IN THE INCOME TAX APPELLATE TRIBUNAL
'A' BENCH : BANGALORE

BEFORE SMT. BEENA PILLAI, JUDICIAL MEMBER
AND
MS. PADMAVATHY S, ACCOUNTANT MEMBER

IT(TP)A No. 440/Bang/2022
Assessment Year : 2017-18

M/s. Herbalife International India Pvt. Ltd., RMZ Pinnacle, No. 15, Commissariat Road, Bengaluru – 560 025. **PAN: AAACH8025R**	**Vs.**	The Deputy Commissioner of Income Tax, Circle – 3(1)(1), Bangalore.
APPELLANT		**RESPONDENT**

Assessee by	:	Shri Percy Pardiwala, Sr. Counsel
Revenue by	:	Shri D.K. Mishra, CIT (DR)

Date of Hearing	:	28-03-2023
Date of Pronouncement	:	17-05-2023

ORDER

PER BEENA PILLAI, JUDICIAL MEMBER

Present appeal is filed by assessee against the final assessment order dated 26.03.2022 passed by the National Faceless Assessment Centre, Delhi on following grounds of appeal:

The grounds mentioned herein by the Appellant are without prejudice to one another.

1. On the facts and in circumstances of the case and in law, the assessment order framed under section 143(3) read with section 144C(13) and section 144B of the Income-tax Act, 1961 ('the Act') passed by Additional / Joint / Deputy / Assistant Commissioner of Income-tax / Income-tax Officer, National e-Assessment Centre, Delhi ('learned Assessing Officer' or 'learned AO') dated March 26, 2022, to the extent prejudicial to the Appellant, is bad in law, contrary to the facts and circumstances of the case and is liable to be quashed.

Grounds relating to transfer pricing ('TP') matters

2. On the facts and in the circumstances of the case and in law, the Hon'ble Dispute Resolution Panel ('Hon'ble DRP') erred in not appreciating that the order of the learned Deputy Commissioner of Income-tax (Transfer Pricing) – 1(3)(1), Bangalore ('learned Transfer Pricing Officer' or 'learned TPO') passed under section 92CA of the Act is contrary to law and, thus, liable to be quashed.

3. On the facts and in the circumstances of the case and in law, the Hon'ble DRP/ learned AO/ learned TPO, erred in determining the arm's length price of an alleged international transaction of an alleged advertising, marketing and sales promotion ('AMP') expenses of INR 2,570,893,895. -

4. **Adjustment with respect to alleged advertising, marketing and promotion expenses**

On the facts and in the circumstances of the case and in law, the Hon'ble DRP / learned AO erred in upholding the learned TPO's approach of:

4.1. assuming that there is an arrangement and understanding between the Appellant and its Associated Enterprise ('AE') to promote the brand or trade name owned by the AE which constitutes an international transaction merely on the basis of an alleged excess spend, unilaterally incurred by the Appellant for the sale of its products to third parties, on what is alleged as expenditure on advertisement, marketing and sales promotion;

4.2. not appreciating that incurring of AMP expenditure by the Appellant does not constitute an 'International Transaction' in terms of Section 92B of the Act thereby, not applying the principles laid down in the judgement of the Delhi High Court in the case of Maruti Suzuki India Limited (ITA 110/ 2014) with respect to incurring of AMP not being an international transaction;

4.3. not considering that the advertisement and sales promotion expenses incurred by the Appellant are in the nature of selling expenses incurred for the sale of its own products to third parties;

4.4. disregarding the concept of economic ownership and construing the alleged AMP expense to be a service consequent to development, enhancement, management, protection and exploitation ('DEMPE') functions performed by the Appellant, resulting in brand building for the AE and not appreciating that the alleged AMP expenses were incurred for the purpose of business of the

Appellant in India and no benefit was intended to be passed on to the AE;

4.5. alleging the various non-marketing and advertising expenses such as selling expenses incurred by the Appellant to be AMP expenses;

4.6. making an adjustment using '*Other Method*' as the most appropriate method ('MAM') and adopting an approach similar to the Bright Line Test ('BLT') without appreciating that no such method is prescribed under the Act or the Rules;

4.7. interpreting the functional, assets and risks ('FAR') profile as furnished in the TP documentation and misquoting the facts leading to erroneous conclusions for the risks assumed by Appellant and its AEs;

4.8. disregarding the economic characterization of the Appellant as a licensed manufacturer achieving arm's length operating margins under transactional net margin method ('TNMM') higher than the comparables by 5.72% for the subject year, concluding that the Appellant is a contract manufacturer and has asserted that separate compensation is required for the alleged excess AMP expenses;

4.9. disregarding the multiple submissions furnished by the Appellant to provide a detailed representation of facts in relation to the FAR profile of the Appellant and its AEs;

4.10. determining the ALP separately for the alleged excess AMP expenses and disregarded that marketing function forms an intrinsic part of the manufacturing along with sales process of the Appellant;

4.11. concluding that the alleged excessive AMP expenditure amounted to a 'service' being rendered by the Appellant to its AE and that a mark-up was required to be charged in respect of such services;

4.12. rejecting the comparability analysis carried out by the Appellant in the TP documentation and in conducting a fresh comparability analysis for the licensed manufacturing segment.

4.13. without prejudice to the above, the learned TPO has erred in performing a fresh comparability analysis to determine the alleged excess AMP expense. In addition, the Hon'ble DRP / learned AO / learned TPO erred in:

a. rejecting filters applied by the Appellants in its TP documentation;

b. applying modified or additional filters;

c. excluding companies, which are functionally comparable to the Appellant (including the additional comparable companies suggested by the Appellant from the search process adopted by the learned TPO);

d. including additional purported companies in the comparability analysis, which do not satisfy the test of comparability in relation to the licensed manufacturing activities performed by the Appellant;

4.14. computing the AMP / Sales ratio of the comparable companies by inconsistently considering certain line items while arriving at sale and total AMP expenditure amount and disregarding the submissions filed with correct computation of the AMP/Sales ratio along with supporting documents;

4.15. performing a comparability analysis to determine the mark-up to be applied on the alleged AMP expenses, whereunder the Hon'ble DRP / learned AO / learned TPO erred in:

a. including companies that are not akin to a marketing service provider;

b. excluding companies, which are akin to a marketing service provider thereby adopting a cherry-picking approach

4.16. not considering the submissions of the Appellant against the functional comparability of the companies selected by the learned TPO and the arguments supporting the comparable companies selected in the TP documentation rejected by the learned TPO

(Tax Effect: INR 889,734,959)

Grounds relating to other than TP matters

5. **Erroneous computation of total income**

5.1. On the facts and in the circumstances of the case and in law, the learned AO erred in computing the total assessed income at INR 4,424,224,530 as against INR 4,419,548,410 resulting in excess assessed income of INR 4,676,120.

