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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

Date of Decision: 13.12.2017

\+ ITA 1142/2017 & CM No.45221/2017

DABUR INDIA LTD ..... Petitioner
Through: Mr. M.P. Rastogi with Mr. K.N. Ahuja, Advs.

versus

PR. COMMISSIONER OF INCOME TAX-III ..... Respondent
Through: Mr. Sanjay Kumar, Jr. Standing Counsel with Mr. Rahul Chaudhary, Sr. Standing Counsel for Revenue.

CORAM:
HON'BLE MR. JUSTICE S. RAVINDRA BHAT
HON'BLE MR. JUSTICE SANJEEV SACHDEVA

S. RAVINDRA BHAT, J.(ORAL)

1. The assessee in its appeal under Section 260A urges that the findings of the lower authorities affirmed by the Income Tax Appellate Tribunal (ITAT) are erroneous. It is urged specifically that the attribution of an international transaction, is premised upon the existence of one under Section 92B, calling for adjustment under Section 92C and in the present case, in fact, there was no such transaction; furthermore it is contended that in the absence of any comparable transaction between

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unrelated third parties or an unrelated third party and the assessee, the attribution of income could not have been made.

2. The facts are that the appellant used to provide expertise and also permit the use of its name "Dabur" by a UAE based entity Redrock. The arrangement was embodied in an agreement in terms of which the overseas entity Redrock paid royalty of 1%. The assessee acquired the shareholding in Redrock; this resulted in a name change – the overseas entity was then described as M/s Dabur International Ltd. Subsequently, the overseas entity which had then become a 100% subsidiary of the assessee ceased to pay the royalty.

3. The TPO to whom the returns were referred by the Assessing Officer (AO) took into account the articulated agreement entered into by the assessee with the Redrock in the earlier orders and computed royalty chargeable from M/s Dabur International Ltd. @ 4%. The TPO, in doing so, clubbed the rates of royalty @ 3% being the royalty payable on manufacturing items with the support of the assessee and while using technical knowhow provided; and 1% of the products manufactured without the aid and support of the assessee. The latter class were marketed under the "Dabur brand". The AO accepted the TPO's additions and finalized the assessment by making appropriate adjustment to the tune of ₹5,44,69,000/-. The assessee appealed against this addition; the Appellate Commissioner considered the grounds and comparing the

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assessments completed for the previous years, accepted the TPO/AO's findings. However, the ALP determination at the appellate stage was modified. The Appellate Commissioner reduced the royalty rate to 2% taking the average of the two categories of transactions. The assessee's arguments with respect to existence or absence of comparables having regard to the mandate of Section 92C and Rule 10B were taken note of. The relevant discussion and findings of the CIT(A) are as follows:-

> *"9.9 The appellant has argued that agreement with Dabur International has become inoperative w.e.f. 01.04.2005 and hence there was no obligation on part of Dabur International to pay royalty. As discussed supra in para 9.4, since income arising from international transaction has to be determined having regards to arm's length price, existence of agreement or otherwise is not relevant. Therefore, argument of the appellant that agreement was not in operation during period under consideration is not relevant as price of international transaction is to be determined by TP regulations. The undisputed fact is that Dabur International Ltd. has been permitted to use Dabur brand name and the appellant had been receiving royalty income for the same upto preceding AY. The TPO has treated said agreement dated 01.04.2003 as basis for arm's length price in the absence of any comparable provided by the appellant. Now the issue is whether TPO is correct in adopting 4% rate of royalty chargeable from Dabur International Ltd. Clause 4 of said agreement is reproduced as under:*

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"In consideration for due discharge by Dabur of its obligations hereunder and use of its trademark/trade name, Dabur is entitled during terms of agreement to a royalty of:

> *(a) 3% of FOB sales (net of taxes and sales return) of Redrock of Dabur branded products which are developed and marketed by Redrock through technical and R&D support from Dabur and which are manufactured in accordance with technical specifications detailed by Dabur*
>
> *(b) 1% of FOB sales (net of taxes and sales return) of Redrock of Dabur branded products which are developed by Redrock from any other party without ant technical and R&D support from Dabur."*

The appellant has argued that since Dabur International had not sourced any technical support from Dabur India, clause (a) above shall not apply. This contention of the appellant cannot be brushed aside completely in view of letters furnished by the appellant mentioned supra. Even, this was also the stand of the appellant before TPO when appellant furnished working of royalty at Rs. 75.27 lakhs on FOB sales of Rs. 7526.84 lakhs i.e. @ 1%. This fact has been mentioned in para 7.9 and 7.16 of TPO's order. Rejecting this computation of the appellant, TPO has worked out royalty @ 4% of FOB sales. This approach of TPO is faulty because even if it is assumed that Dabur International has manufactured all its products by using technical know-how of Dabur India, royalty shall be payable @ 3% as per clause 4(a) above and in that case, sub-clause(b) shall not come into operation. However, considering the material furnished by the appellant, it is seen that products

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manufactured by Dabur International in UAE are different from those manufactured in India and in case of same name of products, it has been shown that oil base (raw material) is different from those products manufactured in India. Therefore, it can be safely inferred that most of the products if not all, manufactured in UAE are being manufacture without technical support from Dabur India. In view of this, there shall be a portion of FOB sales on which royalty becomes payable @ 3% and another substantial portion of FOB sales on which royalty shall become payable @1%. Under no circumstances, royalty shall become payable @ 4% on total FOB sales as held by TPO. In view of these facts, it shall be more realistic and reasonable if royalty payable is worked out @ 2% on total FOB sales i.e. average rate. Accordingly, I hold that arm's length price or royalty from Dabur International is Rs. 150.52 lakhs. The AO is directed to give relief to the appellant on this account accordingly."

