AUGUST 2025

LOCAL CONNECT. GLOBAL OUTLOOK.

Royalty Payments in TP –

Global IP Structuring, Free Zone, Benchmarking & Litigation Insights

Definition of Intangible Property

Aspect	Definition	Inclusions	Exclusions
Indian Regulations	The Income-tax Act does not define "intangible asset." However, **Ind AS 38** defines it as an **identifiable, non-monetary asset without physical substance**, held for **production, supply of goods/services, rental,** or **administrative purposes.**	**as per Sec. 92B(ii): Marketing Intangible, Technology Intangibles, Goodwill Intangibles**	**No** exclusions are mentioned **explicitly** but certain elements are **excluded implicitly** like **group synergy** since they are **not owned** or **controlled**.
OECD Guidelines *(refer Page No. 247 Para 6.6)*	Something **not a physical or financial asset**, capable of being **owned or controlled** for **commercial use**, and whose **use or transfer would be compensated** in an **independent comparable transaction.**	Patents, know-how, trade secrets, trademarks, rights under contracts and government licenses, licenses and similar limited rights in intangibles	Group synergies, market specific characteristics, Goodwill
UN TP Manual *(refer Page No. 277 Para 6.2.1.3)*	Something **neither a physical nor a financial asset**, capable of being **owned or controlled for commercial purposes**, whose **use or transfer would be compensated** between **independent enterprises in comparable circumstances.**	Copy rights, patents, trademarks, literary works, trade secrets or designs, know-how	Group synergies, market specific characteristics
UAE TP Guide *(refer Page No. 111 para 7.3.2*	Something **not** a **physical** or **financial asset**, capable of being **owned or controlled** for **use in commercial activities**, and whose **use or transfer** would be **compensated** if it occurred between **independent parties** in **comparable circumstances.**	Patents, Know-how and trade secrets, Trademarks, trade names and brands, Rights under contracts and government license, Licenses and similar limited rights in intangibles	Group synergies, Market specific characteristics, Assembled workforce

Intangible Property

Licensing

- Involves granting the **right to use** intangible property without transferring ownership.
- Licensing typically results in the payment of a **royalty** or **license fee**.
- These **royalty payments** must be **benchmarked** under TP regulations to ensure they reflect **arm's length price ("ALP").**

Transfers

- Involves the **sale or assignment of ownership** of intangible property from one entity to another.
- The **valuation** of the intangible asset is critical to determine the **ALP**.
- These transaction of transfers require **documentation** and **justification** to ensure compliance with TP regulations.

Free Zone Qualifying IP Income Rules

- If a **Qualifying Free Zone Person** (QFZP) earns **income** from **owning** or **exploiting Qualifying Intellectual Property** (IP), that income can **qualify** for the **0% CT rate**.
- But it is **not automatic** – the QFZP must **calculate** it using the **"nexus approach"** prescribed in a **Ministerial Decision** (currently MD 265 of 2023).
- Qualifying IP is **narrowly defined** – if the IP **doesn't meet** this **definition**, the income is treated as Taxable Income at **9%.**

– Cabinet Decision No. 100 of 2023 (Article 7)
– UAE CT Law – Article 3(2)(b)

Definition of Qualifying Intellectual Property (IP)

Qualifying IP =

- Patents
- Copyrighted software
- Utility models
- Orphan drug designations
- Plant variety rights

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- Trademarks
- Marketing-related intangibles (brand names, logos, customer lists, goodwill)

Nexus Requirement for IP Income

$$\text{Qualifying IP Income} = \text{Overall IP Income} \times \frac{\text{Qualifying Expenditure} + \text{Up Lift Expenditure}}{\text{Overall Expenditure}}$$

Qualifying Expenditure	Overall Expenditures	Overall Income
• Costs for R&D performed by the QFZP itself. • Costs for R&D outsourced to non-related parties inside or outside the UAE. • Must be directly connected to creating, inventing, or significantly developing Qualifying IP.	• All R&D costs related to Qualifying IP creation or significant development. • Includes R&D performed by any party (related or non-related). • Includes acquisition costs of the Qualifying IP.	• Royalties or any other income from Qualifying IP. • Embedded IP income from sale of products or use of processes tied to the Qualifying IP. • Determined under arm's length principle (Article 34, UAE CT Law).

- **Uplift Expenditure:** A maximum 30% uplift of qualifying expenditure can be added for certain acquisition or outsourcing costs.

