

FDI, TECHNOLOGY TRANSFER AND PAYMENTS FOR KNOW-HOW: A Case Study of Automobile Sector

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FDI, TECHNOLOGY TRANSFER AND PAYMENTS FOR KNOW-HOW: A Case Study of Automobile Sector Firms

*Swati Verma & K.V.K. Ranganathan**

[Abstract: Technology transfer is largely considered as the most important contribution of FDI by the Indian policy makers. However, the process of acquiring technology through FDI route involves severe ambiguities mainly related to the complex forms and mode of technology transfer and its pricing. The paper explores this issue by evaluating the intra-firm cross-border royalty and technical fees payments of select listed and unlisted foreign invested automobile firms of India over recent years (mainly 2010-11 and 2011-12) and identifies a range of concerns. Apart from the identification of technology payments from company disclosures being very difficult owing to the various direct and indirect forms of transactions, the susceptibility of such transactions to transfer mispricing is high. The appraisal of such intangible assets using the arms-length criterion of comparability involves various complexities and practical challenges. Where perpetual technology linked outflows of substantial values have happened over years especially after the recent deregulation, the grounds on which such payments are justified by the foreign firms are quite dubious. The pricing and rationale of these payments have been disputed as being inappropriate by revenue authorities in several instances. Also, very few firms engaged in any local R&D and perpetual technological dependence was suggested in many cases. A number of unlisted firms reported losses in two study years with negligible dividend distribution. While far more transparency is required in the disclosure of intra-firm technology payments by firms, the paper primarily argues for a critical evaluation of the gains to the economy through these transactions and cautious discernment in using FDI as a source of technology.]

JEL Classification: O33, F21, F23, L62

Keywords: Technology Transfer, Foreign Direct Investment, Royalty Payment, Technical Fees, Transfer Pricing, Automobile Sector

Context of the Study

Foreign direct investment (FDI) is considered to be the primary investment medium for longer term, technology transfer where the close relationship between FDI and intangible

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technology flows¹ is argued to foster technology change in the host economy². Hence, 'technology transfer' largely considered as the most important contribution of FDI into any developing economy has remained one of the main planks of the Indian government while promoting foreign investment. Since the liberalisation era was initiated, the Indian government has introduced several policy alterations and FDI related reforms in a number of major sectors of the economy with a view to simplify the investment process to attract more foreign investments and to encourage transfer of technology through FDI in the long term.

The 'Foreign Technology Agreement Policy' in 2009 aimed at facilitating the inflow of FDI and technology transfers into the country³ by removing all previous ceilings on technology related payments has been a major recent step in this direction. Earlier, in 1991, automatic permission was given for foreign technology agreements in high priority industries (Annex III) up to a lump sum payment of Rs. 1 crore, 5 per cent royalty for domestic sales and 8 per cent for exports, subject to total payments of 8 per cent of sales over a 10 year period from date of agreement or 7 years from commencement of production (Press Note No. 10, 14th August, 1991). Payment of royalty up to 2 per cent for exports and 1 per cent for domestic sales was allowed under automatic route on use of trademarks and brand names of the foreign collaborator without technology transfer in 2000 (PN No. 9, 8th September, 2000). In the same press note, payment of royalty up to 8 per cent on exports and 5 per cent on domestic sales by wholly owned subsidiaries to offshore parent companies was allowed under the automatic route without any restriction on the duration of royalty payments (SIA, dipp.nic.in). Prior to April 2010, such remittances made by Indian resident companies to foreign collaborators were capped at a lump sum of \$2 million. All such caps were removed retrospectively from December 2009, after a decision by the Ministry of Commerce and Industry in April 2010. The permission to pay lump sum fee and royalty for technology transfer or use of brand names and trademarks via the automatic route effectively meant no specific approval by the government was required now (PN No. 8, 16th December, 2009).

¹ UNCTAD (1998) notes that "...there is a close relationship between FDI and intangible technology flows as well as (a) strong proprietary asset base of FDI". See WIR, UNCTAD (1998). Also See *"Methodological and technological issues in technology transfer"*, A Special Report of the IPCC (2000).