4. The assessee further appealed to the ITAT, which partly accepted its plea and scaled down the rate of royalty to 0.75% and directed adjustments accordingly. In its discussion, the ITAT affirmed the findings of the Appellate Commissioner and also the argument of the assessee with respect to absence of brand building, etc. The discussion by the ITAT in this regard, *inter alia* is as follows:-

"35. From the co-joint reading as contemplated u/s 92C of the Act read with Rules 10B and 10C of the Income Tax Rules, 1962, it would be clear that for the purpose of making transfer pricing adjustments, the arm's length price has to be

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determined on finding out similar type of payments received by similarly situated and comparable independent entities. But in the present case, no comparable case has been brought on record by the TPO or the ld. CIT(A) while making adjustment on account of royalty. Moreover, no agreement was inforce to charge royalty from the AEs and that the FMCG products are new to the assessee who is known for its Herbal and Ayurveda products. In the instant case, it is not brought on record that the assessee had incurred any expenses for marketing the products manufactured by M/s Dabur International Ltd. (AE) in UAE and that the assessee either made any efforts or contributed any money for the establishment of its name in geographical area of UAE and the products manufactured by the UAE were not different from the products manufactured in India by the assessee. Moreover, the claim of the assessee that the raw material and medium used in the manufacturing at UAE was totally different from the raw material and medium used in India has not been rebutted. The products manufactured by the assessee were as per the local needs and taste of the public residing in UAE. Furthermore, the ld. CIT(A) himself admitted that M/s Dabur International Ltd., UAE had not manufactured any products with the technical know-how and R&D support of the assessee but had manufactured on its own, in accordance with the requirement and local taste of the local public, however, he directed the AO to calculate the royalty @ 2% but without any basis. In the present case, it is an admitted fact that the TPO/ AO had not applied any transfer pricing method as prescribed under the Act and simply made the adjustment in respect of royalty based on the earlier agreements which had already expired and

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there was no new agreement between the assessee and its AEs. The earlier agreement was entered by M/s Redrock Ltd. On 1st April 2003, at that point of time, the said company was manufacturing the products with the technical know-how and R&D support of the assessee in respect of Ayurvedic/Herbal products. But later on, when the said company found that the Ayurvedic products were not acceptable in UAE as in the said country Unani system of medicines was acceptable as per the local trend and custom. The said AE in UAE had abandoned the manufacturing of the Ayurvedic/herbal products and then entered into the business of FMCG products which were earlier manufactured by the Redrock Ltd. with its own technology as per the requirement and taste of a local public of UAE by keeping into consideration the geographical and market situation. The said company was acquired by the assessee and now for the manufacturing of its products, the assessee did not provide any market strategies, nothing is brought on record that the assessee had borne the expenses, provided the funds or compensated for market failure and the quality etc. It, therefore, appears that the assessee had not made any effort for establishing the trade name nor had made any other contribution. Therefore, the assessee did not receive any royalty for the year under consideration and in the preceding year, the royalty @ 1% was paid to the assessee for the reason that Ayurvedic products were made with the technical know-how and R&D support of the assessee. However, for the year under consideration, the FMCG products were manufactured which were different from the Indian products having different raw material and medium used in the manufacture. At the same time, the brand name of the assessee was used by the AE

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> *and in the earlier years the assessee provided the R&D support, know-how technologies etc. which helped the AE for the year under consideration also to some extent. It is also noticed that the assessee received the royalty @ 1% in the preceding year. The TPO also while working out the royalty rate for the year under consideration was of the view that the royalty @ 1% was chargeable on the products manufactured without the aid and support of assessee company but marketed by using "Dabur" name, however, no basis has been given for the same."*

5. The assessee contends that the mere absence of consideration for use of the Dabur brand, *per se* cannot amount to an international transaction. Counsel faulted the ITAT for affirming Appellate Commissioner's finding and also urged that for making order in any lawful adjustments, necessarily the Revenue had to take into account comparables, the past history of the assessment of a particular party *ipso facto* cannot constitute a comparable, was allowed.

6. The Court is of the opinion that having regard to the conspectus of facts, no infirmity can be found with the ITAT's approach. If the assessee's submissions were to be accepted *arguendo,* the omission by a party to indicate, an initial income, which was concededly being shown in the past as an international transaction, cannot be scrutinized at all. Such an absolute proposition is not possible to support. The assessee is only to explain why the Dabur brand has been permitted to an overseas entity – of which it is the present sole or principal

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shareholder. That it was not such a sole shareholder in the past is an admitted fact. Equally, with the same overseas entity, when the ownership was of a different pattern, royalty was charged for the use of the Dabur brand. Unless at the entity level there is a complete re-organization so as to result in a complete identity of the two concerns or royalty arising out of the use of the Dabur brand, had to be treated as an international transaction; it was for all previous years. In these circumstances, the conclusions and findings recorded by the Appellate Commissioner and the ITAT cannot be faulted. The assessee's submission with respect to the applicability of second proviso to Section 92CA(2), i.e. that it is entitled to the benefit of the arithmetical mean – not exceeding 5%, is in our mind, insubstantial. The assessee, as a matter of fact, did not offer any adjustment claiming that there was indeed no international transaction. In these circumstances, the question of applicability of the said proviso does not arise. No substantial question of law arises; therefore the appeal is dismissed.

S. RAVINDRA BHAT, J

SANJEEV SACHDEVA, J

DECEMBER 13, 2017
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