(Tax Effect: INR 1,618,312)

6. **Incorrect levy of interest**

6.1. On the facts and in the circumstances the learned AO erred in levying interest under section 234A of INR 9,199,988.

6.2. On the facts and in the circumstances the learned AO erred in computing the interest under section 234B of the Act at INR 551,999,280 as against INR 456,947,567 resulting in excess levy of INR 95,051,713.

(Tax Effect: INR 36,079,429)

7. **Penalty Proceedings**

7.1. On the facts and in the circumstances the Learned AO erred in initiating penalty proceedings under section 274 read with section 270A of the Act.

That the Appellant craves leave to add to and/or to alter, amend, rescind, modify the grounds herein below or produce further documents before or at the time of hearing of this Appeal.

2. Brief facts of the case are as under:

2.1 Herbalife India was incorporated in 1998. It filed its return of income for year under consideration declaring Rs.1,84,86,54,510/-. The case was selected for scrutiny and statutory notices were issued to the assessee. In response to the statutory notices, the assessee filed various details. Before the Ld.AO, the assessee submitted that, it manufactures (through contract manufacturers) and sells wide range of advanced weight management and nutritional products. Herebalife India's products include performance protein powder, Formula 1 nutritional shake mix, multivitamin mineral and herbal tablets,

calcium tablets, cell activator tablets, active fibre control and flavourless vegetarian protein powder.

2.2 It is submitted that, Herbalife India obtains its technical information with regard to manufacture, use and sale of Herbalife Group's products from its AEs. Herbalife India is responsible for managing the procurement of raw and packing materials, standardizing the manufacturing process and quality control. It is submitted that, Herbalife India operates as an entrepreneur in India, under licensed manufacturing model, taking all key decisions and performing all significant functions with respect to its business and thus bears the entrepreneurial risk in India. All expenses including revenues earned by Herbalife India, are entirely on its own account and not on behalf of any of its AE(s).

2.3 It is submitted that, Herbalife India's business model is a direct selling model, where Herbalife India is a direct selling entity. Herbalife India distributes and sells its products through a network of independent members through the direct selling channel (chain of people referred to as associates / supervisors / members / distributors), which is vastly different from a normal retail sale model. It was submitted by the assessee that 'Direct Selling' means, marketing, distribution and sale of goods or providing of services as a part of network of direct selling to the consumers. The assessee submits that, this generally occurs in the consumers' houses, at their workplace or through demonstration of such goods and services at a mutually convenient venue. It is submitted that under this model, the associates / supervisors / distributors are paid incentives / commissions to remunerate them for bringing in new customers.

The independent sales personnel sell products directly to end customers without the involvement of any retail chains.

2.4 During the year under consideration, following international transactions were undertaken by the assessee.

Sl. No.	Nature of international transaction	Amount (INR)
1	Provision of contract IT support services	1,596,061,774
2	Purchase of goods	26,013,067
3	Reimbursement of expenses paid	28,406,607
4	Reimbursement of expenses received	1,918,702
5	Payment of administration fees	675,144,109
6	Payment of IT and other technical services (gross of TDS)	264,760,742
7	Payment of royalty (gross of TDS)	858,044,935
8	Amount written back	1,314,349
9	Amount written off	259,108

2.5 The Ld.AO noted that as the transaction exceeded Rs. 15 crores, a reference was made to the Ld.TPO under 92CA of the act. On receipt of the reference, the Ld.TPO called for economic analysis of the international transactions in form 3CEB. From the details filed, the Ld.TPO noted that the assessee adopted TNMM as the most appropriate method and applied OP/sales as the PLI to determine its margin at 12.76%. The assessee considered all transaction with its AE to be closely linked to the primary transaction of manufacturing of goods (licensed manufacturer).

2.6 The Ld.TPO rejected the consolidated approach by the assessee in the TP study. The Ld.TPO segregated software development service as a separate segment and the remaining segments were treated to be under manufacturing segment.

2.7 Though the Ld.TPO under manufacturing segment adopted some different filters and conducted fresh search, the margin of the new comparables as per the Ld.TPO search was at 14.26% and the margin of assessee computed by the Ld.TPO under

manufacturing segment was 15.55%. Hence no adverse inference was drawn with respect to the ALP of the international transaction of the manufacturing segment and no adjustment was proposed by the Ld.TPO under the manufacturing segment.

2.8 However, the Ld.TPO under SWD segment carried out fresh search of comparables based on certain filters, wherein, the median of 20 comparables was computed at 26.18% and the assessee's margin was computed at 15.63% thereby proposing an adjustment being the shortfall at Rs.14,56,14,319/-.

2.9 The Ld.TPO further observed that assessee carried out certain advertising, marketing functions which could benefit the AE who is a legal owner of the intangibles. The Ld.TPO noted that assessee had not benchmarked the AMP functions separately. He thus proposed to consider following expenditure as international transaction by concluding them to be AMP expenses incurred by the assessee, that resulted in benefit to the AEs.

Sr.No.	Particulars	Amount in Crores
1	Distributor allowances	448.85
2	Business promotion expenses	52.31
	Total expenses	501.16

2.10 The Ld.TPO while proposing the AMP adjustment estimated the adjustment based on the sale of goods by the assessee thus computing it by applying bright line test.

2.11 Thus the total adjustment proposed by the Ld.TPO are as under:

Particulars	Amount of adjustment (INR)
SWD	14,56,14,319
AMP expenses	271,76,64,583

Total adjustment u/s. 92CA	286,32,78,902

2.12 On receipt of the order u/s. 92CA, the Ld.AO passed the draft assessment order by proposing an addition in the hands of the assessee at Rs.471,19,33,412/- by order dated 25.05.2021.

