying and evaluating a vendors manufacturing facility and practices using standard policies and procedures of Benetton Group. Benind S.P.A also provides the vendor with the standard specifications of garments including detailing, stitching coordinates and designs."

5.6.1. From a plain reading of the above, it is clear that vendor identification was the responsibility of Benetton India. Benetton India got remunerated for these functions as a service provider. The claim of the TPO and his basis of rejecting the Appellant's contention is prime facie incorrect. Hence, as substantiated above, it would be inappropriate to conclude that the Sourcing Head was working for the AEs and not Benetton India.

5.6.2 ALP cannot be determined by based on wrong appreciation of facts. Other than this confusion about 'Vendor identification' and 'sourcing' TPO has not introduced any new facts in the analysis.

5.6.3. It should be pointed out that appellant has two sets of main activities in India. Manufacturing activities and procuring and sourcing of merchandise. Ettore Cadamore was working in the segment 'procuring and sourcing of merchandise' which was operating from Bangalore. This unit had around 40 employees. The margin of this unit was remunerated by receipt of commission. The method used was OP/OC and the margin in this segment was 71.89% and 19.23% respectively for AY 2007-08 and 2008-09. The cost in this segment has included the salary cost of Ettore Cadamore. This segment was held to be at arm's length by the TPO. Appellant rightly showed the reimbursement of salary of Ettore Cadamore as an international transaction. There is no basis whatsoever to say that Ettore Cadamore was working for AE. Due to his activities for appellant, it has earned a markup in 'procuring and sourcing of merchandise' activities. Therefore, TPO was wrong in holding that this employee worked for AE.

5.6.4. Other employees in question were, production head - Renzo Gardin (AY 2006-07 & 2007-08), and buying & visual Media head - Andreini Giuseppe (AY 2006-07 & 2007-08). For the rest 2 employees TPO has not offered any reason. TPO has tried to co-relate losses as a justification for his conclusion that these employees have either not worked or their work were not beneficial. They are only arguments and no fresh facts have been brought on record by TPO.

5.6.5. Appellant has argued that, expatriates were in India and were employed in the business operations in India (Para 5.4.1), in substance, the impugned transaction is a third- party transaction (Para 5.4.2), it is not necessary that an expenditure results in direct and tangible benefit for the spender (Para 5.4.3), the TPO misinterpreted expected benefits as tangible benefits (Para 5.4.4) and the TPO failed to provide any data to support his CUP analysis (Para 5.4.5) as the reason to accept the claim of the appellant.

I have no hesitation to state that the appellant has fully discharged its onus by providing the documentation with regard to the fact that these employees worked in the relevant period in India and also by giving the description of their functions. TDS was deducted at source for their salaries. The case laws cited by the appellant in the earlier paragraph i.e., the case of the Me Cann Friction and Dresser Rand are applicable in this case. It is the expected benefit and not the real benefit which is contemplated in the OECD guidelines. In any case it is not the case of the TPO that these employees did not work for the appellant. Further, it is a move point whether the TPO should have brought any 'CUP' data in such a situation. The fact that various softwares are used by the appellant is not denied by the TPO. In view of this, I hold that the addition made in this regard is not sustainable since they are not based on any facts or evidences. TPO/AO is directed to delete the addition made in this regard."

40. The learned ITAT concurred with the decision of the CIT(A) and thus, rejected the Revenue's appeal. The relevant extract of the impugned order is set out below:

"9. We find on considering the detailed arguments advanced before the TPO and the CIT(A) which have briefly been referred to in the earlier part of this order and considering the arguments advanced as brought out in para

5.4.1 wherein the facts evidences and submissions for the Expatriates who were employed in the business operations in India for these two assessment years which has already been addressed at great length in earlier part of this order. We note that in the absence of any rebuttal on facts or arguments, no interference is warranted. It is noted that apart from the reasons considered, it has also been canvassed that infact it is a third party transaction on account of the following facts:

"The Appellant submitted that Benetton India was in need of employees having technical knowledge and relevant experience in their respective fields. The AEs

had similar employees in their workforce and supported Benetton India by seconding skilled workforce to Benetton India without any additional charge. The salary and perquisite costs of the employees seconded by the AEs were credited directly to their bank accounts by the AEs which were subsequently reimbursed by Benetton India (without any mark-up) as the functions performed by the employees during the period of secondment were directly for the benefit of Benetton India.

Hence, in substance this transaction is a third party transaction as the payments were made to the employees, which were neither related to Benetton India nor its AEs. Accordingly, it does not fall within the purview of Section 92 of the Act."

