IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI I-1 BENCH, NEW DELHI

[Coram: Pramod Kumar AM and Beena A Pillai JM]

I.T.A. No.1680/Del/08
Assessment year: 2004-05

YKK India Pvt Ltd ***..........................Appellant***
R13 and 14, LGF, Ansal Chamber II
6 Bhikaji Cama Place, New Delhi 110 066 [PAN: AACY0201G]

Vs.

Deputy Commissioner of Income Tax
Circle 18 (1), New Delhi ***.....................Respondent***

I.T.A. No.6505/Del/12
Assessment year: 2004-05

Assistant Commissioner of Income Tax
Circle 18 (1), New Delhi ***..........................Appellant***

Vs.

YKK India Pvt Ltd ***.....................Respondent***
R13 and 14, LGF, Ansal Chamber II
6 Bhikaji Cama Place, New Delhi 110 066 [PAN: AACY0201G]

CO No. 241/Del/13
Arising out of I.T.A. No.6505/Del/12
Assessment year: 2004-05

YKK India Pvt Ltd ***.................Cross-objector***
R13 and 14, LGF, Ansal Chamber II
6 Bhikaji Cama Place, New Delhi 110 066 [PAN: AACY0201G]

Vs.

Assistant Commissioner of Income Tax
Circle 18 (1), New Delhi ***.....................Respondent***

Appearances by:

Deepak Chopra, along with **Mansvini Bajpai** *for the assessee*
Amrendra Kumar, *for the revenue*

Date of concluding the hearing : April 27, 2016

Date of pronouncing the order : July 25 , 2016

O R D E R

Per Pramod Kumar, AM:

1. The appeal of the revenue, and the cross objection, are directed against the order dated 15th October 2012 passed by the CIT(A) in the matter of assessment under section 143(3) r.w.s 147 of the Income Tax Act, 1961, for the assessment year 2004-05. The cross objection filed by the assessee is not pressed, and is, accordingly, dismissed for want of prosecution.

2. In the appeal filed by the assessee, which is directed against the order dated 25th October 2008 passed by the learned CIT(A) in the matter of assessment under section 143(3) of the Income Tax Act, 1961, for the assessment year 2004-05, the following grievances have been raised:

> **1. That the learned CIT(A) has erred in upholding the disallowance of technical fees of Rs 1,42,72,406 paid to YKK Holding Asia Pte Ltd during the year under reference as under:**
>
> | Sl No. | Particulars | Amount |
> |---|---|---|
> | 1. | AFTP | 15,08,168 |
> | 2. | Sales support on fasteners | 25,10,151 |
> | 3. | Sales Support on Tapes and Plastics | 16,72,089 |
> | 4. | Administrative H R (cost) | 14,96,408 |
> | 5. | Marketing relationship fees | 53,71,246 |
> | 6. | Risk Analysis Consultancy fees | 7,14,344 |
> | | **Total** | **1,42,72,406** |
>
> **2. That the learned CIT(A) has erred in upholding the disallowance of technical fees of Rs 1,42,72,406 paid to a related party, i.e. YKK Holding Asia Pte Ltd, without considering the order passed under section 92CA(3) of the Income Tax Act for AY 2004-05 wherein entire amount of technical fees has been considered and allowed**.

3. Learned representatives fairly agree that whatever we decide in assessee's appeal for the assessment year 2003-04, which was also heard on the same day, will follow *mutatis mutandis* for this assessment year as well.

4. Vide our order of even date, we have decided this issue in assessee's appeal for the assessment year 2003-04 as follows:

> *8. So far as this grievance of the assesse is concerned, a few material facts and the development leading to this appeal will have to be taken note of. The assessee before us is engaged in the business of manufacturing zippers ad fasteners. During the course of the scrutiny assessment proceedings, the Assessing Officer noted that the assessee has made payments, aggregating to Rs. 92,72,214, to it associated enterprises YKK Holdings Asia Pte Ltd. The Assessing Officer also observed that in in the related debit notes furnished by the assessee "nothing is mentioned about the specific jobs performed by YKK Holding Asia Pte Ltd to whom such huge amount of technical services are paid". The Assessing Officer did not stop at that. He went on to observe that "the most important question is whether the collaboration agreement between the assessee company (licensee) and the licensor YKK Corporation Japan warrants such payment of technical fees or such payment is covered under the royalty agreement". In plain words, the case of the Assessing Officer was that since the assessee had paid royalty to YKK Corporation Japan, there was no need to make separate payments towards fees for technical services. It was also noted that in the relevant previous year itself, the assessee had paid Rs 2,33,30,274 and that "this huge amount of royalty payment made to licensor is only in lieu of certain facilities which are to be provided by the licensor". The Assessing Officer further took note of assessee's submissions to the effect that the YKK Holding Asia Pte Ltd was a support centre for 'production planning and implementation' and that the services received by the assessee were in the nature of assistance in marketing and procurement, support in research and development activities of the assessee, informational technology support services (such as infrastructure support, implementation of WAVE System for production planning and control, implementation of WAVE system, helpdesk and technical support for AS400, NT Server, Lotus notes etc etc) and assistance and support in administrative, secretarial, accounting and finance function. The Assessing Officer was of the view that since the assessee was entitled to receive know how under the royalty agreement, no separate payment for production planning in manufacturing process was warranted. It was also noted that the assessee was also entitled to receive updates about any improvement in the products or manufacture thereof, there was no need to make additional payments for the technical fees. On the basis of, inter alia, this analysis, the Assessing Officer concluded that "the type of services which are claimed by the assessee company as technical fees and for which huge amount of Rs 92,72,214 is being paid to YKK Holding Asia Pte Ltd are very much forming part of the licence agreement", that "it was legal duty of the licensor to provide such services for which he was already paid as royalty charges", and that, "therefore, technical fees at Rs 92,72,214 to its own associate enterprises is nothing but a diversion of income and hence is required to be disallowed". Aggrieved, assessee carried the matter in appeal before the CIT(A). Learned CIT(A) noted that so far as payment of Rs 4,99,135 made by the assessee, the same is for threat and vulnerability assessment of the assessee but since*