2.13 On receipt of the draft assessment order, the assessee filed objections before the DRP.

The DRP while considering the objections passed certain directions, wherein the adjustment proposed under the software development segment stood deleted. As per the order giving effect passed on 18.03.2022, the only addition that remained was in respect of the AMP adjustment made in the hands of assessee amounting to Rs.257,08,93,895/-.

2.14 Against the impugned final assessment order, the assessee is in appeal before this *Tribunal.*

3. **Ground nos. 2 – 4 –** The only issue that is raised by the assessee is in respect of the adjustment allegedly made towards the AMP expenses by adopting an approach similar to bright line test.

3.1 The Ld.AR submitted that, the assessee operates as an entrepreneur in India under licensed manufacturing model that takes all key decisions and perform all significant functions with respect to its business and these bears the entrepreneurial risk in India. It is submitted that all expenses incurred and revenues earned by the assessee in India are entirely on its own account and not on behalf of any of its foreign group companies. The Ld.Counsel submitted that, the business model followed by the assessee is “direct selling” model, where the assessee is a direct selling entity. He also submitted that, being a direct selling

entity, the assessee do not rely on marketing or advertising but carry out the same through contracting with potential customers, pressing and demonstrating products, taking of orders, delivery of goods and collection of payments.

3.2 The Ld.Counsel submitted that, this model of sales undertaken by the assessee is an example of multi level marketing system. He submitted that, under this model, the agents / consultants are paid incentives/commissions to remunerate them for bringing in new customers. He submitted that, the independent sales personnel sells products directly to the end customers without involvement of any retail chains. The Ld.Counsel thus submitted that, the distributor allowance amounting to Rs.448.85 crores are the allowance paid by the assessee to the distributors, associates, members, supervisors, who operate on the ground for selling assessee's products. He submitted that these are purely in the nature of sales incentives having direct correlation to the sales made by the direct sellers.

3.3 The Ld.Counsel submitted that, the distributor allowances can be categorised in the following nature.

- *"**Commission:** Associates earns up to 25% as commission on the sales made by their downlines*
- ***Royalty earnings:** All products carry a volume point and 1 volume point = 1 USD. This has been done to maintain a uniform currency throughout the Herbalife Group companies. Volume Points are used for qualification and bonuses and volume rebate earnings are ranging from 1% - 5% made to Fully Qualified Supervisors on the monthly volume/ total transaction done by his downline associates*
- ***Production bonus:** Production bonus is paid to those Associates who are a part of the Top Achievers Business Team (TAB') and can earn bonus ranging from 2%- 7% depending upon*
- *the sales made by them and their member associates who are registered under him*
- ***Mark Hughes Bonus:** The President team members of the Assessee are been provided with additional 1% bonus of*

the value of the total world wide sales based on certain qualifications."

3.4 The Ld.Counsel submitted that, the payouts that form part of distributor allowances have direct nexus to the sales and they are nothing but sales incentives/commissions paid to its members for the sales undertaken by them. He also emphasised that these payments are made only when the sales to the ultimate customers are concluded by the associates / members and if no sales are made, there are no payouts that are done. He also submitted that on the payments made and classified under the distributors allowances TDS has been deducted u/s. 194H of the act and therefore these expenses are purely in the nature of selling expenses and cannot be categorised as AMP as alleged by the revenue authorities.

3.5 The Ld.Counsel submitted that, the Ld.TPO considered 50% of the distributor allowances without appreciating that TDS has already been deducted on these payments and without appreciating that the fact that the marketing activities under the manufacturing segment has been treated to be at arms length by the Ld.TPO himself wherein these payments have already been treated to be operating in nature.

3.6 The Ld.Counsel submitted that, the Ld.TPO treated these expenses to be AMP spending by the assessee accounted them under the head business promotion expenses in the financial statement under note 2.22 of the audited financial report. The Ld.Counsel submitted that, amount of Rs.52.31 crores being total of the business promotion expenses comprises of selling expenses being Rs.47.75 crores and Rs. 3.56 crores are in respect of marketing / business promotion expenses. The details of which has been provided as under:

Break up of business promotions expense

Sr. No	Particulars	Brief Description of Nature of expenses and characterisation into marketing/selling expense	Amount (Rs. Crore)	Nature (Selling vs Marketing)
1	Advertising	The expenses are towards advertisement in print medias, events, conferences etc.	1.16	Marketing
2	Awards & Recognition	The expense includes purchase of Herbalife Pins to be awarded to the associates who qualify to next level and printing of certificates for their achievements. This is been done to boost the morale of the associates and in no means can be construed as a marketing expense.	1.32	Selling
3	Samples and Giveaways	As a part of the selling process, certain samples have been shared with the associates. The cost of this is in relation to the selling activity and should be excluded from the AMP computation	1.3	Selling
4	Event Management team expenses-Travelling, meals and living	These expenses include cost towards spectacular and extravaganza events conducted for the associates as a part of periodic get together. This also includes expenses towards training/ monthly meeting conducted for the associates. This is been done to boost the morale of the associates, keep them updated of the Herbalife products and strategy. Considering the direct selling model,	42.98	Selling

Sr. No	Particulars	Brief Description of Nature of expenses and characterisation into marketing/selling expense	Amount (Rs. Crore)	Nature (Selling vs Marketing)
		Herbalife India operates in, this expense is required to keep the associates/supervisors engaged with the Company and accordingly should not be considered as marketing/business promotion expense.		
5	Printing & Publication	The charges paid towards printing of FAQ booklets which is needed for addressing the queries of the customers by the Associates/supervisors. These are directly linked to the selling activity and hence in the nature of selling expense.	1.48	Selling
6	Sponsorships	The charges paid towards our brand ambassadors and amount paid towards associations and memberships	2.4	Marketing
7	Other selling and distribution expenses	These expenses include charges like purchase of flower bunches, headphones, bike hire etc.	1.67	Selling
	Total		**52.31**	

3.7 It is the submissions of the Ld.Counsel that the above expenses can in no circumstances be treated towards Advertising & Marketing that could lead any benefit to the AE directly.