9.1 The arguments relying upon judicial precedent cited namely that certain transactions need not necessarily attract financial benefits and the commercial expediency of the business expenditure cannot be dictated to by the TPO as advanced in para 5.4.3 of the consolidate order which remains unaddressed by the Revenue. Similarly, the argument that the commercial expediency to incur an expenditure for the business needs and purposes cannot be dictated to by the tax authorities remains unaddressed. Similarly, the reliance on the global legislation namely OECD Guidelines, the Australian Guidelines and 'German Rulings as relied in para 5.4.4 vis-a-vis the facts of the present case namely that the employees had key positions in the organization and in the absence of locally trained personnel in the respective areas of expertise necessitated recourse to outside guidance, advice and expertise aware of the requirement of Benetton group and its business in Benetton India had to be resorted to also stands unrebutted. The decision to so seek the benefit of expertise in the peculiar facts of the present case was necessary and the commercial expediency of its decision it has been argued cannot be questioned. We find that these detailed factual submissions stand unrebutted on record. Further we find that no data has been relied upon by the tax authorities to show that the CUP value of the transaction would be 'nil*. No comparable CUP has been cited where a

> service provider would send its employees, incur salary and related sources to a third party and shall not receive anything in return. Accordingly, finding the aforesaid finding of the CIT(A) on facts justified, the departmental ground qua the issue is dismissed."

41. The TPO's decision to determine the ALP of the international transaction relating to reimbursement of expatriate cost at Nil, cannot be sustained. A plain reading of the TPO's order indicates that it had proceeded on the basis that the Assessee had not derived any benefit from the employees that were seconded to it. The TPO had also held that the Assessee had not established that the employees were working for it in India. The thrust of the contentions advanced on behalf of the Revenue before this court, is to a similar effect; that is, that the Assessee has not established that it had derived any benefit from the expatriate employees and therefore, the TPO was correct in holding that the ALP of the reimbursement of salaries of the expatriates is required to be determined at Nil.

42. It is necessary to bear in mind that there is a distinction between the functions of a TPO and an AO. The TPO is required to conduct a transfer pricing analysis to determine the ALP. It is not the TPO's function to determine whether, in fact, there is any service from which the Assessee derived any benefit. The question whether any expenditure has been incurred by the Assessee for earning revenue is a matter, which is required to be determined by the AO. It would be relevant to refer to the decision of this court in ***Commissioner of Income Tax v. Cushman and Wakefield (India). (P.) Ltd.: (2014) 367***

ITR 730, where this court had also referred to the decision of Income Tax Appellate Tribunal in ***Dresser-Rand India Pvt. Ltd. v. Additional CIT: (2012) 13 ITR (Trib) 422 (Mumbai),*** with approval. The relevant extract of the said decision is set out below:

> "**34.** The court first notes that the authority of the Transfer Pricing Officer is to conduct a transfer pricing analysis to determine the arm's length price and not to determine whether there is a service or not from which the assessee benefits. That aspect of the exercise is left to the Assessing Officer. This distinction was made clear by the Income-tax Appellate Tribunal in Dresser-Rand India Pvt. Ltd. v. Addl. CIT (2012) 13 ITR (Trib) 422 (Mumbai):
>
> > "8. We find that the basic reason of the Transfer Pricing Officer's determination of the arm's length price of the services received under cost contribution arrangement as 'nil' is his perception that the assessee did not need these services at all, as the assessee had sufficient experts of his own who were competent enough to do this work. For example, the Transfer Pricing Officer had pointed out that the assessee has qualified accounting staff which could have handled the audit work and in any case the assessee has paid audit fees to external firm. Similarly, the Transfer Pricing Officer was of the view that the assessee had management experts on its rolls, and, therefore, global business oversight services were not needed. It is difficult to understand, much less approve, this line of reasoning. It is only elementary that how an assessee conducts his business is entirely his prerogative and it is not for the Revenue authorities to decide what is necessary for an assessee and what is not. An assessee may have any number of qualified accountants and management experts on his rolls, and yet he may decide to engage services of outside experts for auditing and management consultancy ; it is not for the revenue officers to question the assessee's wisdom in doing so. The Transfer Pricing Officer was not only going much beyond his powers in questioning commercial wisdom of the assessee's decision to take benefit of expertise of Dresser Rand US, but also beyond the powers of the