² "... Although TNCs are not the only source of technology, they are very important in high technology activities and in providing an entire package of knowledge, and their R&D activities are expanding to the developing world. ... bulk of technology dissemination is still undertaken through internalized channels within the networks of TNCs...". UNCTAD (2010).

Also see "...TNCs are among the main sources of new technology for developing countries. Internalized technology transfer takes the form of direct investment and is, by definition, the preserve of TNCs...." UNCTAD (2001).

³ *Press Note No. 8, (2009 series)*, Department of Industrial Policy & Promotion, Department of Industrial Policy & Promotion, Government of India, 16.12.2009.

Where a perpetual stream of sizeable payments have been made by the local companies (foreign subsidiaries/joint ventures/technological collaborators) to foreign multinationals for more than two decades, a further deregulation of such payments in 2009 highlights the expectation of the policy makers that dismantling all constraints on the limits on these payments will encourage better sourcing and transfer of technology.⁴ A freer royalty regime has led to a notable hike in such payments by several of these companies over the following period.⁵ The royalty payments rose from 13 per cent of FDI in 2009-10 to 18 per cent in 2012-13, overall payments rose by 57.43 per cent.⁶ The amounts of transfers have been markedly high in many cases, and the adverse impact on the current account of the BOP is likely to grow if such trends persist.

Some of these recent developments have brought the 'technology transfer via FDI' issue to the forefront. A host of issues have been raised in policy discussions, academia as well as news reports of late regarding the rationale for such continued loss of resources in the name of technology gains in a resource-constrained economy like India. Particularly high and perpetual payments to foreign collaborators as royalty for technology and branding have been observed for the Indian subsidiaries and joint-venture companies over years and have come to represent a prominent means of earnings for the associated foreign multinational corporations (MNCs).

Royalty payments by subsidiaries are accepted as a standard practice globally for access to technology, processes and brands owned or developed by the MNC parent.⁷ In this arrangement, where the subsidiaries benefit from such received knowhow, the parent company receives a return for the initial risk and investment in R&D undertaken by it.⁸ Payment for acquisition of technology usually takes the form of a lump-sum licensing fee paid by the "licensee" initially and may extend for a number of years as royalty on sales (local/exports) for the right to on-going use of that asset (patent, know-how, trademark,

⁴ See "Technology, brand transfer royalty put on automatic route", ET Bureau, *The Economic Times*, December 18, 2009

⁵ "Royalty payments has increased from \$1.7 billion in 2008-09 to \$4.1 billion in 2012-13", 'Finance ministry rejects DIPP's proposal to put curbs on royalty payment', *The Economic Times*, January 29, 2015

⁶ A recent survey by Institutional Investor Advisory Services (IIAS), a proxy advisory firm, found the royalty outgo of 32 Indian subsidiaries of MNCs to their global parent to be Rs. 6,300 crore in 2014-15, representing 21 per cent of these companies' profits. Their aggregate royalty and related payments increased at a CAGR of 20 per cent compared to 7 per cent growth in their pre-royalty, pre-tax profits over past five years. ("Proxy advisory questions payment of royalties by local subsidiaries of MNCs", *Business Line*, 18 February, 2016).

⁷ See "Royalty bigger than dividends for MNCs", Krishna Kant, *Business Standard*, 17 January 2014.

