A.L.P. OR B.L.T. FOR A.M.P.? FULL DEDUCTIONS FOR ADVERTISING, MARKETING, AND PROMOTIONAL ACTIVITY ON TRIAL IN INDIA

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INTRODUCTION

Several Indian transfer pricing cases regarding the treatment of marketing expenses are about to be addressed by the Indian Supreme Court on appeal by the Indian tax authorities ("I.T.A."). This controversy will be of interest to multinational groups with Indian operations that incur advertising, marketing and promotion ("A.M.P.") expenses to attract customers[1] and generate sales when the group must follow the arm's length principle ("A.L.P.") when pricing intercompany transactions.

This article addresses the differences between the Indian and U.S. administrative rules and controversy environments. Through the use of a Q&A format, the authors have been asked questions reflective of international norms and respond with insights on the arguments critical to the resolution of cross border A.M.P. cases.

BACKGROUND TO THE A.M.P. CASES

The A.M.P. cases reflect a series of long-running controversies between (i) the Indian subsidiaries of various multinational enterprises such as Suzuki Motors, Sony Ericsson, Whirlpool, Canon, Toshiba, PepsiCo and (ii) the Indian transfer pricing officer ("T.P.O.") concerning the annual level of deductible A.M.P. expenses. While it is clear that the purpose of the expenses in issue was to increase brand awareness in the Indian market designed to increase sales volume of Indian subsidiaries, the use of globally well-known trademarks in India has caused the I.T.A. to question which company – the Indian subsidiary or its foreign parent – should incur the A.M.P. expense under relevant A.L.P. rules. The approach taken by the I.T.A. differs from the approach under U.S. transfer pricing rules that appear in Treas. Reg. §1.482-4 and under their counterpart in Chapter VI of the O.E.C.D. Guidelines. This divergence is not unexpected.

The Indian approach to transfer pricing has departed from international norms for many years, and the country routinely stands out as (i) a vocal defender of its tax base in O.E.C.D. proceedings and draft policy releases[2] and (ii) a key promoter of U.N. transfer pricing policy as an alternative to the O.E.C.D. approach. It is not surprising, therefore, that the Competent Authority is known for promoting bilateral acrimony, although its relationship with the U.S. has been repaired in recent years.

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1 A.M.P. expenses do not include selling activities such as trade discounts or volume discounts.

2 The O.E.C.D. Amount B draft contained 12 notes, seven of which were marked "Note by India." India was the only country to request notes. (O.E.C.D. (2024), *Pillar One - Amount B: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project*, OECD Publishing, Paris, https://doi.org/10.1787/21ea168b-en.)

The country's history in transfer pricing matters has been influenced by its unique factors:

- Considerable population and productive capacity
- Relatively low cost of labor
- High skill levels and innovation in several sectors
- Import substitution
- Rapid technological development
- Global success of Indian multinationals
- Recent growth of household income
- A large population of consumers

Foreign multinationals recognize India as a significant consumer market with great potential. A.M.P. is needed to reach these consumers, as consumers can choose between products offered by many manufacturers or distributors.

QUSTIONS & ANSWERS

Q1. What are the A.M.P. cases in more detailed terms, and to what extent are the cases similar?

Under the Indian Income Tax Act, 1961 ("I.T. Act"), any expenditure, unless otherwise restricted, that is wholly and exclusively incurred for the purposes of the business or profession is allowable as a deduction when computing income chargeable to tax under the category of profits and gains of a business or a profession. Expenditures for marketing and advertising activities that are incurred wholly and exclusively for the purposes of the business are allowable as business expenditures.

The Indian transfer pricing ("T.P.") provisions that run parallel provide that any income arising from an international transaction must be computed at an arm's length price that is consistent with the A.L.P.

The two parallels collide when the I.T.A. makes transfer pricing adjustments, asserting that expenditures by the Indian entity on A.M.P. activities while operating under a license to use brands owned by a related foreign entity is not wholly deductible. This approach ushered in an era of litigation, which currently awaits final outcome before the Supreme Court of India.