> Assessing Officer. We do not approve this approach of the Revenue authorities. We have further noticed that the Transfer Pricing Officer has made several observations to the effect that, as evident from the analysis of financial performance, the assessee did not benefit, in terms of financial results, from these services. This analysis is also completely irrelevant, because whether a particular expense on services received actually benefits an assessee in monetary terms or not even a consideration for its being allowed as a deduction in computation of income, and, by no stretch of logic, it can have any role in determining the arm's length price of that service. When evaluating the arm's length price of a service, it is wholly irrelevant as to whether the assessee benefits from it or not ; the real question which is to be determined in such cases is whether the price of this service is what an independent enterprise would have paid for the same. Similarly, whether the associated enterprises gave the same services to the assessee in the preceding years without any consideration or not is also irrelevant. The associated enterprises may have given the same service on gratuitous basis in the earlier period, but that does not mean that the arm's length price of these services is 'nil'. The authorities below have been swayed by the considerations which are not at all relevant in the context of determining the arm's length price of the costs incurred by the assessee in cost contribution arrangement. We have also noted that the stand of the Revenue authorities in this case is that no services were rendered by the associated enterprises at all, and that since there is no evidence of services having been rendered at all, the arm's length price of these services is 'nil'."

35. The Transfer Pricing Officer's report is, subsequent to the Finance Act, 2007, binding on the Assessing Officer. Thus, it becomes all the more important to clarify the extent of the Transfer Pricing Officer's authority in this case, which is to determining the arm's length price for international transactions referred to him or her by the Assessing Officer rather than determining whether such services exist or benefits have accrued. That exercise—of factual verification is retained by the Assessing Officer under section 37 in this case. Indeed, this is not to say that the Transfer Pricing Officer cannot—after a consideration of the facts—state that the arm's length

price is 'nil' given that an independent entity in a comparable transaction would not pay any amount. However, this is different from the Transfer Pricing Officer stating that the assessee did not benefit from these services, which amounts to disallowing expenditure. That decision is outside the authority of the Transfer Pricing Officer. This aspect was made clear by the Income-tax Appellate Tribunal in Deloitte Consulting India Pvt. Ltd. v. Deputy CIT/ITO (2012) 19 ITR (Trib) 378 (Mumbai) ; (2012) 137 ITD 21 (Mumbai):

> "37.On the issue as to whether the Transfer Pricing Officer is empowered to determine the arm's length price at "nil", we find that the Bangalore Bench of the Tribunal in Gemplus India P. Ltd. 2010-TII- 55-ITAT-BANG-TP, held that the assessee has to establish before the Transfer Pricing Officer that the payments made were commensurate to the volume and quality service and that such costs are comparable. When commensurate benefit against the payment of services is not derived, then the Transfer Pricing Officer is justified in making an adjustment under the arm's length price.
>
> 38. In the case on hand, the Transfer Pricing Officer has determined the arm's length price at 'nil' keeping in view the factual position as to whether in a comparable case, similar payments would have been made or not in terms of the agreements. This is a case where the assessee has not determined the arm's length price. The burden is initially on the assessee to determine the arm's length price. Thus, the argument of the assessee that the Transfer Pricing Officer has exceeded his jurisdiction by disallowing certain expenditure, is against the facts. The Transfer Pricing Officer has not disallowed any expenditure. Only the arm's length price was determined. It was the Assessing Officer who computed the income by adopting the arm's length price decided by the Transfer Pricing Officer at 'nil'."

This is a slender yet the crucial distinction that restricts the authority of the Transfer Pricing Officer. Whilst the report of the Transfer Pricing Officer in this case ultimately noted that the arm's length price was 'nil', since a comparable entity would pay 'nil' amount for these services, this court noted that remarks concerning and the final

decision relating to, benefit arising from these services are properly reserved for the Assessing Officer.

36. In this case, the issue is whether an independent entity would have paid for such services. Importantly, in reaching this conclusion, neither the Revenue, nor this court, must question the commercial wisdom of the assessee, or replace its own assessment of the commercial viability of the transaction. The services rendered by CWS and CWHK in this case concern liaising and client interaction with IBM on behalf of the assessee – activities for which, according to the assessee's claim – interaction with IBM's regional offices in Singapore and the United States was necessary. These services cannot – as the Income-tax Appellate Tribunal correctly surmised – be duplicated in India in so far as they require interaction abroad. Whether it is commercially prudent or not to employ outsiders to conduct this activity is a matter that lies within the assessee's exclusive domain and cannot be second-guessed by the Revenue."