expenses for information technology support is also paid under a separate bill, the claim "does not advance the cause of the assesse". As regards the payments of Rs 22,55,270 under the head technical research and development fees, the documents furnished by the assessee relate to training report, training schedule, quality management system and environmental management system, various charts, photographs and factory layouts but "these documents do not support actual rendition of services by YHA". As regards the payment of Rs 14,93,297 for "sales support to the fasteners division", the CIT(A) noted that the TP report categorically states that "YKK India's marketing strategy is essentially driven through relationship marketing whereby company's marketing personnel maintain regular contact and goodwill with its dealers and direct customers" and that "YKK India does not resort to significant advertising on the brand as the YKK is already a strong and recognized brand", it is clear that "the appellant follows a specific marketing strategy and there is no apparent reason for making a separate payment to YHA for sales support". It was also noted that these expenses cannot be said to be genuine expenses. As far as expenses of Rs 13,24,702 on sales support on tapes and plastics, the CIT(A) did acknowledge that the reports under the head internal quality audit and management review, various charts on different aspects were placed by the assessee but he was of the view that these things donot evidence rendition of services, and that in any event, as the TP study states "YKK India's marketing strategy is essentially driven through relationship marketing whereby company's marketing personnel maintain regular contact and goodwill with its dealers and direct customers" and that "YKK India does not resort to significant advertising on the brand as the YKK is already a strong and recognized brand", it is clear that "the appellant follows a specific marketing strategy and there is no apparent reason for making a separate payment to YHA for sales support". Similarly, the payment of Rs 5,17,195 for administration/ HR cost, was also held to be without basis as no services were established to have been rendered. Accordingly, the CIT(A) confirmed the disallowance to the extent of Rs 60,89,599. The assessee is aggrieved and is in appeal before us.

9. Having heard the rival contentions and having perused the material on record, we see merits in the grievance of the assessee. The payments made by the assessee to its AE were covered by the international transactions reported by the assesse and the TPO have accepted the same to be arm's length payments. Under these circumstances, it cannot be open to the Assessing Officer to usurp the powers of the Transfer Pricing Officer and hold that these are not arm's length payments. Such a parallel analysis of transactions by the AO and the TPO is not at all contemplated under the Act. Under the garb of making disallowance under section 37(1) what the Assessing Officer is really doing is that he is holding the payments made to the AEs as payments not at an arm's length- something which the Assessing Officer is not entitled to deal with once he has referred the matter, regarding determination of arm's length price, to the TPO. It is also elementary that what the Assessing Officer cannot do directly, he cannot do indirectly either. What has been termed as a disallowance under section 37(1), given the facts of the case in which a reference was made to the TPO which has held that the

> *payments to AE for technical services fees are at arm's length price, are de facto ALP adjustments mace directly by the Assessing Officer. However, once a reference is made by the Assessing Officer under section 92CA(3), the Assessing Officer is bound to accept the same. Section 92CA(4), as it stood at the material point of time, provides that "On receipt of the order under sub-section (3), the Assessing Officer shall proceed to compute the total income of the assessee under sub-section (4) of section 92C having regard to the arm's length price determined under sub-section (3) by the Transfer Pricing Officer." It cannot thus be open to the Assessing Officer to disregard the arm's length price determined by the TPO. When an Assessing Officer holds that no services are rendered by the AE, essentially he holds that the payments made in the international transaction in question are not arm's length payments. The ascertainment of ALP by the TPO is not a theoretical exercise inasmuch as the ALP determination is for the actual transaction and not a hypothetical transaction envisaged by the contractual arrangement. It cannot, therefore, be open for the Assessing Officer to say that even though transaction value is held to be an at ALP by the TPO, the ALP can be reduced on account of actual rendition, or non-rendition, of services. Once an international transaction is reported by the assessee, and held to be an ALP by the TPO, it cannot be open to the Assessing Officer to make the ALP adjustment, in the garb of disallowance under section 37(1), on the basis of assumption that the services are not rendered. That is clearly contrary to the scheme of the Act and would result in overlapping jurisdictions. As our day to day experience shows, the TPOs not only examine what is stated in the contract but also what has happened on the ground. In view of these discussions, and for the short reason that the payments for international transactions in question, i.e. payment of technical services fee to the AEs, have been held to be at ALP by the Transfer Pricing Officer, the impugned disallowances were wholly unsustainable in law. In any case, we have perused the nature of evidences for the rendition of services and we are satisfied that it is not a case in which services are not rendered by the AE.*