3.8 The next argument advanced by the Ld.Counsel that, there is no agreement between the assessee and the associated enterprises in relation to any AMP expenditure to be incurred by assessee and that the revenue authorities as adopted a cherry picking approach without providing any cogent reason for determining the AMP spent on behalf of the assessee. He thus submitted that the elements considered for computing AMP expenses in the hands of the assessee are related to transaction and does not form part of intra group services. The Ld.Counsel presented before us the computation of alleged AMP expenses computed by the Ld.TPO as under:

Particulars	Amount (INR crore)
Commission	20.61
Royalty earnings	317.16
Production bonus	79.62
Mark Hughes bonus	4.14
Tax deducted at source	27.32
Distributor allowance	**448.85**
50% of distributor allowance (A)	**224.425**
Business promotion expenses	52.31
Income from sale of tickets	(20.17)
Net business promotion expenses (B)	**32.14**
Alleged AMP expense (A+B)	**256.565**

3.9 He submitted that the Ld.TPO used bright line test to bench mark the alleged AMP expenditure under CUP. The Ld.Counsel emphasised that, bright line test is not applicable, as it does not fit into any of the 5 methods prescribed under the transfer pricing regulations. He placed reliance on the decision of *Hon'ble Delhi High Court* in case of *Sony Ericsson Mobile Communication India (P) Ltd.* reported in *(2015) 374 ITR 118* wherein the *Hon'ble High Court* held that the direct marketing / sales related expenses or discounts/concessions would not form part of the AMP expenditure. He emphasised on the following observations of the *Hon'ble High Court* in case of *Sony Ericsson Mobile Communication India (P) Ltd. (supra).*

> *"176. The aforesaid argument, when AMP expenses are segregated from the composite transaction including distribution and marketing function, is flawed and has to be rejected. The respondent-assessees are engaged in distribution and marketing of consumer goods. Distribution and marketing exercise in case of tangibles requires transfer/sale of goods to third parties, be it sub-distributors or retailers. The said transaction is in the nature of sale of goods for consideration. The marketing or selling expenses like trade discounts, volume discounts, etc. offered to sub-distributors or retailers are not in the nature and character of —brand promotion||. They are not directly or immediately related to —brand building|| exercise, but have a live link and direct connect with*

marketing and increased volume of sales or turnover. The brand building connect is too remote and faint. To include and treat the direct marketing expenses like trade or volume discount or incentive as ―brand building‖ exercise would be contrary to common sense and would be highly exaggerated. These reduce the net profit margin. It would lead to abnormal financial results defying accountancy practices and commercial and business sense. The expenses being in the nature of selling expenses have an immediate connect with price/consideration payable for the goods sold. They are not incurred for publicity or advertisement. Direct marketing and sale related expenses or discounts/concessions would not form part of the AMP expenses."

(Emphasis Supplied)

3.10 He also relied on the decision of *Hon'ble Delhi High Court* in case of *Maruti Suzuki India Ltd. vs. CIT* reported in *(2015) 64 taxmann.com 150* and *Sony Ericsson Mobile Communication India (P) Ltd. (supra)* in respect of the existence of the international transaction of AMP expenses. He referred to the following observations of the *Hon'ble High Court* in case of *Maruti Suzuki India Ltd. vs. CIT (supra)*

"43. …. In any event, none of them appeared to have questioned the existence of an international transaction involving the concerned foreign AE. It was also not disputed that the said international transaction of incurring of AMP expenses could be made subject matter of transfer pricing adjustment in terms of Section 92 of the Act.

44. However, in the present appeals, the very existence of an international transaction is in issue. The specific case of MSIL is that the Revenue has failed to show the existence of any agreement, understanding or arrangement between MSIL and SMC regarding the AMP spend of MSIL. It is pointed out that the BLT has been applied to the AMP spend by MSIL to (a) deduce the existence of an international transaction involving SMC and (b) to make a quantitative 'adjustment' to the ALP to the extent that the expenditure exceeds the expenditure by comparable entities. It is submitted that with the decision in Sony Ericsson having disapproved of BLT as a legitimate means of determining the ALP of an international transaction involving AMP expenses, the very basis of the Revenue's case is negated.

45. Since none of the above issues that arise in the present appeals were contested by the Appellant who appeals were decided in the Sony Ericsson case, it cannot be said that the

decision in Sony Ericsson, to the extent it affirms the existence of an international transaction on account of the incurring of *the AMP expenses, decided that issue in the appeals of MSIL as well.*

51. The result of the above discussion is that in the considered view of the Court the Revenue has failed to demonstrate the existence of an international transaction only on account of the quantum of AMP expenditure by MSIL Secondly, the Court is of the view that the decision in Sony Ericsson holding that there is an international transaction as a result of the AMP expenses cannot be held to have answered the issue as far as the present Appellant MSIL is concerned since finding in Sony Ericsson to the above effect is in the context of those Appellant whose cases have been disposed of by that judgment and who did not dispute the existence of an international transaction regarding AMP expenses. (Emphasis Supplied)"

3.11 In respect of application of bright line test for ALP determination, the Ld.Counsel relied on the following observations of *Hon'ble Delhi High Court* in case of *Sony Ericsson Mobile Communication India (P) Ltd. (supra).*

"121. On the other hand, as recorded by us above, applying 'bright line test' on the basis of parameters prescribed in paragraphs 17.4 and 17.6 would be adding and writing words in the statute and the Rules and introducing a new concept which has not been recognised and accepted in any of the international commentaries or as per the general principles of international taxation accepted and applied universally. There is nothing in the Act or the Rules to hold that it is obligatory that the AMP expenses must and necessarily should be subjected to 'bright line test' and the non-routine AMP expenses as a separate transaction to be computed in the manner as stipulated.

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(vii) When the Assessing Officer/Learned TPO rejects the method adopted by the assessed, he is entitled to select the most appropriate method, and undertake comparability analysis. Selection of the method and comparables should be as per the command and directive of the Act and Rules and justified by giving reasons.