– Ministerial Decision No. 265 of 2023 (Article 2–5)

Global IP Structuring

- **Global IP structuring** refers to how multinational enterprises (MNEs) **organize the ownership, development, and exploitation** of intangible assets (like patents, trademarks, and know-how) across different jurisdictions to:
  - Optimize global **tax efficiency**
  - Comply with TP regulations
  - Protect **legal rights** and minimize **withholding tax exposure**

Common Global IP Holding Structures

Structure Type	Description
IP Holding Company	- A centralized entity (usually in a low-tax or treaty-friendly jurisdiction) holds all IP rights and licenses them to operating companies.
Contract R&D Model	- R&D is outsourced to group entities (e.g., India) on a cost-plus basis, while IP is owned elsewhere.
Principal/Hub Model	- Combines procurement, IP ownership, and supply chain control in one jurisdiction.
Cost Contribution Arrangement (CCA)	- Multiple entities share IP development costs and jointly own the IP.

Key Transfer Pricing Considerations

- **Royalty payments** should **align** with **DEMPE functions**, ensuring that **entities actually performing** and **controlling** value-creating activities **receive** appropriate **returns**.
- Legal vs. Economic Ownership — mere legal ownership is not enough, but contribution to DEMPE matters more (OECD BEPS Actions 8–10).
- Royalty/License Fees must reflect:
- Functions performed
- Risks assumed
- Assets used

Tax & Regulatory Aspects

Aspect	Consideration
Withholding Tax	- Royalty payments often attract WHT, and tax treaty planning is critical
BEPS/GAAR/POEM	- Ensure substance and economic activity to withstand GAAR/ BEPS/ POEM scrutiny
Form No. 3CEB	- All royalty/licensing payments between AEs must be disclosed

Jurisdiction – Specific Structuring of Royalties & IP (1/2)

NETHERLANDS

IP Holding Co with **group licensing**, benefiting from **7%** effective **tax** via **Innovation Box**. However, **substance** is required **to avoid** treaty **anti-abuse** provisions, making it **ideal** for **EU/global IP** hub.

IRELAND

IP Development Co with **cost-sharing or LRDs**, benefiting from **12.5% CIT** and **R&D tax credits**; however, must perform **R&D functions** and is subject to **EU DAC6 scrutiny**, making it **ideal** for **US MNEs locating IP** in **EU with R&D credits**.

LUXEMBOURG

IP Co licensing via **sub-license** to **Ops**, benefiting from **~5%** effective **tax** under **IP box** regime; however, must demonstrate **DEMPE** and maintain **strong documentation**, making it **ideal** for **multilayer structures** with **EMEA** coordination.

SWITZERLAND

IP Co in **low-tax Swiss canton**, benefiting from **patent box** and **R&D** super deduction; however, tax rate **~10%** requires proper setup and **faces OECD scrutiny** on rulings, making it **ideal** for **complex IP structures** with **real R&D**.

SINGAPORE

Global IP Co or **Asia IP Sub-Licensing Co**, benefiting from Pioneer/Dev incentive **(0–5%)**; however, requires **EDB approval**, **economic substance**, and **local employees**, making it **ideal** as an **Asia-Pacific IP base** with **regional licensing**.

UAE (FREE ZONE)

QFZ Entity as **IP Holder** or Regional **Sub-Licensee**, benefiting from **0% CT** if QFZ and no UAE mainland income; however, faces **DEMPE risk** and **no treaty benefit** unless full **FZ conditions** and **TRC** are **met**, making it **ideal** as a **royalty conduit** or **low-tax buffer** for **foreign-sourced royalty**.

Jurisdiction – Specific Structuring of Royalties & IP (2/2)

MALTA

Holding and **IP licensing Co**, benefiting from effective **5%** tax post-refund; however, faces **high PPT/GAR risks** and must **align** with **EU rules**, making it **ideal** when supported by **adequate employees** and **advisory functions**.

INDIA

Royalty-paying OpCos with **limited scope** for inbound **IP Co**, benefiting from **10%** WHT under **treaty and deductibility**; however, requires **strong benchmarking** and **benefit test**, with **94B/40(a)(ia) risks**, making it **suitable** for **royalty payers** but **not** as an **IP holding base**.

HUNGARY

Direct IP licensing or **R&D** hub, benefiting from **9%** CIT rate; however, **no IP box** regime but offers **low tax** and **EU base**, making it **ideal** for **straightforward setup** with **real operations**.

MAURITIUS

IP Co in **Global Business Company** (GBC) format, benefiting from **partial exemption on royalty**; however, **no** longer **enjoys treaty benefits** and **faces** high **BEPS impact**, making it **suitable** only for **legacy setups** and **risky now**.