43. In the present case, the Assessee had asserted that the expatriate employees had rendered services to it. The AO had not doubted that the expenditure incurred by the Assessee was wholly and exclusively for its business. In the circumstances, the TPO's role was confined to determining whether the international transaction was on arm's length basis. A careful reading of the TPO's order indicates that it is not premised on the basis that the ALP for the services derived by the Assessee from the expatriate employees ought to be less than what it had paid. It is the TPO's view that the Assessee has failed to establish that it had derived any benefit at all from the expatriate employees. It is also suggested that the payments made for the expatriate employees were essentially a method of syphoning off funds to the AE. Plainly, this conclusion cannot be sustained and is unfounded.

44. It is important to note that the Assessee had disclosed the role of each of the expatriate employees. It had also produced sufficient evidence to show that the employees had served in India. It is further the Assessee's contention that it had only reimbursed the amounts paid by the AEs to the expatriate employees without any mark-up. Since there was no element of any mark-up, the ALP could not be lower than the cost paid. Indisputably, the TPO cannot question the commercial wisdom in hiring expatriate employees for rendering assistance. The said decision falls within the scope of commercial expediency and the TPO cannot supplant its opinion in place of the Assessee in regard to need for such services.

45. The TPO had also proceeded to conduct inquiry whether the Assessee had derived any additional profit on account of hiring the expatriate employees and had concluded that since the Assessee had incurred a loss, the ALP was required to be determined at Nil. This reasoning is also fundamentally flawed. The question whether the activities conducted by the Assessee ultimately resulted in a profit or loss, is not determinative of whether any international transaction of availing of services, is on arm's length basis and at ALP. Plainly, price of resources employed to carry on business cannot be treated as nil if the assessee makes a loss. Illustratively, an assessee may lease an office for its business purposes but incurs a loss. Clearly the ALP of the lease rentals would not be nil because the assessee does not make a profit in the given year. The price of a resource is not contingent on whether the assessee makes a loss or profit.

46. Having stated the above, we must also add that the Assessee is required to maintain proper documentation with regard to any international transaction. Thus, the Assessee was obliged to produce relevant documents to establish the arrangement with the AE for employees seconded to the Assessee in India and the remuneration paid to each of the said expatriate employees. It is apparent from the order passed by the TPO that the Assessee had not produced such documentation. The TPO had also noted that the Assessee had not produced the break-up of the payments made to each of the employees.

47. It is also necessary to note that the international transactions regarding receipt of commission for assistance and sourcing was benchmarked using transactional net margin method (TNMM) as the most appropriate method. The commission earned for sourcing activities was found to be on arm's length basis. Indisputably, the cost of any expatriate employees seconded to the Assessee for assistance in such activities would be subsumed as an element of cost.

48. In ***Sony Ericson Mobile Communications India P. Ltd. v. Commissioner of Income Tax (2015) 374 ITR 118 (Del)***, this court had explained that the definition of the expression 'transaction' as used in Rule 10A(d) of the Income Tax Rules, 1962 (hereafter *the Rules*) read with Section 92C(1) of the Act does not prohibit clubbing of closely connected or intertwined transactions.

49. It is also necessary to bear in mind that the object of determining the ALP is to ensure that the real value of the transaction is captured for

the purposes of taxation. One of the prescribed methods for determining the ALP is TNMM. The said method is tolerant to various functional dissimilarities as it is premised on comparing the net margins of the tested and uncontrolled transactions. In the present case, the commission earned by the Assessee had been determined on arm's length basis. This would necessarily take into account all elements of costs including payments made to AEs for reimbursement of salaries to expatriate employees. In the aforesaid view, we find no infirmity with the decision of the learned ITAT in accepting the CIT(A)'s decision to delete the addition made by the TPO in respect of reimbursement of costs of expatriate employees.

ROYALTY

50. During the previous year, relevant to AY 2007-08, the Assessee had paid royalty of ₹37,198,024/- to Bencom S.R.L. (AE). The said royalty was paid at the rate of 4.8% on domestic sales of goods, which were manufactured and sold by franchises. Additionally, royalty was paid at the rate of 2.4% of sales in respect of goods manufactured and sold by the Assessee from its own retail outlets. However, no royalty was paid by the Assessee in relation to the goods that were not manufactured by it but were traded by it. The royalty paid by the Assessee fell within the norms as fixed by the Central Government (SLA, Ministry of Industry), and the Technical Know-how Agreement dated 21.12.2005 entered into between the Assessee and the AE (Beucom S.R.L.) was approved by the Central Government.