(x) Parameters specified in paragraph 17.4 of the order dated 23rd January 2013 in the case of L.G. Electronics India Pvt Ltd (supra) are not binding on the assessed or the Revenue. The `bright line test' has no statutory

mandate and a broad-brush approach is not mandated or prescribed. We disagree with the Revenue and do not accept the overbearing and orotund submission that the exercise to separate 'routine' and 'non-routine' AMP or brand building exercise by applying 'bright line test' of non-comparables should be sanctioned and in all cases, costs or compensation paid for AMP expenses would be 'NIL', or at best would mean the amount or compensation expressly paid for AMP expenses. It would be conspicuously wrong and incorrect to treat the segregated transactional value as 'NIL' when in fact the two AEs had treated the international transactions as a package or a single one and contribution is attributed to the aggregate package. Unhesitatingly, we add that in a specific case this criteria and even zero attribution could be possible, but facts should so reveal and require. To this extent, we would disagree with the majority decision in L.G. Electronics India Pvt. Ltd. (supra). This would be necessary when the arm's length price of the controlled transaction cannot be adequately or reliably determined without segmentation of AMP expenses."

3.12 The Ld.AR relied on the following observations in case of *Sony Ericsson Mobile Communication India (P) Ltd. (supra).*

"The High Court asserted that applying BLT would be introducing a new concept which has not been recognised and accepted in any of the international commentaries or as per the general principles of international taxation accepted and applied universally.

"111. Accepting the parameters of the 'bright line test' and if the said parameters and tests are applied to Indian companies with reputed brands and substantial AMP expenses, would lead to ***difficulty and unforeseen tax implications and complications.*** *Tata, Hero, Mahindra, TVS, Baja], Godrej, Videocon group and several others are both manufacturers and owners of intangible property in the form of brand names.* ***They incur substantial AMP expenditure. If we apply the 'bright line test' with reference to indicators mentioned in paragraph 17.4 as well as the ratio expounded by the majority judgment in L.G. Electronics India Pvt Ltd case (supra) in paragraph 17.6 to bifurcate and segregate AMP expenses towards brand building and creation, the results would be startling and unacceptable. The same is the situation in case we apply the parameters and the =bright line test' in terms of paragraph 17.4 or as per the contention of***

the Revenue, i.e. AMP expenses incurred by a distributor who does not have any right in the intangible brand value and the product being marketed by him. This would be unrealistic and impracticable, if not delusive and misleading. *(Aforesaid reputed Indian companies, it is patent, are not to be treated as comparables with the assessed, i.e. the tested parties in these appeals, for the latter are not legal owners of the brand name/ trademark.)*

……..We have elaborately discussed the concept of term — brand and brand building and observe that it would be incorrect to treat advertisement as equivalent or synonymous with —brand building for the latter in commercial sense refers to several facets and components

120. Notwithstanding the above position, the argument of the Revenue goes beyond adequate and fair compensation and the ratio of the majority decision mandates that in each case where an Indian subsidiary of a foreign AE incurs AMP expenditure should be subjected to the 'bright line test' on the basis of comparables mentioned in paragraph 17.4. Any excess expenditure beyond the bright line should be regarded as a separate international transaction of brand building. ***Such a broad-brush universal approach is unwarranted and would amount to judicial legislation.***

…….There should be adequate and proper compensation for the functions performed including AMP expenses. ***Thus, we disagree with the Revenue and do not accept the overbearing and orotund submission that the exercise to separate =routine' and =non-routine' AMP or brand building exercise by applying 'bright line test'*** *of non-comparables and in all case, costs or compensation paid for AMP expenses would be 'NIL', or at best would mean the amount or compensation expressly paid for AMP expenses.*

Further, the Hon'ble Delhi NC in the case of ***Maruti Suzuki*** *stated that Sony Ericsson has expressly negated the use of BLT for both forming the base as well as determining if there is an international transaction or for the purpose of determining Arm's Length Price. An extract of the ruling has been provided below for your good self s ready reference:*

(vi) The TPO/AO could overrule the method adopted by the Assessee for determining the ALP and select the most appropriate method. The reasons for selecting or adopting a particular method would depend upon

functional analysis comparison, which required availability of data of comparables performing of similar or suitable functional tasks in a comparable business. When suitable comparables relating to a particular method were not available and functional analysis or adjustment was not possible, it would be advisable to adopt and apply another method.

(viii) The Bright Line Test was judicial legislation. By validating the Bright Line Test the Special Bench in LG Electronics Case went beyond Chapter X of the Act.

…….It is submitted that with the decision in Sony Ericsson having disapproved of BLT as a legitimate means of determining the ALP of an international transaction involving AMP expenses, the very basis of the Revenue's case is negated.

47. As regards the submission regarding the BLT having been rejected in the decision in Sony Ericsson is concerned. the Court notes that the decision in Sony Ericsson expressly negatived the use of the BLT both as forming the base and determining if there is an international transaction and secondly for the purpose of determining the ALP. ***Once BLT is negatived, there is no basis on which it can be said in the present case that there is an international transaction as a result of the AMP expenses incurred by MSIL.***

65. As already noticed. the decision in Sony Ericsson has done away with the BLT as means for determining the ALP of an international transaction involving AMP expenses.

The ruling in the case of Sony Ericsson, has also been further echoed in the case of India Medtronics Pvt. Ltd. vs. DCIT (ITA No. 2168/M/2014), wherein reliance has been placed on the Sony Ericsson ruling and concluded that 'bright line' is not a method mandated by the statute. The relevant extract of the ruling is as follows:
"It is a legally decided issue now by virtue of the judgment of the Hon'ble Delhi High Court in the case of Sony Ericsson (supra), the Special Bench decision in the case of L.G. Electronics (supra) stands reversed on many issues such as adopting the bright line method" in matters of benchmarking the AMP transactions"

Further, reliance is placed on the ruling in the case of MSD Pharmaceuticals Private Limited, wherein ITAT held that BLT has clearly been disregarded in binding judicial precedents and it cannot be ignored merely because these have been challenged by the revenue authorities in higher courts. The extract to support the same is represented below:

'binding nature of a judicial precedent, as long as it holds the filed i.e. not overturned, remains unaffected.'.

In light of above, it is submitted that the Bright Line Test applied by your good self in the notice lacks statutory mandate and is ought to be struck down. Therefore, the entire adjustment proposed by your good self by applying BLT ought to be deleted since the application of BLT has been rendered ultra-vires by the Hon'ble HC."