UK

IP development or **licensing Co** with Patent Box, benefiting from **~10%** effective tax; however, requires **qualifying IP**, **R&D**, and **DEMPE presence**, making it **ideal** for **IP holding** across **UK**, **EU**, and **US markets**.

CYPUS

IP Co owning economic and **legal rights**, benefiting from **2.5%** tax under **IP regime**; however, requires **real business presence** and not a pure shell, making it **ideal** for **treaty routing** and **EU-compliant IP income**.

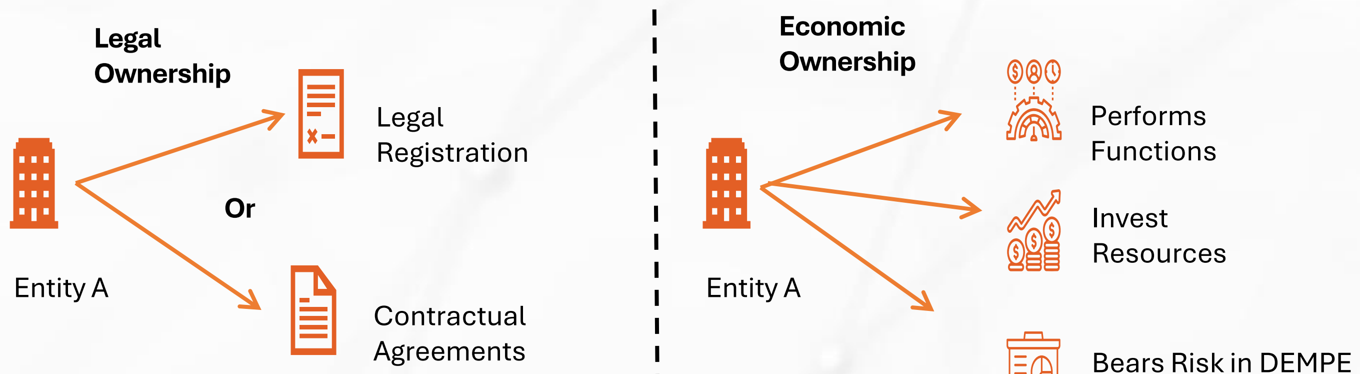
DEMPE Functions

1. **Development** – Creation of new intangibles through R&D and related activities, involving control over risks and funding.
2. **Enhancement** – Improvement of existing intangibles to increase value or functionality, with active involvement and investment.
3. **Maintenance** – Activities to preserve the legal status, functionality, and relevance of intangibles over time.
4. **Protection** – Legal and strategic actions to safeguard an intangible's ownership, exclusivity, and value. (e.g., trademark registration)
5. **Exploitation** – Commercial use of intangibles to generate income, including licensing, internal use, and market deployment.

– Chapter X of OECD Guidelines pg. no 255 para 6.32

– Para 7.3.3 of UAE TP Guide pg. no 113

Legal vs. Economic Ownership of Intangibles – DEMPE Perspective



The legal ownership of intangible assets refers to the owner of the intangible assets identified through legal registration, contractual agreements, etc.

Analysis from a TP perspective **should consider not only the legal ownership relationship** of the intangible asset **but also the extent of the contribution made in the activities of Development, Enhancement, Maintenance, Protection and Exploitation (DEMPE)** of the **intangible asset**.

Aligning Transfer Pricing Outcomes with Value Creation

Objective: OPERATIONAL PROFITS are ALLOCATED to ECONOMIC ACTIVIIES which generate them

Action Plan 8: Intangibles

- Wider and clearer definition of "intangibles"
- 6 step framework to analyze TP aspects of intangibles
- Hard-to-value intangibles (HTVIs)
- Cost Contribution Arrangements (CCAs)

Action Plan 9: Risk and Capital

- Introduction of a six-step framework to analyze risks for TP purposes
- Focus on conduct of parties, their capability and functionality manage risks
- Assumption of risk without 'control' over that risk likely to be problematic
- Separate consideration regarding an appropriate return to any investment

Action Plan 10: Other high-risk transactions

- Intra-group services / low value add services
- Profit Splits Method
- Recognition of transactions
- Commodity transactions

Definition of "Royalty" u/s 9(1)(vi), Income-tax Act, 1961

Royalty" means any consideration (including a lump sum payment), but excluding any amount taxable as capital gains, paid for:

- The transfer of all or any rights (including the grant of a licence) in respect of any **patent, invention, model, design, secret formula or process, trademark, or similar property**;
- The imparting of information concerning the **working or use** of any of the above;
- The **use of** any such intellectual property;
- The imparting of **technical, industrial, commercial, or scientific knowledge, experience, or skill**;
- The **use or right to use any industrial, commercial, or scientific equipment**, other than amounts covered under Section 44BB;
- The transfer of all or any rights (including granting of licence) in respect of **copyrights** in literary, artistic, or scientific works, including **films or tapes for television or radio broadcasting**;
- The **rendering of any services** in connection with any of the above activities.

