



disallowance made of royalty paid by the assessee to C.A. Management Inc. USA for distribution of software products in India without appreciating that the royalty had been paid on the amount of bad debts even where the software had not worked at all ?”

3. The respondent had entered into a Software Distribution Agreement with CA Management Inc. (hereinafter referred to as “CAMI”) whereunder the respondent was appointed as a distributor of the products of CAMI in India. Under the agreement, the respondent is liable to pay an annual royalty on all amounts invoiced at a rate of 30%.

4. The assessee filed its return of income for the A.Y. 2002-2003 declaring a loss of about Rs.14,55,99,340/-. The Assessing Officer (AO) referred the matter to the Transfer Pricing Officer (TPO) under section 92A(1) of the Act for determining the Arm's Length Price (ALP) in respect of the royalty paid by the respondent to CAMI. The respondent claimed the ALP at the contractual value of about Rs.7.43 crores. The AO computed the ALP of the royalty at about Rs.5.85 crores resulting in a reduction of loss of about Rs.1.50 crores.

5. The respondent's appeal was rejected by the CIT (A).

6. It is pertinent to note that the TPO by the order under section 92CA(3) observed that the respondent's contention regarding

the rate of royalty being justified was not relevant, as there was no dispute regarding the same but that the issue was whether the royalty should be allowed to be written off to the extent of the unpaid invoices during the year itself. This, we presume, refers to the bad debts in respect of some of the invoices raised by the respondent on its customers. The CIT (A) made a similar observation in the order dated 27.7.2006, dismissing the respondent's appeal. The CIT (A) held that the respondent's contentions that it had paid royalty at a lower rate than in the comparable transactions was irrelevant "because the rate of royalty is not in dispute".

It is therefore, clear that the ALP was not disputed by the department and the CIT (A) did not question the correctness of the same either. The only basis of the order of the AO and the CIT (A) was that the respondent had paid the royalty to its principal CAII even on the bad debts and in cases where the customers had raised complaints regarding the quality of the products. It was held that such cases ought to be dealt with on the basis that no sales had occurred and that therefore, there was no question of payment of any royalty to that extent, as the payments were not received by the respondent and were written off in its books of account.

7. The ITAT by the impugned order, rightly came to the conclusion that merely because the respondent had paid the royalty

even in respect of the products sold by it to the clients, who had not paid for the same, it would make no difference to the determination of the Arm's Length Price of the transaction.

8. Section 92C of the Act reads as under :-

**“92C. Computation of arm's length price.** - (1) The arm's length price in relation to an international transaction shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe, namely :-

- (a) comparable uncontrolled price method ;
- (b) resale price method ;
- (c) cost plus method ;
- (d) profit split method ;
- (e) transactional net margin method ;
- (f) such other method as may be prescribed by the Board.

(2) The most appropriate method referred to in sub-section (1) shall be applied, for determination of arm's length price, in the manner as may be prescribed: “

9. Section 92C provides the basis for determining the ALP in relation to international transactions. It does not either expressly or impliedly consider failure of the respondent's customers to pay for the products sold to them by the respondent to be a relevant factor in

determining the ALP. Indeed in the absence of any statutory provision or the transactions being colourable bad debts on account of purchasers refusing to pay for the goods purchased by them from the assessee can never be a relevant factor while determining the ALP of the transaction between the assessee and its principal. Once it is accepted that the ALP of the royalty is justified, there can be no reduction in the value thereof on account of the assessee's customers failing to pay the assessee for the product purchased by them from the assessee. Absent a contract to the contrary, the vendor or licensor is not concerned with whether its purchaser / licensee recovers its price from its clients to which it has in turn sold / licensed such products. The two are distinct, unconnected transactions. The purchaser's / licensee's obligation to pay the consideration under its transaction with its vendor / licensor is not dependent upon its recovering the price of the products from its clients.

10. In the present case the transactions between the respondent and CAMI are unrelated to the transactions between the respondent and its clients i.e. purchasers of the products from the respondent. CAMI was not concerned with the respondent's inability to recover the consideration from its clients. It is not suggested that the transactions in this case either between the respondent and

CAMI or the respondent and its clients are colourable.

11. The question is therefore, answered in the affirmative in favour of the respondent – assessee.

12. The appeal is accordingly dismissed.

**(M.S. SANKLECHA, J.)**

**(S.J. VAZIFDAR, J.)**