51. The Assessee had adopted the Comparable Uncontrolled Price (CUP) method for benchmarking the royalty paid by it. The Assessee had collated data with regard to other companies, which were involved in manufacture and sale of apparel and had collaborated with foreign entity(ies). A tabular statement summarizing the comparable transactions as furnished by the Assessee is set out below:

> "The table below briefly summarizes the particulars of the comparable transactions:

S. No.	Name of foreign collaborator	Nature of Indian Company	Item of manufacture	Royalty Rates	
				Domestic	Exports
1	Devanlay, S.A.	Sports And Leisure Apparel Ltd	Apparel For Men Light Wear. Heavy Clothing, Apparel For Women. Apparel For Children And Other Apparel.	5	8
2	H.D. Lee Company Inc.	Arvind Fashion Ltd	Textile Garments	**5**	5
3	Htil Corporation B.V.	Continental Clothing Company	Ladies, Men's & Children's Knit And Woven Apparel, Swimwear, Belts And Bags With Brand Name "Pipeline"	5	4.8
4	Jockey International Inc.	Page Apparel Manufacturing Pvt. Ltd.	Ready Made Garments	5	5
5	Keltec Inc.	Ashra Consultants Pvt Ltd.	Ladies' Blouses. Ladies	5	5

			Trousers. Ladies Skills, Ladies Shorts, Ladies Dresses And Ladies Leisure Wear.		
6	Moda Musica Sri	Pantaloon Retail (India) Ltd	-Apparels For Men, Ladies &Teens Including Accessories Etc.	3.25	3.25
7	Nike International Limited, Usa	Siena Industrial Enterprises Pvt Ltd	Sourcing. Marketing And Sale Of Nike Brand Athletic Footwear, Apparels, Bags And Accessories Etc.	5	NA
8	Paws Incorporated Albany	Gini & Jony Apparel Pvt. Ltd.	Ready Made Garments	3.85	NA
9	Pom	Jay Gee Fashions Pvt. Ltd.	Branded Apparel Manufacturing Through Job Work Marketing And Retailing	**S**	5
10	Puma Ag Rudolf Dassler Sport	Planet Sports Pvt Ltd.	Manufacture Of Leisure Clothing	5	8
11	R & S Trading Inc	Pantaloon Retail (India) Ltd	Apparels For Men, Ladies & Teens Including Accessories Etc.	3.85	3.85
12	Rider Inc..Usa	Arvind Clothing Ltd	Ready-Made Garments	4	5
13	Start-Rite Shoes Ltd,	Sarwp Tanneries	Children Shoes	5	NA

	Uk	Ltd			
	Average			4.84	5.29

52. The learned TPO called upon the Assessee to furnish the justification for payment of royalty including the description of the intangibles transferred or licensed to the Assessee as well as the cost benefit analysis of the same.

53. The Assessee explained that the royalty was paid for receiving designs for products and by paying royalty, the Assessee was able to achieve significant savings on account of costs that it would have to otherwise incur for designing its own products. The Assessee also claimed that even if it had incurred the costs in designing its own products, it would not be able to bring an international touch to its products and outlets. The Assessee asserted that the average rate of royalty paid for manufacturing technology in the same industry computed on the basis of comparable transactions, worked out to be 4.84% of sales, which is higher than the royalty paid by the Assessee.

54. The learned TPO rejected the Assessee's explanation primarily for the reason that the Assessee had incurred losses during the relevant financial year. The learned TPO selected comparable entities (41 companies) engaged in manufacture of apparels and computed the mean profit level indicator (OP by sales) of the said entities at 8.9%. The learned TPO also noted that the indicative set of entities had turnover between ₹6.88 crores to ₹1034.45 crores. However, in contrast to the same, the Assessee had incurred a loss (a negative margin of 4.67%) on

sales. On the aforesaid basis, the learned TPO rejected the transfer pricing analysis as furnished by the Assessee and the method used by the Assessee for determining the ALP. The learned TPO concluded that the Assessee was neither able to furnish the basis on which the rate of royalty was fixed nor provided any cost benefit analysis to justify the same. On the aforesaid basis, the AO determined the ALP of royalty as Nil and consequently directed an addition of ₹3,71,68,024/- under Section 92CA of the Act.

55. It is material to note that learned TPO had found that CUP was not the appropriate method, *inter alia*, on account of geographical differences between the Assessee and the comparable entities. According to the TPO, such differences vitiated the comparison between the tested parties and the uncontrolled entities.