A.M.P. disputes usually arise where a foreign brand owner owns an Indian entity that manufactures goods in India or distributes goods or services manufactured or provided by the foreign brand owner. That brand owner grants a license in favor of its Indian affiliate to use the brand, trademark, and know-how of the owner. There may or may not be a royalty paid as consideration for the license granted to the Indian entity.

The amount spent by the Indian entity on A.M.P. activities is paid to unrelated parties in India. Under a plain-language reading of the provisions of Chapter X of the I.T. Act, the expenditures do not constitute an international transaction between related parties. To elaborate, a transaction is defined in the I.T. Act to include an arrangement, an understanding, or an action that is conducted in concert. An international transaction is defined in the I.T. Act to mean a transaction between two or more related parties, where one or both are nonresident for Indian tax purposes. Consequently, T.P. provisions for international transactions apply when at least one party to the transaction is a nonresident and both parties are related.

The I.T.A. has rejiggled the basic fact pattern involving A.M.P. activities between two Indian resident companies into an excess A.M.P. expense incurred by the Indian subsidiary in a deemed transaction with its nonresident affiliate. It contends that a portion of the A.M.P. constitutes marketing services provided to the foreign brand owner for which reimbursement plus a mark-up is due. The excess is measured using the bright line test ("B.L.T.") that compares (i) the ratio of the annual A.M.P. expense to sales of the Indian entity with (ii) the ratios of annual A.M.P. expense to sales of the comparable companies.

All cases involving A.M.P. issues are similar given they revolve around the fundamental question of whether the excess expenditure incurred for A.M.P. activities can be construed to be an international transaction between the Indian entity and its foreign related party, and thereby subject to T.P. provisions.

Q.2. Courts in India looked at the matter of A.M.P. in the LG Electronics case. Is the precedent reached in that case at stake in the three cases that will be presented to the Supreme Court?

The A.M.P. controversy first reached the courts in 2010, in *Maruti Suzuki India Ltd. (MSIL) v. ACIT.*[3] There, the Delhi High Court set aside the order of the T.P.O. and remanded the case, observing that A.M.P. expenditures from a domestic entity related to a foreign entity on A.M.P. activities regarding a foreign trademark or brand did not require any payment or compensation from the foreign owner so long as the A.M.P. expenses incurred did not exceed the A.M.P. expenses that would have been incurred by a similarly situated and comparable independent domestic entity. In the event excess expenditures were incurred by the related Indian entity, the foreign related party would need to compensate the domestic party for the excess A.M.P. expenditures. According to the court, the excess amount reflects a form of brand building that benefits the owner of the brand. The excess amount incurred by the related Indian entity must be augmented by an arm's length mark-up that compensates the Indian affiliate for the deemed performance of an intercompany service.

The decision was appealed, and in 2011, the Supreme Court of India[4] directed the T.P.O. to disregard the guidance given by the Delhi High Court in computing a T.P. adjustment on account of A.M.P. activities. Nonetheless, the decision of the Delhi High Court paved the path for the B.L.T. approach. Under the B.L.T. approach, one portion of A.M.P represents routine business expenses, and the remainder represents the amount spent on brand building.

In 2013, a special bench of the Income Tax Appellate Tribunal ("Tribunal") interpreted the T.P. provisions in a fact pattern similar to the *Maruti Suzuki India Ltd.* In *L.G. Electronics India (P.) Ltd. V. ACIT,*[5] the Tribunal determined that the ratio of A.M.P.

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3 328 ITR 210 (Delhi High Court, 2010).

4 *Maruti Suzuki India Ltd. v. ACIT*. 335 ITR 121 (Supreme Court of India, 2011).

5 22 ITR(T) 1 (Delhi -Trib. (SB), 2013).

expenditures incurred to sales was greater than the ratio found in comparable situations between two unrelated entities. That latter ratio was considered by the Tribunal to be a bright line that separated routine A.M.P. expenditures from brand building services benefiting a foreign related party. In that manner, the Tribunal inferred the existence of an international transaction between L.G. Electronics India and its foreign related entity. Viewed in this light, it was immaterial that the payments funding A.M.P. activities were made to third parties. The international transaction was embodied in the domestic payment made on behalf of the foreign related party that assisted the latter in adding value to the brand in the Indian market.