Aligning Royalty Payments with DEMPE Functions under OECD Guidelines

DEMPE Analytical Framework

- **Identify the specific intangibles and key risks involved.**
- **Assess legal ownership and review all relevant contractual arrangements.**
- **Perform functional analysis** to determine who conducts DEMPE functions and controls risks.
- **Verify alignment** between legal agreements and actual conduct, focusing on risk control and financial capacity.
- **Delineate the true nature** of the controlled transactions, considering legal, contractual, and functional substance.
- **Determine ALP** based on contributions of FAR (unless special guidance applies).

– Chapter VI of OECD Guidelines pg. no 260 para 6.34

– Para 7.3.3 of UAE TP Guide pg. no 114

Special ALP Considerations for Royalty

1. Comparability of transactions must be carefully assessed.

2. Evaluate the expected benefits from the use of the intangible.

3. Consider geographic limitations on the use of rights.

4. Account for capital investment, start-up costs, and development efforts.

5. Review rights like sub-licensing, distribution networks, and participation in future developments.

TP Benchmarking Steps

1. Determination of years to be covered

2. Broad-based analysis of the taxpayer's circumstances

3. Understanding the controlled transactions based on functional, assets & risks analysis, in order to choose the tested party

4. Review of existing internal comparables, if any

5. Identify reliable external sources of royalty rate information, as needed, ensuring their comparability and reliability.

6. Selection of the most appropriate transfer pricing method and determination of the relevant financial/Profit level indicator

7. Identification of potential comparables using TP databases: Based on the relevant factors identified in Step:3

8. Determination of and making comparability adjustments where appropriate.

9. Interpretation and use of data collected, determination of the arm's length rate.

Key Factors for Benchmarking Royalty Payments

1. Identification of databases used to conduct the royalty benchmarking search.

2. Selection of the appropriate method for benchmarking the royalty payment.

3. Application of the 'Benefit Test' to assess the arm's length nature of the royalty.

Overview of Royalty Databases

- RoyaltyStat and RoyaltyRange are databases used to benchmark royalty rates for transfer pricing purposes.
- They support the evaluation of intercompany intangible licensing in line with OECD guidelines.

Provider	Database	Content	Region/Transaction specific
RoyaltyStat	License Agreement Database	Intangibles License Agreements (Sourced from US SEC)	Royalty/Intangible Agreements
Royaltysource	RoyaltySource		
Royaltyrange	Royaltyrange		

RoyaltyStat An Exactera company RoyaltySource® [Royalty Range]

Selection of Most Appropriate Method

- The selection of the most appropriate method for intangible-related transactions depends on functional and comparability analysis.
- The following are the most commonly used methods for benchmarking royalty payment :

1 **CUP Method**
When third-party comparables exist, adjustments can be made for differences in contractual terms, exclusivity, or geographic factors.

2 **PSM**
When both parties contribute uniquely and significantly to the value creation of intangibles involved in integral operations, their remuneration should reflect their respective roles.

3 **TNMM**
Where transactions are primarily based on multiple business scenarios involving intangibles, aggregation at the entity level is appropriate for determining the ALP.

Comparable Uncontrolled Price Method

01 — **Reliable** Comparable Uncontrolled **transactions** can be **identified**

02 — **Access** the **comparability** of intangibles in controlled transactions with those in potential comparable uncontrolled transactions

03 — Make comparability **adjustments**, where required

04 — Apply this **adjusted price** to **determine** the **arm's length price** for the controlled transaction involving the intangible

05 — Use the **price paid** by the **MNE group** to an **independent** enterprise

– Chapter X of OECD Guidelines pg. no 291 para 6.146 – 6.147

Profit Split Method

Profit Split Method is further classified into **Residual Profit split and Combined analysis Method**. The steps for computation of arm's length range is provided accordingly:

Residual Profit Split method

- **Initial** (routine) **profits** allocated to contributions that can be reliably benchmarked using **one-sided methods**.
- **Residual profits** allocated based on the relative value of **unique** and **valuable contributions**.
- Ideal when **one** party's **contributions** are **benchmarkable** and the **other's are not**.
- **Combination** of benchmark data for routine functions and internal data.
- It's a **two-step approach** that distinguishes routine from non-routine returns.