56. The learned CIT(A) did not concur with the decision of the learned TPO. The learned CIT(A) faulted the decision of the learned TPO in determining the ALP as Nil on the basis that the Assessee had incurred a loss in comparison to other companies engaged in manufacture and sale of apparel and have earned profits. The learned CIT(A) also did not concur with the learned TPO in rejecting the CUP method on account of the geographical differences without appreciating how it would affect the rate of royalty. The relevant extract of the decision of the learned CIT(A) is set out below:

> "6.5. I have carefully considered the order of the TPO and the submission of the appellant. The appellant has produced

external CUP and internal CUP. External CUPs are the royalty-agreements between various parties as approved by the Govt. India. This data was extracted from SAI News Letter. Internal CUP was in the form of agreement between AE (Benetton SRL) and a third party in Syria. TPO has rejected them by stating that the geographical differences make the agreements unusable as CUP. The agreements relied upon by the appellant were agreements between entities located in different parts of the world whereas the transaction under question was between the appellant who is in India and its AE which is in Italy. Therefore, TPO was of the view that the geographical difference vitiates the comparison of these agreements (which is mentioned in para 6.2. above).

I am of the considered view that this is a spacious argument by the TPO without holding any water in die facts and circumstances of this case. No two geographical points under the sun can be equal, in strict physical and mathematical sense. However, how the geographical or market difference affect the rate of royalty should be demonstrated. It is well understood that price of a commodity differs depending on the geographical location or the segment in which it is being compared, All of us know that the same Coke or Pepsi bottle cost differently depending on whether it is in a street corner shop or in a cinema hall or in a 5 star hotel. In the present case of the appellant, we are not concerned with the price or cost but the rate of royalty. The rate of royalty is calculated as a percentage of sales. Therefore, the impact of geographical difference will be much less as compared to the absolute price of a commodity or a service.

The appellant is getting designs and sketches, measurement specifications, advertisement and sales promotion materials, store ambience specifications, packing, information etc. as part of the royalty agreement. The appellant has also shown that there were six agreements between entities in India and entities in Europe which could have been used to arrive at a narrower set of comparables (para no. 6.4.6 above). The terms and condition of these agreements were almost similar. The appellant had also produced evidences in the form of documentation to show that technical knowhow was received

by the appellant (para no. 6.4.12 to 6.4.14 above). Therefore, the conclusion that the appellant has not benefitted from the royalty agreement is not based on a fact.

6.6. The TPO has also argued that the appellant had suffered losses and had the royalty agreement really beneficial to the appellant then it would not have suffered losses. This argument is fallacious on the face of it because the losses or profits are not the criteria to judge the commercial benefit of any expenditure. The appellant has also shown that there are other reasons for incurring losses (para no. 6.4.17 above). It is also been submitted that the appellant would have not gained anything in terms of tax planning by payment of royalty as the same has suffered with holding taxation (para no. 6.4.19 above).

The appellant has relied on the decision of the Jurisdiction High Court in the case of EKL Appliances (supra). I hold that the decision of the Hon'ble High Court is squarely applicable in this case. Apart from the above, the Hon'ble ITAT Delhi in its decision [Benetton India Pvt. Ltd. vs ITO, Ward 2(4), New Delhi (2012) 17 taxmann.com 5 (Delhi) dated 30.11.2011] i.e. in the case of the appellant itself for the AY 2006-07, has held that the royalty payment was at arm's length.

In view of the above reasons, I hold that the international transaction involved in the payment of royalty is at arm's length. The addition made in this regard should be deleted.

In effect, the appeal is partly allowed."

57. The learned ITAT had rejected the Revenue's appeal against deletion of adjustment made on account of ALP as directed by the learned TPO.

58. The learned ITAT found that the Assessee had furnished documents to establish that technical know-how was received from the AE. The Assessee had also provided material in the form of technical specification sheets indicating the design of the garments along with

material and components to be used, which enabled the Assessee to maintain the quality standard of its products. We consider it apposite to reproduce the justification provided by the Assessee before the learned TPO as quoted in the impugned order:

> *6.4.12. <u>Detailed documentation submitted by the Appellant to prove the technical knowhow received by it from its AEs.:</u>*
>
> *The Appellant submitted that it is a well know fact that a plain T-Shirt is sold in India at various prices starting from Rs 50 (or even lower) upto INR 10,000 (and more). Customers value the quality, design and appeal of the product and buy only if the pricing is found appropriate on such standards.*
>
> *Benetton India sells international range of garments and accessories in India. The price that Benetton products command in the market is attributed to its superb quality and international and trendy designs. To be able to maintain the same standard of quality and international designs, the company would need to undertake similar activities as Bencom's design centre. Herein, we submit the following extract from the website of Benetton Group:*
>
> *"A staff of 300 designers from all over the world creates the collections for the casual United Colors of Benetton, the glamour oriented Sisley, the leisurewear brand Playlife.*
>
> *The design team is also engaged in researching new materials and creating new lines for different targets from children, men and women to expectant mothers, offering them not only practical and modern styles but also maximum comfort.*
>
> *The result is the latest trends in design and a rich output of many models a year which are realized with computer assisted design systems fully integrated with the rest of the company's production phases."*
>
> *By merely paying the royalty to Bencom, Benetton India is able to achieve significant cost savings, which it would have had to*

incur for the designing of its own products. Even after incurring the same amount of expense (or a much higher expenditure) as compared to the amount of royalty paid by Benetton India, Benetton India would not have been able to bring a truly international touch and feel to its products and outlets.