The issue arose again in 2015 before the Delhi High Court in *Sony Ericsson Mobile Communications India (P.) Ltd. v. CIT.*[6] There, Indian entities engaged in distribution and marketing of products manufactured and sold by related nonresident entities. The High Court upheld the I.T.A.'s assertion that the expenditure pertaining to A.M.P. was in the nature of an international transaction, primarily pursuant to the concession given by the entities therein that there existed an international transaction for incurring cost *vis-à-vis* A.M.P. activities. However, while doing so, the High Court held various principles applied in the case of *LG Electronics* to be erroneous. Among various guidelines in this decision, the most important was the rejection of the B.L.T. The High Court expressed concern that the B.L.T. lacked statutory authorization, and as such, would amount to judicial legislation. Additionally, the High Court observed that, in cases where the T.P.O. accepts the comparables adopted by the Indian entity using the Transactional Net Margin Method ("T.N.M.M."), no separate adjustment for A.M.P. would be warranted provided the profit margin of the Indian entity matches the margins of the comparable companies. The High Court remanded the A.M.P. issue to the T.P.O. to determine whether the A.L.P. of the international transaction was consistent with recognized T.P. principles in India. While favorable for the taxpayer, the decision applied only where a distributor accepted that the A.M.P. activity comprised an international transaction.

In December 2015, the Delhi High Court issued a revised decision in *Maruti Suzuki India Ltd. v. CIT,'*[7] holding that no international transaction existed to trigger application of the T.P. provisions where an Indian manufacturing entity received no oral or written direction from its foreign related entity regarding brand building services. The I.T.A, was allocated the burden of proof to demonstrate that an agreement existed and the B.L.T. could not be used to meet that burden. The High Court went on to state that, in the absence of any substantive provisions contained in the I.T. Act to recognize the existence of an international transaction resulting from A.M.P. expenses, a T.P. adjustment could not be made. This decision has been appealed to the Supreme Court level and is currently awaiting adjudication.

In another decision, *Honda Siel Power Products Ltd vs. DCIT*,[8] the Delhi High Court held that the existence of a license giving an Indian entity the right to use a brand name does not imply the existence of a further understanding or arrangement under which the A.M.P. expense is to be used for promoting the brand of the foreign related party.

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6 374 ITR 118 (Delhi, 2015).

7 381 ITR 117 (Delhi, 2016)

8 283 CTR 322 (Delhi, 2016)

In the meanwhile, the I.T.A. identified another method to make A.M.P. adjustments, known as the intensity approach. Under this approach, A.M.P. expenditures of a taxpayer are computed as a percentage of sales as a means to compute the intensity of A.M.P. expenditures. Similar average intensity computations are made for comparable companies. To the extent the taxpayer's intensity exceeds the average intensity of comparable companies, brand awareness services are deemed to be provided to the foreign related party. In *Widex India Private Limited*,[9] the Chandigarh bench of the Tribunal characterized the intensity approach as mirror image of B.L.T., and was held to be invalid.

In a nutshell, the following main issues in relation to A.M.P. expenses are pending adjudication before the Supreme Court as of December 1, 2025:

- Do A.M.P. expenses incurred by Indian entities constitute an international transaction under the Indian transfer pricing provisions?
- If so, what methodology should be adopted to compute the arm's length price of the A.M.P. expenses?
- Can the B.L.T. be used to benchmark A.M.P. transactions?
- Is a transfer pricing adjustment regarding A.M.P. expenses warranted if the transactions are found to be at arm's length under the T.N.M.M.?

Q.3. On a global basis, are the A.M.P. cases properly viewed to be recharacterization cases?