Refer OECD Guidelines – section C.3.1.2, para 2.152-2.153.

Contribution Analysis Method

- The entire combined profit or loss from the controlled transactions is **allocated directly** between the **associated** enterprises based on the **relative value** of **contributions** made by each party.
- Suitable when it's possible to **reasonably assess** and **compare** the **relative value** of the contributions made by each party.
- Can be based on **internal data** and **supported** by **external comparables**, if available.
- **No distinction** is made between **routine** and **non-routine contributions**. It's a **single-stage allocation.**

Refer OECD TP Guidelines - Section C.3.1.1, para 2.150–2.151.

Key Filters for Royalty benchmarking

- **Eight key comparability factors** are **essential** for **determining arm's length royalty rates.**
- These **factors** ensure consistent **evaluation** of **licensing arrangements** in **line** with **OECD guidelines**, supporting reliable royalty benchmarking.

Expected future benefits

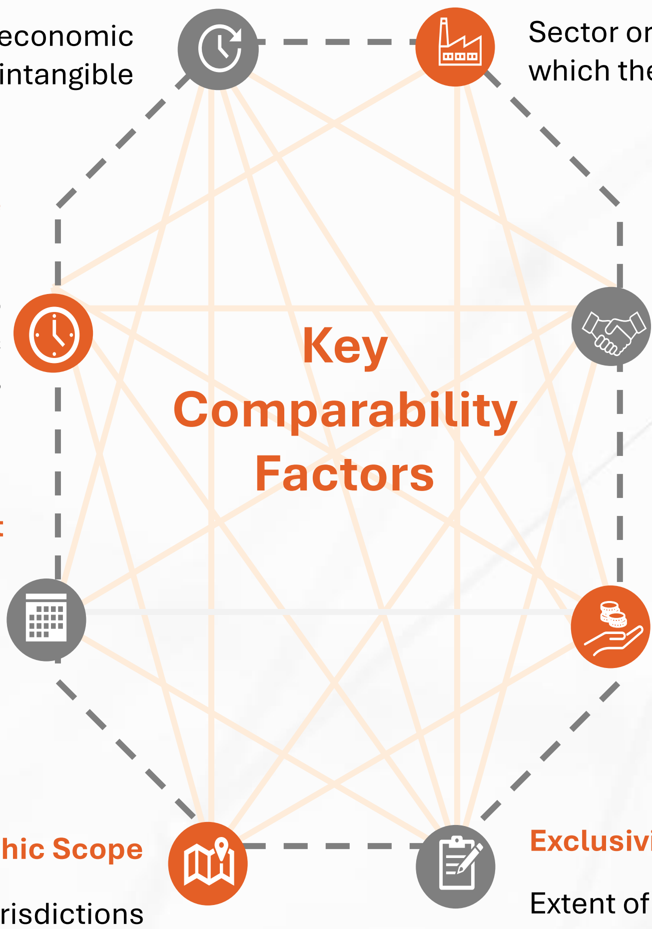
Anticipated returns or economic value derived from use of intangible

Industry

Sector or line of business in which the intangible is used

Useful life of intangible

Duration for which the intangible is expected to generate economic benefits



Type of agreement

Nature of the licensing agreement (e.g., trademark, patent, know-how, franchise)

Stage of Development

Early-stage intangibles attract lower royalties due to higher risk.

Royalty Base

Basis on which royalty is calculated (e.g., net sales, units sold, operating profit)

Geographic Scope

Territory or jurisdictions covered by the license

Exclusivity

Extent of rights transferred (e.g., exclusive, non-exclusive, sublicensable)

– Chapter VI of OECD Guidelines pg. no 282 to 285

Benchmarking Royalty transaction Based on Agreement Types

Type of arrangement	Description	Common TP method	Key factors
Trademark/ Brand royalty	**Licensing** of brandname, logo, or trademark to group companies	CUP/TNMM	Brand recognition, market exclusivity, geography, marketing support
Technical Know-how	**Licensing** of manufacturing processes	CUP, TNMM, or PSM	Patented technology, lifecycle, exclusivity
Software/IP license	**Use** of **proprietary software** by subsidiaries	CUP if third-party license exists or TNMM	Enterprise Vs Backend tech, exclusivity
Franchise fees	**Full Business model transfer**	CUP or PSM	Sector, degree of support, location
Patent/IP royalty for R & D Entities	**Licensing** of patented technology	PSM or CUP	Patent lifecycle, industry, DEMPE alignment