⁸ "...To the MNE, transferring technology by the direct investment route is frequently the preferred means of capturing the full economic rent of the technology and unique ownership advantages...." See 'The consequences of the international transfer of technology by MNEs : A home country perspective' (Chapter 15), J. H. Dunning in Chen (UNLTC, 1994).

brand-name, license, copy right, franchise or any other alike business or commercial rights). Royalty arrangements may exist in technological alliances and partnerships (like joint ventures). The rates of royalty payments have often been disputed and have frequently come under the tax scanner (locally and globally) in several instances.⁹

In reality, understanding the nature of such payments, identifying their rationale or subsequent benefit to any host economy or even evaluating their factual value is no easy task practically as it is mired in a number of ambiguities largely owing to the fundamentally ambiguous nature of such an intangible asset as technical knowhow. Yet, the apparent value involved in such processes is not that trivial to be ignored easily.¹⁰

Since most of these payments are of 'intra-group' nature, the possibilities of transfer mispricing (manipulations in the pricing of intra-firm transactions) remain high. On the other hand, the assessment of such payments involving intangible assets is quite difficult as there are serious complexities in the use of arms-length criterion followed under the OECD guidelines and various practical challenges in its application.¹¹ Establishing a fair price is a foremost challenge in identifying the extent of overpricing of technology. Various items may be supplied under the broad head of 'intangible asset' or 'intangible property' which complicate the matter.¹² Incidentally, there has been an increasing presence of composite contracts and 'package deals' involving an MNE group globally where a composite contract may contain a number of elements including royalties, leases, sale and licenses all packaged into one deal thereby adding further intricacies to the overall phenomenon. Often, royalty payments for technical service and technical assistance are integrated as

⁹ "The Licensing Economics Review (The Royalty Rate Journal of Intellectual Property, December 2002) reported in 2002 that in a review of 458 license agreements, over a 16-year period, it found an average royalty rate of 7 per cent. ... the range extended from 0 per cent to 50 per cent. All of these agreements may not have been at "arm's length" (En.wikipedia.org/wiki/Royalties).

¹⁰ "...The engineering major ABB, indeed a lot many others, too have been charging hefty royalties not only from their Indian affiliates, but worldwide ... Technology patented or otherwise cannot be the alibi for squeezing the Indian companies by foreign collaborators in perpetuity", S. Murlidharan, 'Why allow royalty payouts in perpetuity', January 23, 2013, *Business Line*.

¹¹ It is increasingly difficult to apply the arm's length principle due to increasing integration of companies and markets due to globalization which increases the difficulty in finding comparable independent transactions, higher levels of specialization in products and services, insufficient trade in comparable goods and services, patented product or process traded not provided by anyone else, difficulty in pricing of intangibles which represent significant part of cross-border intra-group trade and associated enterprises being not independent of each other in reality. {See Terra & Wattél (1993), (pp-596) for further discussion}

¹² The UNCTAD publication on 'Transfer Pricing' lists the following intangibles: ... patents, inventions, formulas, processes, designs or patterns; -copyrights, literary musical or artistic compositions; - trademarks, trade names or brand names; franchises, licences or contracts; -methods, programmes, systems, procedures, campaigns, surveys, studies, forecasts, estimates, customer lists or technical data; and other intellectual property not listed above. (UNCTAD, 1999; also see Satapathy, 2001).

elements of technology transfer process where these may not represent intellectual property themselves.^{13,14}

Various conceptual and practical difficulties in apt assessment of technology transfer exist, yet the government's policy outlook doesn't seem to be adequately engaging into addressing or even acknowledging such underlying ambiguities and its implications. The contracts, nonetheless, are assumed to imply actual technology transfer over the agreement period by a non-questioning policy environment, even though the process happens to be much complicated and intractable. The possibilities of a continued drain of resources of extractive nature through such processes under the guise of intellectual property transfers are easily overlooked. The implications could be more serious than what meets the eye given the various cases identified frequently by tax authorities across the globe where large financial transfers have happened within branches of MNE groups for profit shifting and tax evasion purposes.