Yes, the A.M.P. cases can be viewed to be recharacterization cases. The T.P.O. regularly construes alleged excessive A.M.P. expenditures by an Indian entity as expenditures incurred for promotion of the global brand of a foreign related entity, even when no such transaction exists in reality.

Under the law, the T.P.O. is required to examine an international transaction as he finds it. The task of the T.P.O. is to determine the arm's length price of an international transaction in accordance with the methods prescribed under the I.T. Act. Accordingly, the powers accorded the T.P.O. under the law cannot be exceeded simply by recharacterizing a transaction. The existence of an international transaction cannot be a matter for inference or surmise.

In *CIT vs. EKL Appliances Ltd.*,[10] the Delhi High Court ruled that the I.T.A. cannot recharacterize a transaction except in exceptional circumstances where

- the economic substance of a transaction differs from its form or
- the form and substance of the transaction are consistent, but arrangements made in relation to the transaction differ from those that would have been adopted by independent enterprises behaving in a commercially rational manner, when viewed in their totality.

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9 ITA No. 269/CHD/2017

10 2012 (4) TMI 346

If the Supreme Court holds that A.M.P. expenditure does not constitute an international transaction, the issue of recharacterization would stand resolved. It is the position of the I.T.A. that transfer pricing adjustments are required for some or all of the A.M.P. expenses because an embedded service is provided by the Indian resident for the benefit of a related foreign person. If that approach of the I.T.A. is invalidated, no related party transaction will have been viewed to occur.

Q.4. A question exists as to why the A.M.P. cases are not viewed simply as disputes focused on the terms of a particular licensing agreement and the question of whether a third-party licensor would impose comparable A.M.P. expenses on an independent licensee. Why did the T.P.O. take the B.L.T. approach rather than relying on licensing agreement comparability analysis arguments.

It is difficult to assume the exact reason why the I.T.A. relied so heavily on the B.L.T. approach. One possible reason is that the B.L.T. method allows the I.T.A. to adopt an easier route to make an adjustment. It simply requires access to data of comparable companies in the same industry as available in the databases and usage of appropriate search query and filters.

"It is difficult to assume the exact reason why the I.T.A. relied so heavily on the B.L.T. approach."

The legal problem that has been encountered is that this approach cannot be sustained. The level and nature of A.M.P. spending depends on a variety of business factors like market share, market environment, contractual mechanisms, and management policies. All of these can differ within the same industry as many are company specific.

Q.5. Is the B.L.T. viewed as an application of T.N.M.M.? It is so different than anything we see in the U.S. that readers could confuse the approach with the ratio-driven approach taken in formulary apportionment or the Amount A and B computations underlying Pillar 1.

Use of the B.L.T. is indeed a unique phenomenon. Interestingly, there is a view that the concept originated in a U.S. case,[11] perhaps building on the Tax Court analysis of developer or assister expenses in comparison to promotional expenses of a comparable trademark licensee at arm's length.

As discussed above, the B.L.T. compares (i) the ratio of the annual A.M.P. expense to sales of the Indian entity with (ii) the ratios of annual A.M.P. expense to sales of comparable companies. The benefit of the approach from the I.T.A.'s viewpoint is that the data supporting the adjustment requires number crunching through usage of specialized databases. The weakness is the absence of qualitative adjustments based on particular facts and circumstances.

In any event, B.L.T. is a method that is not prescribed anywhere in the Indian T.P. provisions. This is the reason why the B.L.T. method was rejected by the Delhi High Court in *Sony Ericsson* and the *Maruti Suzuki* decisions.

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[11] *DHL Corp. v. Commr.*, T.C. Memo 1998-461C, *revd*. 285 F.3d 1210, (9th Cir. 2002).

Q.6. Selling and distribution cost is a wide category. Advertising and marketing expenses tend to increase with new product launches and promotions, which may differ across companies in timing and strategic emphasis. Foreign brands like Suzuki (despite the long-term Maruti association) and domestic brands advertise and promote from fundamentally different starting points. Tata is known for a great many products, including tea, Mahindra makes tractors, and Hindustan Motors stopped producing the Ambassador, known widely as a taxi model (like the Ford Crown Victoria in the latter part of the 20th century in New York City), in 2014 and might not sell any more Ambassadors with even an infinite advertising budget.