Benefit Test

1. **Evaluate** which **group entities perform** and **control DEMPE** functions, who **funds R&D** and assumes associated **risks**, and assess the **nature** and **scope** of rights transferred (e.g., geographic limitations, duration, and usage rights).
2. **Identify** the relevant **intangibles**, their **contribution** to **value creation**, and how they interact with other assets and operations within the DEMPE framework.
3. The taxpayer must provide **clear, tangible** and **quantifiable evidence** of **economic** and **commercial benefits** derived from the use of the intangible.
4. It should be demonstrated that the **IP** was **unique**, **not available** from **low-cost alternatives**, and that the **taxpayer lacked** the **capability** to **develop** it internally.
5. The **Benefit Test** requires showing **measurable benefits** from the **use of the intangible**; merely having an agreement is not sufficient.

Benefit Test documentation Checklist

Item	Specific Requirement
Transaction Delineation	- Functional analysis report - Internal memos and emails evidencing actual conduct
DEMPE functional chart	- Detailed DEMPE functional matrix (who performs/controls each function) - R&D funding agreements, cost-sharing arrangements - Risk assumption evidence (contracts, board approvals)
Intangible Identification	- IP register, patent filings, trademarks - Technical descriptions, R&D project reports - Evidence of uniqueness (market studies, expert reports)
Benefits & Value Contribution	- Financial analyses showing revenue/cost savings - Internal reports linking intangible use to performance
Legal & Contractual Documentation	- License/cost-sharing/service agreements - Supporting Invoices - Board resolutions and meeting minutes approving IP use
Benchmarking & Arm's Length Analysis	- Benchmarking study - Comparability analysis with third-parties - Arm's-length range calculation and method selection

Key Litigation Challenges in Royalty Payments

01 Inadequate alignment of royalty payments with DEMPE functions

02 Royalty rates not aligned with the arm's length principle (ALP)

03 Hard-to-Value Intangibles (HTVI) leading to ex-post adjustments

04 Cash-Box Entities – Payments to such entities may be recharacterized as dividends or capital transfers

05 Mismatch between legal ownership and economic value creation.

Key Litigation Challenges in Royalty Payments

06 Country-by-Country (CbC) disclosures exposing royalty misalignments

07 Benefit Test: Authorities often dispute whether the assessee derived any benefit from the royalty.

08 Commercial Rationale: Need to demonstrate a clear business rationale for royalty payments.

09 Nature of Intangible – Classification (routine vs. unique) and licensing scope affect TP assessment.

10 Burden of Proof – Assessee must prove IP use, ownership, and absence of royalty duplication in prices.

Global Best Practices and Risk Mitigation

01	Misaligned DEMPE	Document **DEMPE functions** with **clear substance**; align royalty recipients with functions.
02	Arbitrary royalty rates	Use **third-party CUP** data or robust **TNMM benchmarking**; avoid static internal rates.
03	HTVI exposure	Include **contingency clauses** or **profit-split adjustments** in **intercompany IP agreements**.
04	Cash-box structures	Avoid **assigning IP** to **low-substance entities**; use **DEMPE-based economic ownership**.
05	Legal vs. economic ownership	**Functional analysis** must **supersede legal** title in **TP allocations**.
06	CbCR impact	Align **royalty income** with **FTEs**, **assets**, and **functions** disclosed in **CbC reports**.
07	Benefit Test	Document **tangible benefits** (e.g., sales growth, market access) **to justify royalty**.
08	Commercial Rationale	Clearly link **royalty payments** to **business strategy** and **economic value**.
09	Nature of Intangible	Accurately **classify intangibles** and **define licensing scope** with **supporting analysis**.
10	Burden of Proof	Maintain **strong evidence of IP use**, **ownership**, and **independent pricing**.

Jurisdiction Specific Summary: Royalty TP Issues

INDIA

- **Disallowance** of royalty where no actual benefit is demonstrated.
- TPOs challenge royalty on grounds of **low value addition**.
- Payment of royalty to AE requires Form **3CEB disclosure**.
- RBI caps still **affect outward royalty** for technical know-how/brand **licensing**

Section 92(1), Rule 10B/10C of Income Tax Act, 1961

UAE

- New Corporate Tax Law (2023) mandates **arm's length royalty pricing.**
- TP **compliance** is **mandatory** for all related party royalty payments.
- Qualified Free Zone Entities (**QFZEs**) must comply with **9% CT** on royalty income unless exempt.
- Royalty received by **low-substance entities** may trigger **POEM/PE risks**.

