Latest Delhi High Court 107 Page Order in Maruti Udyog WP No 6876/2008

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ADVOCATE DELHI HIGH COURT

Outline

- Brief Background
- Facts of the case
- Rival Contentions of Writ Petitioner and Revenue before Delhi High Court (DHC)
- Reasoning of DHC
- Final Conclusion

Brief Background

- Intangible – Domestic Taxation used in Section 32 – depreciation which includes "any other business or commercial right" held by Delhi ITAT in Guruji Entertainment case to include Marketing rights etc

Facts of the case (DHC)

- From 1993 onwards Maruti (M) started using Suzuki's (S) logo with its own used logo of Maruti that is joint logo MARUTI SUZUKI
- Financial Year 2004-2005 Reference to TPO (Transfer pricing officer) u/s 92CA was made for ALP determination of Intl Transaction (M's case)

Facts….contd..

- Initially TPO issued SCN for replacement of logo of Maruti by Suzuki in 3 models- proposing to treat it as deemed sale of M logo

- M submitted to TPO without assignment instrument executed with registrar of trademarks- no sale of trademark can be percieved

Facts….

- Further, submitted on said 3 models M continued to use its logo with S's logo

- In final order of TPO: Held

  – S's logo has piggybacked M's logo (that is interalia- re-informcement of S logo which was weaker brand compared to M in India)
  – M developed marketing intangible in India for S, at its cost without being compensated

Facts ….contd

- TPO suo motto apportioned 50% royalty amount (Rs 198 crores.app.) for usage of S trademark in total royalty paid for manufacture etc….and adjusted it to NIL by applying CUP method (on the ground that no compensation by S for co-brabded with M in India)

- TPO adjusted non routine advt expense of Rs 107 crores (app) for being not compensated by S in hands of M

- Hence Total adjustment made at Rs 206 crores (app)

TPO order extracts…

- 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. ***<u>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</u>***.

TPO order extracts

- 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***

TPO Order extarcts

- OECD TP Guidelines for MNE’s 2001 Para 6.4 relied and followed
- DHL Case as pressed into service by TPO:
- 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.

TPO Order extracts

- 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.

TPO order extracts

- 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)***.

TPO rejecting Maruti's contention

- 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.

TPO rejecting Maruti's contention

- 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

- 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'.

TPO rejecting Maruti’s contention

- 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.

Comparable's by TPO

- 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

Writ Petitioner –Maruti Contentions

- No specific opportunity of being heard (Initial SCN and final TPO order at variance)
- No right to S to use M’s logo in agreement, TPO did not pointed use of M’s logo by S
- De-licensing and entry of foreign players like Hyundai, GM etc

Writ Petitioner –Maruti Contentions

- 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.

Writ Petitioner –Maruti Contentions

- 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.

Writ Petitioner- Maruti Contentions

- 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

Revenue’s Contentions before DHC

- 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 <u>migration of the economic value embedded in the ‗Maruti‘ trademark to the ‗Suzuki‘ trademark, for which no compensation was paid to the petitioner.</u> 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.***

Revenue’s Contentions before DHC

- 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 Marut*

DHC Principles laid down…1

- 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 para 23 page 29/30

DHC Principles laid down…1

- 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

DHC Principles……2

- 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 (Para 64/Page 73)

DHC Principles…..3

- 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**
- **(Para 65/Page 74,75)**

Principles…DHC order…4

- 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

Principles…DHC order…4

CONTD…..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

PARA 66/PAGE 76

Principles…DHC order…5

- 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 Para 66-Page 77,78

DHC Principles….6

- 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

- Para 67/Page 78

DHC Principles…..7

- 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 …Page 80

DHC Principles …..8

- 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**.

DHC principles…..9

- 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 Para 71/Page 83,84

DHC Principles….Contra observations

- Para 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.

- Para 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

Principles…DHC …Contd

- Para 73/Page 84,85
- 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***

Reasoning for above principle by DHC

- Reasoning for above

- a) 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.

Reasoning for above principle by DHC

- Reasoning for above

- B) 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.

Test spelled out for difficulty in finding comparables

- 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.
- PARA 75/Page 86,87

Qua Advertisement expenses DHC Principles Para 78 Page 90

- 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.

Comparables by TPO: DHC views

- 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**

DHC vis a vis OECD guidelines

- …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.

WHOLESOME VIEW REQUIRED

- 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** …

WHOLESOME VIEW REQUIRED

- ,….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.

Nascent Provisions Clarified TPO to re-examine the case

- 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.**

THANK YOU

Send ur feedback at cakapilgoel@gmail.com