The prior decisions indicate that some comparability analysis was conducted by the Tribunal with respect to selling and distribution cost of MSIL and the selected comparable companies. This misses much of comparability analysis that is expected in transfer pricing matters under most country and multilateral rules.

Why did the T.P.O. focus on what appears to be a very simple ratio analysis and ignore the ratio components for the comparables – Tata Motors, Hindustan Motors, Mahindra & Mahindra?

Selling and distribution costs cover a wide and diverse category of expenses. Advertising and marketing expenses are highly sensitive to factors like new product launches, promotional cycles, and strategic positioning of a brand. Comparing Maruti Suzuki with companies such as Tata, Mahindra, or Hindustan Motors without unpacking those contextual drivers oversimplifies the issue.

Those differences may explain why the T.P.O. performed a simple ratio analysis rather than a deeper comparability study. Several practical reasons suggest why the T.P.O. focused on the B.L.T.

- **Ease of administration:** Ratio analysis of selling and distribution costs to sales is easy to quantify. It allowed the T.P.O. to draw conclusions about excess A.M.P. without accurately identifying the substance of the costs, the contractual responsibilities, or the brand-specific context.

- **Lack of availability of detailed data / information constraints:** Detailed cost breakdowns for comparables – such as how much Tata spends on truck promotions rather than passenger cars, or how Mahindra allocates A.M.P. between tractors and sport utility vehicles – are not typically available in the public domain. Without those granular disclosures, the T.P.O. relied on top-line ratios, even if those are not truly comparable.

- **Revenue-oriented approach:** A nuanced functional analysis would likely show that Maruti's A.M.P. expenditures were aligned with its role as a full-fledged manufacturer and market leader, and were not incurred as an excess service to Suzuki. By sticking to a simplistic ratio-based approach, the T.P.O. effectively created a framework in which excess A.M.P. would almost always be identified, thereby ensuring adjustments even when the expenditure could be commercially justified as part of a manufacturer / distributor's normal business operations.

Q.7. The examination of the MSIL 2006/2007 tax year transfer pricing positions was concluded with no change. This suggests that the notion of MSIL paying A.M.P. expenses to raise Suzuki brand awareness in India is a non-starter, as foreign tourists visiting India likely do not go home and buy a vehicle from a Suzuki dealer because they watched Maruti-Suzuki ads or visited showrooms in India.

If all the other transactions of MSIL were found to be arm's length, what does this case suggest as the means by which Suzuki obtained a benefit from the allegedly excessive MSIL A.M.P.?

A search of the WIPO brand trademark database showed MSIL to be the owner of a number of different Maruti-Suzuki marks. How can the T.P.O. contend that A.M.P. expenditure in respect of the Indian automotive market by MSIL promoted anything other than the company's own intangible property? Suzuki sells motorcycles in India under the Suzuki brand, but the positive effect of A.M.P. on motorcycle sales is not taken into account.

The identified factors go to the root of the dispute. The Delhi High Court in *Sony Ericsson* dismissed the T.P.O.'s argument that huge spending on A.M.P. expenses amounted to brand building and trademark enhancement of the brand owned by the foreign related party. To that end, the High Court observed the following:

> To assert and profess that brand building as equivalent or substantial attribute of advertisement and sale promotion would be largely incorrect. It represents a coordinated synergetic impact created by assortment largely representing reputation and quality. There are a good number of examples where brands have been built without incurring substantial advertisement or promotion expenses and also cases where in spite of extensive and large scale advertisements, brand values have not been created. Therefore, it would be erroneous and fallacious to treat brand building as counterpart or to commensurate brand with advertisement expenses. Brand building or creation is a vexed and complexed issue, surely not just related to advertisement.[12]

"The Delhi High Court in Sony Ericsson dismissed the T.P.O.'s argument that huge spending on A.M.P. expenses amounted to brand building and trademark enhancement of the brand owned by the foreign related party."