Federal decree law no. 47 of 2022, BEPS Action 5 & 13 aligned

UNITED STATES

- IRS challenges **"cost-sharing"** royalty structures aggressively.
- Ex-post **periodic adjustments** often applied.
- Royalties under **scrutiny** if allocated to low-substance IP entities.
- **APAs encouraged** but **underutilized** for **intangible transactions**.

IRC section 482, Treas. Reg. 1.482-7

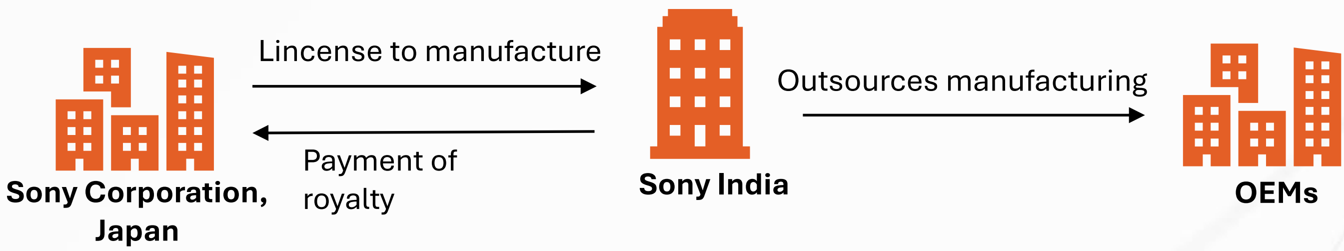
OECD Guidelines

- Demands **DEMPE alignment** for royalty entitlement.
- **Rejection** of **"cash-box"** IP owners.
- **Royalty rates** must **reflect value creation**, not merely legal ownership.
- **CbCR** used to **detect misalignment of royalty income** with functions.

OECD TP Guidelines – Paras 6.32-6.59, BEPS action 8-10,13

Judicial Precedents on Royalty Payments

PCIT Vs Sony India Pvt. Ltd. – ITA no. 551/2023



Issue

Whether **royalty paid** by Sony India to its AE (Sony Corporation, Japan) on products manufactured through third-party OEMs was **justified.**

Assessee’s Stand

- Assessee had a **valid license agreement** with Sony Corporation, Japan **for use** of licensed patents, know-how, and trademarks.
- License **permitted subcontracting** manufacturing to OEMs.
- OEMs **not paying** royalty **separately**

HC ruling

- TPO’s jurisdiction is limited to **ALP determination, not business rationale.**
- Royalty payable under valid **IP license agreements** is deductible, even if manufacturing is **outsourced.**
- In line with OECD, assessee is a **licensed manufacturer,** not contract manufacturer
- ALP **cannot be NIL** solely because goods are made by **subcontractors; royalty justified.**
- TPO **exceeded scope** by questioning **commercial expediency.**

TPO Stand

- **Royalty** was **paid** by the **assessee** despite **outsourcing manufacturing to** Original Equipment Manufacturers **(OEMs).**
- **ALP** of **royalty** should be determined at **NIL.**
- Relied on its **own interpretation** that **no** royalty is warranted when licensee is **not directly manufacturing** goods.

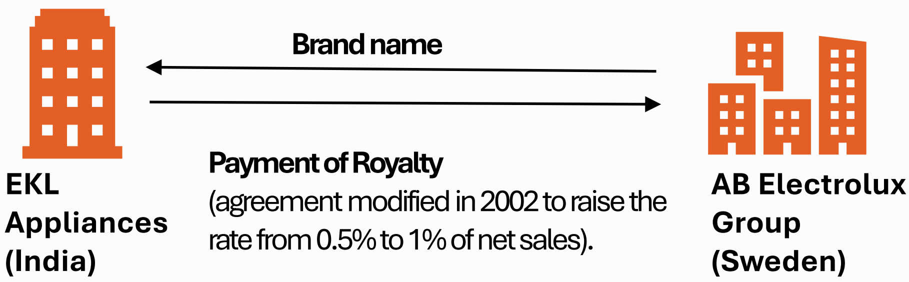
Tribunal’s findings

- TPO cannot question **commercial expediency**
- Royalty **linked** to **IP use** and **brand, not physical manufacturing**
- OEMs were subcontractors and that the **license belonged** to **assessee.**
- Adjustment deleted.