5. We see no reasons to take any other view of the matter than the view so taken by us in assessee's own case. However, we have decided the issue only on jurisdiction and have, therefore, refrained from deciding on merits.

6. Respectfully following these views in assessee's own case, we uphold the grievance of the assessee in the terms, and to the extent, indicated above, and direct the Assessing Officer to delete the impugned disallowances of Rs 1,42,72,406. The assessee gets the relief accordingly.

7. The appeal of the assessee is, therefore, allowed.

8. In the appeal filed by the Assessing Officer, following grievance is raised:

> **Learned CIT(A) erred in law and on the facts of the case in deleting the addition of Rs 2,14,71,287 made by the AO by treating the royalty paid to YKK Corporation as capital expenditure.**

9. The short reason for which the Assessing Officer made a disallowance to the extent of 75% of the payment for royalty was treating the same as capital expenditure and restricting the deduction to depreciation @ 25% in respect thereof. In a very brief, rather cryptic order passed by the Assessing Officer, it was observed by the Assessing Officer that ñ**in consideration of the royalty paid, the assessee has been granted non-exclusive and non-assignable licence to utilize the trademark the patents and knowhow from M/s YKK Corporation Japan**ö and that ñ**it is clearly seen ………that the payment of royalty result in long term benefit of enduring nature to the assessee**ö. The Assessing Officer thus concluded that ñ**the expenditure on royalty payment is thus clearly an expenditure of capital in the nature**ö. Out of the payment of Rs 2,86,28,382 on account of royalty, the deduction was restricted to 25% being deprecation thereon. Aggrieved, assessee carried the matter in appeal before the CIT(A). It was, *inter alia*, submitted by the assessee that the royalty was computed @ 4% of the net sales amount on slide fasteners and even this computation clearly showed that the nature of rights granted by the licensee is sell products by use of YKK trademarks which is duly approved by the Reserve Bank of India. Learned CIT(A) was of the view that the payment of royalty to the AE is an international transaction reported to the TPO and once such a transaction is found to be at an armøs length, no disallowance can be made from the same. Reliance was also placed on Honøble jurisdictional High Courtøs judgment in the case of CIT Vs Oracle India Pvt Ltd [reported as: (2011) 59 DTR 222 (Del)]. Accepting these arguments, learned CIT(A) deleted the impugned disallowance and held the entire royalty payment to be revenue in nature. The Assessing Officer is aggrieved and is in appeal before us.

10. Having heard the rival submission and having perused the material on record, we are not inclined to uphold the grievance of the Assessing Officer. Under the royalty agreement, undoubtedly the assessee gets the valuable knowledge and

know how but the royalty is computed with reference to the net sale proceeds which clearly shows that the linkage is with revenue generated by the assessee. As noted by Honõble jurisdictional High Court, in the case of **CIT Vs Modi Revlon Ltd. [(2012) 78 DTR 342 (Del)]**, ñ**there is nothing in the agreement suggestive of any vesting of the know-how, or part of it, or the goodwill in the brand, in the licensee/ assessee. In these circumstances, this Court is of the opinion that the revenue's arguments about the royalty amount being really in the nature of capital expenditure, is meritless**ö. What is material is that the royalty is linked to the revenue, that the benefit from the royalty arrangement, even though on continuous basis, are not of enduring advantage, that the ownership of brand (i.e YKK, in this case) continues to be of licensor and the payment for royalty is only in respect of the goods actually sold. Under these circumstances, the royalty payment cannot be said to be in the capital field. We have also noted that the payment for royalty has been accepted to be an armõs length payment and there is no dispute on that aspect. There is also no dispute that the royalty payment is in respect of the net sales revenues of the current year. In view of these discussions, as also bearing in mind entirety of the case, we approve the conclusions arrived at by the CIT(A) and decline to interfere in the matter. The appeal of the revenue, therefore, fails.

11. In the result, while the appeal of the assessee is allowed, the cross-objection filed by the assessee as also the appeal filed by the revenue is dismissed. Pronounced in the open court today on 25th day of July 2016.

Sd/-	Sd/-
Beena A Pillai	**Pramod Kumar**
(Judicial Member)	(Accountant Member)

Dated: 25th day of July, 2016.

Copies to: (1) The appellant (2) The respondent
(3) Commissioner (4) CIT(A)
(5) Departmental Representative (6) Guard File

By order

Assistant Registrar
Income Tax Appellate Tribunal
Delhi benches, New Delhi