Far from acknowledging such vulnerabilities of losses to the exchequer, the policy stance appears to be facilitating resource transfers via this route in a largely liberal way especially in recent years. A DIPP proposal seeking re-introduction of restrictions on royalty payments for preventing excessive outflow of foreign exchange has been turned down by the Finance Ministry recently.¹⁵ Also, the tax levies are only of a perfunctory nature and do not address the revenue aspects in any appropriate way. In the 2013-14 Budget, the government increased the rate of tax on payments by way of royalty and fees for technical services to non-residents from 10 per cent to 25 per cent.¹⁶ But this did not have much effect as India has DTAA with many countries where rates are lower, and the DTAA prevails over the domestic law when there is a conflict.¹⁷ The unfounded emphasis of the Indian government on the substantial capital flows through FDI with very little questioning of actual gains from technology transfer and the drive towards a matured tax jurisdiction following a non-adversarial approach (recent CBDT policy reform)¹⁸ only worsens the situation. The overall policy approach only highlights the structurally weak

¹³ Ref: En.wikipedia.org/wiki/Royalties.

¹⁴ As an example , Toyota Kirloskar Auto Parts Pvt. Ltd. was required to pay the royalty under the Technical Assistance Agreement to Toyota Motor Corporation/Aisin Takaoka Company (IT(TP)A No. 1462/Bang/2012 M/s. Toyota Kirloskar Auto Parts Pvt. Ltd.; www.indiakanoon.org)

¹⁵ 'Finance ministry rejects DIPP's proposal to put curbs on royalty payment', *The Economic Times*, January 29, 2015.

¹⁶ Budget Speech, 2013-14, 28 February, 2013

¹⁷ "DIPP meets today to plan curbs on rising royalty outflows at MNC arms", Arun S, *Financial Express*, May 20, 2014

¹⁸ "In what could be major relief to MNCs' in India, the government has decided to considerably reduce the incidences of transfer pricing audits with regard to their cross border transactions. The CBDT has directed its field officers to refrain from manual selection of transactions for scrutiny based on the threshold value, and instead restrict audit to cases only where the revenue risk to the government is huge ..." "Govt. Allays MNCs' tax worries", *Financial Express*, 27th October, 2015.

position of developing world in aptly addressing any resource drain which could be happening in the garb of these processes.¹⁹

From the perspective of a host developing economy like India, it is pertinent to ask after experiencing more than two decades of liberalisation whether such perpetual and apparently high payments made on account of technology transfer via FDI linkage can be taken at its face value. At least, some basic reasonable questions need to be raised with or without the fear of losing the interest of potential future FDI. Incidentally, a similar concern has been expressed by the National Manufacturing Competitiveness Council of India which has raised following points in its report:

...these technologies (acquired through FDI, purchases and M&As) are not the state of the art technologies but are at least one or two generations behind what is available elsewhere in the world. ...Purchase of technology is increasingly becoming costly and in view of liberal FDI policies, companies from abroad are reluctant to part with technology even for purchasing.

...there has been little or no emphasis on whether technology transfer is taking place or whether the kind of technologies that are brought in were appropriate or not...

(Report of the Prime Minister's Group: Measures for Ensuring Sustained Growth of the Indian Manufacturing Sector, September 2008)

Largely, in this backdrop, the actual benefits that have accrued to the economy on the technology front via such technology related payments virtually remain vague. The present study aims to engage in some very basic questions regarding the ambiguities surrounding the technology transfer via FDI route in India. The complex forms of technology procurement, shadowy nature of technological collaboration contracts, formal or informal control exercised in such transfer modes by the MNC owner, limited mechanism existing to evaluate spill-over of technical knowhow or question contractual limitations in such corporate arrangements and possibility of perpetual technology dependence on the supplier are obvious issues of concern. The implications of the above state of affairs are discussed and highlighted in this study, with a special focus on the various difficulties faced in evaluating the pricing of technology which is of crucial significance, given the tendency to attain highest return on technology being an essential part of the technology suppliers' operations.

¹⁹ The weak technological base of developing countries and popularity of foreign brand names etc. may lead to terms settled for technology imports being excessive and onerous owing to monopolistic power of technology suppliers and poor bargaining capacity of developing economy buyers. For further discussion, see "Technology Transfer : Critical Issues", K. K. Subrahmanian & P. Mohanan Pillai [Chapter 11 (pp. 316-317) in Singer et al (1988)].