Final outcome

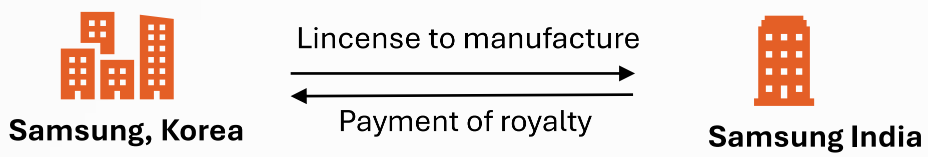
- **No** substantial **question of law arises.**
- The TPO’s approach to benchmark royalty at NIL was **beyond its jurisdiction.**
- The ITAT’s order granting full relief to Sony India **stood confirmed.**

CIT v. EKL Appliances Ltd.- High Court (I.T.A. Nos.1068/Del/2011)



Aspect	Summary
Issue	TPO disallowed royalty paid by EKL to its AE, stating that **no actual benefit** was derived due to **perpetual business losses**.
TPO's Stand	Royalty payment was **not justified**, as losses continued despite brand use. Applied **"benefit test"**, set ALP of royalty at **nil**.
Assessee's Argument	Royalty was for **legitimate business purpose**; losses were due to high fixed costs, not brand ineffectiveness. Also provided external CUP (unrelated party paid similar royalty to AE).
CIT(A) & ITAT	Rejected TPO's view. Held that the **TPO cannot question commercial expediency**. Accepted that royalty helped improve turnover.
Delhi HC Ruling	• Held that the **"benefit test" is not a legal requirement** under Indian transfer pricing law. The Court emphasized that the **TPO cannot disregard a legitimate royalty transaction** merely because the assessee incurred continuous losses or failed to show quantifiable benefits from the payment. • Citing the **OECD Transfer Pricing Guidelines** as a valid interpretative tool, the Court clarified that **profitability is not a precondition** for the allowability of royalty payments, and **commercial rationale cannot be second-guessed by the tax authorities**. • Accordingly, the disallowance of royalty based on the absence of direct benefit or continued losses was held to be unjustified.
Final Outcome	**Royalty allowed in full**. Disallowance struck down. TPO's reasoning held **beyond jurisdiction**.

PCIT Vs Samsung India Electronics Pvt. Ltd. – ITA no. 40/2018



➢ Issue

- Whether TP adjustment relating to royalty payment made by Samsung India to its Korean parent company was justified?

➢ Revenue's argument

- Assessee acted as a **contract manufacturer** for Samsung Korea.
- Royalty payments effectively made **"to itself"** (same group), hence **ALP** should be **NIL**.

➢ Assessee's stand

- Operated as a **licensed manufacturing** company, **not** as a **contract manufacturer**
- **OECD guidelines** (1995 & 2022) on contract manufacturing **not attracted**.
- Royalty paid for **essential** technology and know-how **without** which manufacturing was **impossible**.

➢ ITAT's findings

- TPO cannot question **commercial expediency**
- Samsung India operated as a **full-fledged licensed** manufacturer using parent's technology and know-how, not as a contract manufacturer.
- **Adjustment deleted**.

➢ HC rulings

- **No material on record** to classify Samsung India as a contract manufacturer.
- **Manufacturing** and **sales** decisions were **independent** and not dictated by Samsung Korea.
- **Royalty justified** as Samsung Korea provided **essential IP**
- **Entitled** to arm's length return.
- TPO **exceeded scope** by questioning **commercial expediency**.

➢ Final Outcome

- Revenue's appeal **dismissed**.
- ITAT's **deletion of TP adjustment upheld**.
- TPO's approach to set ALP at **NIL** was **beyond jurisdiction**

How can SBC help?

01 **Royalty Flow & Structuring –** Managing cross-border royalty arrangements, mapping IP flow chains, and addressing transfer pricing and withholding tax challenges.

02 **Global IP Migration –** Structuring IP ownership migration, handling buy-in/exit charges and performing DEMPE analysis under OECD TP Guidelines.

03 **Royalty Benchmarking & Compliance –** Determining arm's length royalty rates, aligning Local/Master File documentation, and supporting BEPS reporting requirements.

04 **Withholding Tax Optimization & Benefit Test –** Minimizing WHT leakage through treaty planning, ensuring economic substance, and preparing exhaustive benefit test packs.

05 **Audit Defense & Litigation Support –** Defending royalty structures under TP litigation, supporting audit defense, and enabling successful dispute resolution.

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