Further, its association with Bencom enables Benetton India to introduce a fresh collection every six months to be able to capitalize on each and every change in the fashion industry."

59. As noted above, the principal controversy regarding the ALP adjustment of royalty is that the Assessee had incurred a loss during the relevant AY. This according to the learned TPO indicated that the value of technical know-how received by the Assessee was of little value. The learned TPO had reasoned that since royalty was paid for technical know-how for reduction of costs and earning profits, the fact that the Assessee had not earned profit was indicative that the value of technical know-how, if any, received by the Assessee was nil.

60. The ALP in respect of royalty cannot be determined as Nil on the ground that the Assessee had incurred losses. The decision of the Assessee to procure technical know-how for its activities is a commercial decision. The cost paid for technical know-how is one of the elements of costs, which was incurred by the Assessee for carrying on its business. The fact that the business retuned a loss cannot possibly lead to the conclusion that the ALP of the technical know-how is Nil. The learned TPO's reasoning in this regard is clearly flawed.

61. Apart from acquiring technical know-how, there may have several other elements of costs such as cost for utilities, cost of labour

etc. The fact that an assessee may incur a loss in its business, does not necessarily mean that the value of the utilities availed by it or the value of the labour employed is Nil. As noted hereinbefore, the arms' length analysis is not concerned with the commercial expediency of incurring costs. It is merely confined to determining the ALP of the material or the services used.

62. In the present case, the Assessee had in its commercial wisdom decided to acquire technical know-how for carrying on its business activities. This decision is not subject of a review on merits by the learned TPO. The learned TPO is to merely examine whether the amount paid by the Assessee for acquiring the technical know-how was on arms' length basis. In other words, what would be the costs an assessee would require to pay if it had acquired the technical know-how from an entity other than its AE on an arms' length basis.

63. We consider it apposite to refer to the decision of this court in ***Commissioner of Income-tax v. EKL Appliances Ltd.: Neutral Citation No.2012:DHC:2201-DB.*** In its decision, this court had referred to the Transfer Pricing Guidelines for Multi-National Enterprises and Tax Administrations issued by Organization for Economic Co-operation and Development (OECD) and held as under:

> "17. The significance of the aforesaid guidelines lies in the fact that they recognise that barring exceptional cases, the tax administration should not disregard the actual transaction or substitute other transactions for them and the examination of a controlled transaction should ordinarily be based on the

transaction as it has been actually undertaken and structured by the associated enterprises. It is of further significance that the guidelines discourage re-structuring of legitimate business transactions. The reason for characterisation of such re-structuring as an arbitrary exercise, as given in the guidelines, is that it has the potential to create double taxation if the other tax administration does not share the same view as to how the transaction should be structured.

18. Two exceptions have been allowed to the aforesaid principle and they are (i) where the economic substance of a transaction differs from its form and (ii) where the form and substance of the transaction are the same but arrangements made in relation to the transaction, viewed in their totality, differ from those which would have been adopted by independent enterprises behaving in a commercially rational manner.

19. There is no reason why the OECD guidelines should not be taken as a valid input in the present case in judging the action of the TPO. In fact, the CIT (Appeals) has referred to and applied them and his decision has been affirmed by the Tribunal. These guidelines, in a different form, have been recognized in the tax jurisprudence of our country earlier. It has been held by our courts that it is not for the revenue authorities to dictate to the assessee as to how he should conduct his business and it is not for them to tell the assessee as to what expenditure the assessee can incur. We may refer to a few of these authorities to elucidate the point. In ***Eastern Investment Ltd. v. CIT*** (1951) 20 ITR 1 (SC), it was held by the Supreme Court that "there are usually many ways in which a given thing can be brought about in business circles but it is not for the Court to decide which of them should have been employed when the Court is deciding a question under Section 12(2) of the Income Tax Act". It was further held in this case that "it is not necessary to show that the expenditure was a profitable one or that in fact any profit was earned". In ***CIT v. Walchand & Co. (P.) Ltd.*** (1967) 65 ITR 381, it was held by the Supreme Court that in applying the test of commercial expediency for determining whether the expenditure was wholly and exclusively laid out for the purpose of business, reasonableness of the expenditure has to be judged from the point of view of the businessman and not of the Revenue. It was