3.13 The Ld.Counsel relied on the following decisions to support the submissions that unless and until the Ld.TPO brought on record any evidence to prove that assessee had rendered any services to its AE by making such AMP expenses which has led to any benefit to the AE, it cannot be treated as a separate international transaction. He emphasised that without there being an agreement between the assessee and its AE, such expenditure cannot be treated as independent international transaction.

a) *Nestle India Ltd. 111 TTJ 498*
b) *CIT vs. Adidas India Marketing (P) Ltd. reported in (2010) 195 Taxman 256 (Delhi)*
c) *Wiltshire Brewery Ltd. vs. Bruce reported in 6 TC 399 (HL)*
d) *Campa Beverages (P) Ltd. vs. IAC reported in 34 ITD 241 (ITAT Delhi)*
e) *Star India (P) Ltd. vs. Addl. CIT reported in (2006) 103 ITD 73, 104 TTJ1 (ITAT Mumbai)*
f) *CIT vs. Chandulal Keshavlal reported in 38 ITR 601 (SC)*
g) *Maruti Country Auto Financial Services Pvt. Ltd. in ITA Nos. 2181 to 2183/Del/2010*
h) *Honda Siel Power Products Ltd. reported in TS-631-SC-2016-TP*

i) Mattel Toys (India) Pvt. Ltd. reported in TS-466-ITAT-2016 (Mum)-TP in ITA No. 4415/Mum/2014

j) Heinz India Pvt. Ltd. reported in TS-194-ITAT-2016 (Mum)-TP in ITA No. 7732/Mum/2010.

3.14 The Ld.DR on the contrary relied on para 2.3.15 to 2.3.28.2 of the DRP directions in support of his arguments that reads as under:

2.3.15 Though the assessee claims that it is a licensed manufacturer, the TP study report indicates that it is a contract manufacturer and distributes a wide range of advanced weight management and nutritional products. In addition, the minor trading activity is considered as part of overall manufacturing and distribution activity of the assessee. The assessee is not exclusive manufacturer is evident from the fact that it houses IT support services for the distribution segment of the group as well as the assessee. The assessee is entered with agreement with Herbalife America for receipt of certain support services related to distributor information, maintenance of inventory and marketing services like providing sales promotion material, meetings, events and marketing analysis. The functions of the assessee therefore include manufacturing, distribution and marketing of Herbalife group products and the products manufactured using the technical knowhow of the group. However, the assessee has not benchmarked the functions of AMP services. Accordingly, the TPO has analysed (paras 26- 29) and rejected the TP study and proceeded to benchmark the AMP expenditure by adopting other method. In this regard, we completely agree with the TPO. Hence

the function of sales and business promotion is quite distinct from the manufacturing function and requires to be separately benchmarked. The Panel has already discussed on the segregation approach of determining the ALP of the AMP functions.

2.3.16 It is also seen that there was no requirement of incurring advertisement expenses displaying the name of the parent entity, its logo /trademark on the bills, advertisements or during the workshops or conferences. Herbalife is one of the leading multilevel marketing (MLM) company in India which sense Herbalife branded products. The assessee outsources the manufacturing activity but procures the raw material from the AE. Even in respect of products manufactured, based on the inputs provided by the group, the assessee performs marketing related activities to promote the new products of the group. This is mentioned in the TP study report in para 4.3.2.1 under the head marketing. For this purpose of marketing, the assessee has designed a model wherein the products are sold to the end customers through a network of distributors consisting of Herbalife Associates, Supervisors, Members and Distributors. The Distributors are trained in such a way that they are made aware of the benefits of products of Herbalife in maintaining good health and fitness. They inturn promote these products to other customers based on their needs in a systemized method. In this manner, Herbalife India implements marketing activities and plans to maximize market share, profit and volumes as directed by Herbalife group (para 4.3.2.1 under the head marketing). The above mentioned structure and roles of Associates, Supervisors and Members are thus nothing but marketing and sales of Herbalife products in a well-organized network of marketing team. The above role of the assessee in marketing the Herbalife products is evident from the sales function described in the TP study report which is reproduced as under:-

> "Sales: The sales function primarily includes planning promotional and sales events, training, communication with the distributors, etc. Herbalife India maintains constant contact with distributors to achieve high level of motivation and recognition of distributor's networks and to promote, protect and enrich the business and organizational productivity.
> Herbalife India implements annual and multiyear promotional plans, events and training to match with the overall strategies and objectives of the group."

2.3.17 In order to motivate the above network of distributors, the assessee has structured various modes of incentives in the name of distributor allowances. This incentives include Commission, Royalty Earnings, Production Bonus and Mark Hughes Bonus etc,. According to the volume of sales made by the Associates and other members of distribution network the percentage of benefit is awarded in various names as described above. As observed by the TPO and also the information provided in Herbalife's guide to Associates suggest that the sale of products is done by the distributors by wearing badges, Company T-shirts.

2.3.18 The above role of the assessee in marketing and sales supports the fact that the products of AEs are marketed in India through the well-oiled network of distributors. The AEs are, therefore, benefitted more by selling goods/products in India which has potential market for their products. This means that the brand value of their products is definitely enhancing. By way of sale of products in India, the AE is also benefited and therefore it needed brand building expenses. Thus, the claim of the assessee that the expenses of distribution allowance in business promotion expenses pertain only to sales and do not involve any promotional activity is proved to be wrong.

2.3.19 In the instant case, the assessee has merely purchased products from its AEs and sold further to distributor/dealers in India. Thus, functions of the assessee are akin to distributor. On Page 14 and 15 of the TP study report, the assessee has reported various risks associated with the transaction of purchase of products by the assessee in relation to the distribution function as under:

	Type	Herballife India	Herballife group (AEs)
a.	Business risk/ market risk	yes	Yes
b.	Credit risk	No	yes
c.	Foreign exchange risk	limited	yes
d.	Inventory risk	limited	Yes
e.	Product liability Risk	No	Yes
f.	Technology risk	No	yes

2.3.20 Thus, we find that along with the inventory risk shared with the assessee, the AE was subjected to hundred percent market risk and product

liability risk. The relevant clause of the productivity risk on page 14 of the TP study reads as under:

> "Significant risks with respect to product liability are borne by Herbalife Group as it is the owner of all marketing and product intangibles across the world. Herbalife Group having worldwide insurance policy for its products bears significant risks"

2.3.21 We also find that it is the AE who is assuming the risk of the legal dispute and worldwide insurance policy with respect to the products sold in India. According to us, it is the reason as to why AE is interested in increasing technical awareness of its products among the customers/users of products in India, for which the assessee has incurred expenses advertisement and promotion. The assessee as described above is thus considered to be low risk entity in terms of distribution of products of the group in India.