The study focuses on the automobile sector of India which had the highest 'royalty payment to sales ratio' among the various manufacturing sectors in recent years *i.e.* 2008-09 to 2011-12.²⁰ This sector also happens to be one of the prominent industries in manufacturing sector that have received FDI in recent years and accounted for 13.48 per cent of total FDI inflows into manufacturing sector over 2000-2012 (SIA, DIPP, 2013).

The study analyzes the royalty and technical fees payments in foreign exchange of select listed and unlisted set of foreign invested companies operating in this sector. Some of the major automobile manufacturing companies and component manufacturing companies which had 100 per cent foreign equity or were joint venture companies were selected. Since many companies in this sector remain unlisted, the required database was built from the balance sheets of these companies downloaded from the MCA website which provides data for unlisted companies (available in the XBRL format). The study period covered is 2010-11 and 2011-12 for the 92 unlisted companies and a smaller set of listed foreign companies was analysed for the 1994-95 to 2014-15 period where the time series was available in the Prowess database of the CMIE. Several legal disputes involving technology payments by sample companies have been procured from legal databases like www.itatonline.in and www.indiakanoon.org. to explore the issue from a contemporary legal perspective.

Issues in Identification and Data Challenges

While evaluating these technology related payments of foreign affiliates is quite crucial, it is very difficult to identify such payments distinctly. The only available source of information is the related party transaction disclosures of the Indian companies in the 'notes to accounts' section of their annual reports which is mandatory in accordance with the Indian Accounting Standard, AS 18 for accounting periods on or after 1.4.2004. However, these disclosures in the annual reports are frequently inadequate and are not uniform across the companies or across years for the same company. Also, many companies do not report such disclosures in different years. The issue of identification is far more challenging for the unlisted companies which frequently evade the public scrutiny of their operations and also the technology used by them. This study has tried to identify the technical payments made by the sample companies from the related party transaction details reported in the respective company annual reports. Where the 'royalty payments' have been identified directly from the foreign exchange transaction disclosures, the various technology-related payments including technical or license fees have been identified separately from the related party transaction disclosures and have been clubbed under the broad head 'technical payments' in this study. Both these payment categories represent foreign transactions (mentioned or otherwise). The findings from the sample are discussed in following sections.

²⁰ See RBI Study on "Finances of Foreign Direct Investment Companies, 2011-12", *RBI Monthly Bulletin*, January, 2014.

Technical Payment Pattern of Foreign Companies: Findings from Sample

Table 1 shows that the aggregate technical payments of the sample were higher for all the three sales categories in 2011-12 as compared to 2010-11 where the rise has been much higher for the 24 companies in the above 500 Cr. sales range. The rise in the aggregate technical payments for the entire sample of 92 unlisted companies highlight the importance of such payments. The subsidiary companies, which represent majority of the sample, have shown rise in technical payments on aggregate, where the rise remained marginally higher than the joint venture companies. The expenses on research and development remained much higher for a smaller set of joint-venture companies and rose also, while 83 subsidiaries had spent very little on this front overall, when sales value is considered. Clearly, R&D is not a preferred activity for these foreign affiliated companies. Also, the foreign exchange expenses on dividend distribution has been very meagre for companies in each category (sales or ownership wise) when compared to technical payments, and has in fact, become negligible in the last year for 83 subsidiary companies on an aggregate basis.

Table 1: Description of Data for Unlisted Sample Firms (Rs. Cr.)

Sales Range (Cr.)	No. of Cos.	Sales		R&D		Royalty+ Tech. Related Payments		Dividend	
		2010-11	2011-12	2010-11	2011-12	2010-11	2011-12	2010-11	2011-12
Less than 100 Cr.	37	1238.5	2178.0	5.4	4.9	16.1	16.3	0.0	0.0
100 - < 500 Cr.	31	6190.8	8064.3	3.5	7.3	98.2	107.2	8.8	0.0
Above 500 Cr.	24	50890.9	59037.7	118.9	322.3	770.8	779.1	4.0	3.7
Foreign Ownership Type									
Joint Venture	9	11880.3	13469.0	89.3	248.5	132.2	81.1	0.4	3.7
Subsidiaries	83	46440.0	55810.9	38.5	86.0	752.9	821.6	12.4	0.0
Grand Total	92	58320.3	69279.9	127.8	334.5	885.1	902.6	12.9	3.7

Source: Generated from Company Annual Reports downloaded from Ministry of Company Affairs Website.