further observed that the rule that expenditure can only be justified if there is corresponding increase in the profits was erroneous. It has been classically observed by Lord Thankerton in ***Hughes v. Bank of New Zealand*** (1938) 6 ITR 636 (HL) that "expenditure in the course of the trade which is unremunerative is none the less a proper deduction if wholly and exclusively made for the purposes of trade. It does not require the presence of a receipt on the credit side to justify the deduction of an expense". The question whether an expenditure can be allowed as a deduction only if it has resulted in any income or profits came to be considered by the Supreme Court again in ***CIT v. Rajendra Prasad Moody*** (1978) 115 ITR 519 (SC), and it was observed as under: -

> "We fail to appreciate how expenditure which is otherwise a proper expenditure can cease to be such merely because there is no receipt of income. Whatever is a proper outgoing by way of expenditure must be debited irrespective of whether there is receipt of income or not. That is the plain requirement of proper accounting and the interpretation of Section 57(iii) cannot be different. The deduction of the expenditure cannot, in the circumstances, be held to be conditional upon the making or earning of the income."

It is noteworthy that the above observations were made in the context of Section 57(iii) of the Act where the language is somewhat narrower than the language employed in Section 37(1) of the Act. This fact is recognised in the judgment itself. The fact that the language employed in Section 37(1) of the Act is broader than Section 57(iii) of the Act makes the position stronger.

20. In the case of ***Sassoon J. David & Co. (P.) Ltd. v. CIT*** (1979) 118 ITR 261 (SC), the Supreme Court referred to the legislative history and noted that when the Income Tax Bill of 1961 was introduced, Section 37(1) required that the expenditure should have been incurred "wholly, necessarily and exclusively" for the purposes of business in order to merit deduction. Pursuant to public protest, the word "necessarily" was omitted from the section.

21. The position emerging from the above decisions is that it is not necessary for the assessee to show that any legitimate expenditure incurred by him was also incurred out of necessity. It is also not necessary for the assessee to show that any expenditure incurred by him for the purpose of business carried on by him has actually resulted in profit or income either in the same year or in any of the subsequent years. The only condition is that the expenditure should have been incurred "wholly and exclusively" for the purpose of business and nothing more. It is this principle that *inter alia* finds expression in the OECD guidelines, in the paragraphs which we have quoted above.

22. Even Rule 10B(1)(a) does not authorise disallowance of any expenditure on the ground that it was not necessary or prudent for the assessee to have incurred the same or that in the view of the Revenue the expenditure was unremunerative or that in view of the continued losses suffered by the assessee in his business, he could have fared better had he not incurred such expenditure. These are irrelevant considerations for the purpose of Rule 10B. Whether or not to enter into the transaction is for the assessee to decide. The quantum of expenditure can no doubt be examined by the TPO as per law but in judging the allowability thereof as business expenditure, he has no authority to disallow the entire expenditure or a part thereof on the ground that the assessee has suffered continuous losses. The financial health of assessee can never be a criterion to judge allowability of an expense; there is certainly no authority for that. What the TPO has done in the present case is to hold that the assessee ought not to have entered into the agreement to pay royalty/brand fee, because it has been suffering losses continuously. So long as the expenditure or payment has been demonstrated to have been incurred or laid out for the purposes of business, it is no concern of the TPO to disallow the same on any extraneous reasoning. As provided in the OECD guidelines, he is expected to examine the international transaction as he actually finds the same and then make suitable adjustment but a wholesale disallowance of the expenditure, particularly on the grounds which have been given by the TPO is not contemplated or authorised."

64. In view of the above, we find no infirmity in the decision of the learned CIT(A) or the learned ITAT in setting aside the ALP adjustment as made by the AO on the recommendation of the TPO.

65. As noted above, the question of law as framed also refers to an element of double deduction. We had pointedly asked the learned counsel for the Revenue as to what is the element of double deduction, however, apart from referring to the merits of the deletion of the ALP adjustments recommended by the learned TPO, the learned counsel did not point out any other aspect, which could possibly lead to the conclusion that the Assessee had availed of any double deduction in respect of any element of international transaction.

66. In view of the above, we find no merit in the appeals. The same are, accordingly, dismissed.

VIBHU BAKHRU, J

SWARANA KANTA SHARMA, J

FEBRUARY 06, 2025
RK