2.3.22 Further, the Hon'ble High Court in case of Sony Ericson has discussed as how a pure or a simple independent distributor or a distributor having low-risk should be compensated. The relevant finding of the Hon'ble High Court is reproduced as under:

> *"124. There is a difference between a pure and a simple independent distributor and a distributor with marketing rights. An independent distributor with a full marketing right is a person or an entity legally independent of the manufacturer, who purchases goods from the manufacturer for re-sale on its own accounts. The transaction between the two is a straightforward sale in which the distributor takes all economic risk of product distribution and ultimately gains or makes loss depending upon market and other conditions. The manufacturer is not concerned. In case of a low or no risk distributor and he virtually acts as an agent for the loss and gain is that of the manufacturer. There is no economic risk on distribution of profits. He is, therefore, entitled to fixed remuneration for the self efforts, i.e., relating to the task or function of distribution.*
>
> *Similar will be the position of a low risk distributor with marketing functions, except that the said distributor should be compensated for the marketing, including AMP function. A distributor with marketing function can be normal or a high risk distributor. Such distributors should be compensated but the quantum of compensation would be higher. Such cases have to be distinguished from cases of a true distributor, who is in an independent business, uses his own money for purchasing at a low price and selling at a high price and accordingly shoulders the burden in*

case of a bad judgment. Profits or losses, therefore, correspond to the risk and market consideration. There is also functional incompatibility between a distributor and a retailer. Retailers cannot be compared with distributor also performing marketing functions. Foreign global enterprises frequently adopt a subsidiary model, i.e. the products are distributed and marketed in a targeted country through a wholly owned subsidiary or a sales subsidiary. A comparable would be an unrelated identity with similar distribution and marketing functions".

2.3.23 Thus it is clear that the assessee has not acted as any nominal independent distributor and that its advertisement and selling expenses are approved by the Herbalife Group, which also go to show that there is an arrangement and agreement with the AE and parent company in regard to incurring of advertisement and selling expenses which also include AMP Spend. In view of these information in the TP Study reports, we do not find any merit in the contentions of the assessee that the assessee decides and undertakes all functions and controls the manner in which the advertisement and sales promotion can be incurred and that there was no involvement of AE in this aspect. The perusal of the functional analysis given in TP study report for AY 2017-18 clearly reveal that the AE has direct operational management control over the assessee, including direct involvement in the expenditure to be incurred towards advertisement and brand promotion expenses. This is evident from the functions performed by the Herbalife Group in the areas of product development, manufacturing, buy back policies, network marketing system and Global distribution system. The above said information in TP study reports also clearly show that the assessee has been assigned a crucial role to play, at least in the Enhancement and Maintenance of the AEs brand in India and accordingly the assessee has been providing such service or benefit to the AE over the years, which is also reflected in the excessive AMP Spend.

2.3.24 The conduct of the taxpayer in pursuance of such arrangement / understanding is a relevant factor to decipher the function carried out by the assessee. It is pertinent to refer to the relevant extract in the BEPS Report for the purpose, which is as under: -

"It is, therefore, particularly important in considering the commercial or financial relations between associated enterprises to examine whether the arrangements reflected in the actual conduct of the parties substantially conform to the terms of any written contract, or whether the associated

enterprises' actual conduct indicates that the contractual terms have not been followed, do not reflect a complete picture of the transactions, have been incorrectly characterized or labelled by the enterprises, or are a sham. Where conduct is not fully consistent with economically significant contractual terms, further analysis is required to identify the actual transaction. Where there are material differences between contractual terms and the conduct of the associated enterprises in their relations with one another, the functions they actually perform, the assets they actually use, and the risks they actually assume, considered in the context of the contractual terms, should ultimately determine the factual substance and accurately delineate the actual transaction". (Paragraph 1.46 in Section D.1.1. of chapter 1 of OECD guidelines revised through BEPS final report).

2.3.25 We note that the assessee has created an extensive network of distributors, Herbalife Authorized Associates and Members to market and promote the AE's brand in India. All these concerted marketing efforts certainly go to enhance the brand presence, awareness and consequently the brand equity in India. It cannot be said that all these efforts and expenses were incurred by the assessee without the involvement or concurrence of the AE, merely to sell the products in India. The fact that the assessee procures brochures and advertisement materials and Herbalife's Guide to Associates from the AE goes to show the concerted effort to promote the brand presence, awareness and strength in India. All these conduct lead to infer the existence of international transaction of AMP. An unrelated independent party would not make these marketing efforts for promoting a brand not owned by him, which apparently explains the reasons for the excessive AMP Spend compared to a nominal distributor.

2.3.26 We also note that the extensive distribution and service network promote direct sales in India as the customers are assured of the requisite service and other facilities provided by the network apart from price difference. Therefore, we do not find any infirmity in the TPO's conclusion of considering excessive AMP as international transaction and benchmarking of the such AMP spend by other method.

2.3.27 In the light of above discussion, the various pleas raised in the above objections are rejected.

We have perused the submissions advanced by both sides in the light of records placed before us.

3.15 In rejoinder the Ld.Counsel submitted that the DRP without appreciating the Business model adopted by the assessee took

the view in 2.3.19 that the assessee merely purchases the products from AE and sells it further to the distributors / dealers in India. The DRP failed to appreciate that the products are sold to end customers by Direct Selling model and all the incentives / payouts to the agents are subjected to TDS.

3.16 He also referred to para 2.3.16 wherein the DRP is accepting that the assessee do not require to incur any advertisement expenses as they are one of the leading multilevel marketing company. He thus submitted for the adjustment to be deleted.

3.17. Indian subsidiaries of foreign entities may carry out certain activities as part of their business in India. Generally, they may undertake manufacturing, advertising, or promotion activities and the costs incurred are known as advertising, marketing, promotion expenditure ('AMP expenditure'). The inclusion of AMP expenditure by an associated company in transfer pricing analysis has been a point of contention in India. The contentions emerge as assessing officers allege that these expenses result in the creation of intangibles like brand identity and image which are part of the intellectual property rights of the foreign entity. And in general, these costs are in excess of the costs that would be incurred by unrelated parties. Hence, they argue that it should come under 'international transaction' and should be included in the transfer pricing study. However, Indian subsidiaries contend that such expenditure is carried out for their own purposes to build the business in India and is not meant to contribute to the global business.