The Delhi High Court in the above case also held that brand-building is a journey and brand value depends on a number of factors including the quality and nature of goods and services. Therefore, it would be incorrect to state that advertising is synonymous with brand-building as the latter in a commercial sense involves several factors and components, the primary element being the quality and reputation of the product or the name, which is acquired gradually and silently over a span of time.

Judicial precedents have held that merely because there is an incidental benefit to a foreign related party, it cannot be said that the A.M.P. expenses incurred by the Indian entity were made to promote the brand of a foreign related party. The increase in brand value happens at a very slow pace over a long period of time and there

[12] Taxbymanish. "Transfer Pricing Applicable on AMP, Brightline Test Rejected: Delhi HC." Tax of India, February 13, 2016.

cannot be direct correlation between A.M.P. expenditure and brand value because brand value depends upon numerous other factors which may not be linked with A.M.P. expenditure.

Thus, the arguments of the I.T.A. to connect 'brand building' with substantial A.M.P. spending have been rejected in the cases discussed above.

Q.8. Several references were made in the lower court decisions to a batch approach for transfer pricing cases. The procedure seems to be to hear a number of like cases at once, as opposed to the U.S. approach of individual cases being designated for litigation by the I.R.S. due to their potential precedential value and the high possibility of success. What advantage do you see to the Indian batching approach?

The volume of income-tax litigation currently pending before the Courts in India is significant. To address situations where multiple taxpayers face a common legal issue, the appellate courts in India often consolidate such matters into a batch of cases involving a shared/similar question of law. This approach facilitates a more efficient and consistent adjudication, enabling speedier resolution of a recurring tax dispute.

Q.9. In the U.S., the I.R.S. field examiner and the national equivalent of the T.P.O. cease direct involvement in a case generally at the Appeals level, unless directed by a court. The T.P.O. remained engaged throughout almost all levels of appeals in India. Does this approach in India help with the application of transfer pricing case law precedent in India to ongoing field audit controversy in India?

Even in India, T.P.O.'s usually take a back seat once an assessment is concluded. They generally are not involved if an assessment is challenged before the appellate authorities. However, since transfer pricing is a technical subject, T.P.O.'s are consulted by counsel representing tax authorities on various occasions – and in some instances by the judicial authorities – to provide comments and assistance on the approach they adopted in a particular matter. This helps the judicial authorities and counsel for the revenue authorities in understanding the intricacies of a transfer pricing dispute.

Q.10. Might the cases awaiting a decision in the Supreme Court of India be resolved differently by Competent Authorities engaged in a Mutual Agreement Procedure under the relevant tax treaty?

Why did the A.M.P. cases end up in protracted litigation in India rather than in Competent Authority proceedings, especially as Competent Authority decisions made under an income tax treaty, if accepted, supersede country law in many instances?

In a perfect world, the issue before the Supreme Court of India should have been addressed through the Mutual Agreement Procedure under relevant income tax treaties.

Having said that, the stakes in A.M.P. litigation are very high. The I.T.A. is not keen in resolving A.M.P. disputes under the Mutual Agreement Procedure of a relevant income tax treaty for several possible reasons. The first is that Mutual Agreement Procedures involve a degree of "horse trading." The I.T.A. is not interested in stepping back from its position and feels it has a better opportunity to win in the Supreme Court of India. This view may be supported by institutional memory that looks back at the I.T.A.'s initial victory in the first court hearing involving an A.M.P. deduction. Second, the I.T.A. may feel uncomfortable arguing its position against senior tax officials representing the treaty partner jurisdiction. Specious arguments presented by the I.T.A. in the course of a Mutual Agreement Procedure may be met with chuckles from the other side, resulting in a loss of "street cred" among Competent Authority peers.

CONCLUSION

The transfer pricing issue involving A.M.P. expenditures by Indian entity of foreign multinationals is now under consideration the Supreme Court of India. Nothing will change until a decision is entered.