3.18. Indian authorities have also adopted the "bright-line test" to determine whether such transactions can be included in the transfer pricing. This test was laid down by the United States

Courts. The test states that the AMP expenditure which is in excess of the expenses incurred by comparable companies in a controlled transaction has to be compensated to the overseas enterprise. The Indian authorities consider this excessive expenditure as an enhancement of the global branch and a step towards creating marketing intangibles.

3.19. This issue was been heavily contended for years. In 2010, in the case of *Maruti Suzuki*, reported in *(2010)192 Taxman 317*, *Hon'ble Delhi High Court* had held that that the AMP expenditure amounted to an international transaction. A similar matter was then again heard by *Hon'ble Delhi Special Bench* in case of *LG Electronics*, reported in *[2013] 29 taxmann.com 300*, wherein it was held that, bright-line test can be used to determine if the AMP expenditure is an international transaction. The second decision in case of *Maruti Suzuki* by *Hon'ble Delhi High Court* reported in *[2015] 64 taxmann.com 150,* held that there should be an understanding between the domestic company and the associated enterprises for incurring AMP expenditure for it to be considered an international transaction.

3.20. Now, it is fairly well established that determination of arm's length price of AMP expenditure by applying BLT method is not valid. In a catena of decisions, the Hon'ble Delhi High Court while disapproving the decision of *Hon'ble Delhi Special Bench* in *L.G. Electronics India (P.) Ltd.* (*supra*) have held that, BLT method is invalid as it is not prescribed in the statute. In this context, we may refer to the decision of the *Hon'ble Delhi High Court* in *Maruti Suzuki India Ltd.* (*supra*). Following the decision of the *Hon'ble Delhi High Court* in *Maruti Suzuki India Ltd.* (*supra*) and various other decisions, different Benches of the *Tribunal*

have also held that in absence of an express arrangement/agreement between the assessee and the AE for incurring AMP expenditure to promote the brand of the AE, AMP expenditure incurred by making payment to third parties for promoting and marketing the product manufactured by the assessee, does not come within the purview of international transaction. Thus the sum and substance of the ratios in various decisions by *Hon'ble High Court*s, consistently followed by the *Tribunals* are that:

- Bright-line test alone cannot be considered an indicator that the AMP expenditure constitutes an international transaction under the Income Tax Act.
- Even if the foreign entity is to gain by the AMP services carried out by the domestic entity, that will not be proof of an international transaction if the services were carried out specifically for the development of the domestic entity in India.
- Transfer pricing officers must look for further evidence such as subsidies, grants, or contractual arrangements between the associated enterprises to prove that such expenses were a part of an international transaction.
- If the AMP is shown to be an international transaction, then it must be added as part of the computation of the arm's length price.

3.21 Admittedly, in the present facts of the case, the assessee is a distributor and is functioning its activities under the MLM sales model. On perusal of the records and the activities carried out by the assessee described in the TP study reports, no action foised it as an international transaction. The entire sales of the assessee

is effectuated in India and the entire profits are also assessee's own profit. The expenditure incurred by assessee is to carry out its day to day business activity of distribution and are directly linked with the business carried out by assessee in India. It is not disputed by the revenue that TDS has been deducted by the assessee on the royalty earning, production bonus u/s. 194H of the Act, and thus payouts are made only when the members / associates /distributors effectuate a successful sale. In any event, all these expenses have been considered by the assessee while computing the margin under the manufacturing segment which already has been held to be at arms length by the Ld.TPO in the transfer pricing order u/s. 92CA.

3.22 In this context, we draw specific reference to the observation of *Hon'ble Delhi High Court* in case of *Sony Ericsson Mobile Communication India (P) Ltd. (supra)* which is as under:

> *"101. However, once the Assessing Officer/TPO accepts and adopts TNM Method, but then chooses to treat a particular expenditure like AMP as a separate international transaction without bifurcation/ segregation, it would as noticed above lead to unusual and incongruous results as AMP expenses is the cost or expense and is not diverse. It is factored in the net profit of the inter-linked transaction. This would be also in consonance with Rule 10B(J)(e), which mandates only arriving at the net profit margin by comparing the profits and loss account of the tested party with the comparable. The TNM Method proceeds on the assumption that functions, assets and risk being broadly similar and once suitable adjustments have been made, all things get taken into account and stand reconciled when computing the net profit margin. Once the comparables pass the functional analysis test and adjustments have been made, then the profit margin as declared when matches with the com parables would result in affirmation of the transfer price as the arm's length price. Then to make a comparison of a horizontal item without segregation would be impermissible"*

3.23 We also find merit in the submission of the Ld.Counsel that, if the net profit margin meets the Arm's length price, then no

separate addition needs to be made. Considering the fact that no adverse inference is drawn by the Ld.TPO in respect of the Manufacturing segment which means that the Ld.TPO has accepted the overall margins of the said segment and respectfully following decision of the *Hon'ble Delhi Court* in the case of *Sony Ericsson* (*supra*), we direct the Ld.TPO to delete the adjustment made towards the AMP.

Accordingly ground nos. 2 to 4 raised by assessee stands allowed.

4. **Ground nos. 5 & 6** are raised by assessee seeking correction of computation errors of total income and incorrect levy u/s. 234A of the Act. We direct the Ld.AO to compute the total income correctly in accordance with law. In respect of levy of interest u/s. 234A, we note that the assessee has filed its return on time and therefore 234A interest cannot be levied. Accordingly the same is directed to be deleted.

Accordingly, ground nos. 5 & 6 raised by assessee stands allowed.

In the result, the appeal filed by the assessee stands allowed.

Order pronounced in the open court on 17th May, 2023.

Sd/-	Sd/-
(PADMAVATHY S)	(BEENA PILLAI)
Accountant Member	Judicial Member

Bangalore,
Dated, the 17th May, 2023.
/MS /

Copy to:

1. Appellant
2. Respondent
3. CIT
4. DR, ITAT, Bangalore
5. Guard file

By order

Assistant Registrar,
ITAT, Bangalore