The importance of technical payments is further highlighted for various unlisted companies in Table 2. Many subsidiaries incorporated ten years or before have been making significant technology payments. Also, technical payments have been the only route of such payments and involve significant amounts for certain fully-owned subsidiaries. The high values of transfers on this account can be seen for certain listed companies in Table 3, where both 'royalty' and 'technical payments' are considered together.²¹ For certain large companies, the cumulative values transferred over last 21 years (1994-2015) on this account are substantial. Noticeably, majority of such transfers for various companies have happened over the recent 2010-15 period, since the removal of policy caps on royalty

²¹ The Prowess database does not identify technical fee and clubs it with the royalty payments in foreign exchange.

payments. This clearly indicates the response of certain big companies to the liberal policy directives and hint that the value of transfers involved could be sizable if other foreign affiliated companies are accounted as well. However, the state of data availability makes any further examination difficult especially for unlisted companies.

Table 2: Illustrative List of Unlisted Companies Making Large Technology Payments

Company	Inc	Foreign Equity (%)	2010-11 (Rs. Cr.)			2011-12 (Rs. Cr.)		
			Royalty	Tech. Related Payment	Royalty+Tech Related Payments	Royalty	Tech. Related Payment	Royalty+ Tech Related Payments
Suzuki Powertrain (India) Ltd	2002	Amalgamated	249.0	30.9	279.9	217.3	46.6	263.9
General Motors (India) Pvt Ltd	1994	100	107.9		107.9	92.2		92.2
India Yamaha Motor Pvt Ltd	2007	100	33.4	30.3	63.6	45.2	36.2	81.4
Bombardier Transportation (India) Pvt Ltd	1995	100		37.4	37.4		63.7	63.7
Mobis India Ltd	2005	100	47.5	2.4	49.8	57.1	1.2	58.3
Fiat (India) Automobiles Ltd	1997	50	95.3	3.4	98.8	34.2	3.4	37.6
Denso (India) Ltd	1984	73.46	19.9	0.7	20.6	25.7	0.4	26.1
Renault Nissan Automotive (India) Pvt Ltd	2007	100		13.1	13.1	16.3	7.5	23.7
Continental Automotive Components (India) Pvt Ltd	2007	100		16.8	16.8		22.7	22.7
Gestamp Automotive (India) Pvt Ltd	2008	100		22.8	22.8		21.5	21.5
Bosch Automotive Electronics (India) Pvt Ltd	2008	100		10.1	10.1		18.5	18.5
Musashi Auto Parts (India) Pvt Ltd	2002	100	9.5	5.8	15.2	11.4	5.3	16.7
Shriram Pistons & Rings	1963	40.97	12.8		12.8	15.4		15.4
Carraro (India) Pvt Ltd	1997	100	8.2		8.2	14.6		14.6
VE Comml. Vehicles Ltd	2008	50		7.3	7.3		13.4	13.4
Lumax Industries Ltd.	1981	37.50	12.3		12.3	13.2		13.2
Skoda Auto (India) Pvt Ltd	1999	100	14.1		14.1	12.5		12.5
Mando (India) Ltd	1997	67	6.8	0.3	7.1	10.1	1.8	11.9

Source: Same as Table 1

Table 3: Illustrative List of Royalty/Tech. Fees Payments by Listed Firms: 1994-2015 (in Million \$)

<i>Company</i>	<i>1994</i>	<i>2004</i>	<i>2015</i>	<i>Sum 1994- 2015 (A)</i>	<i>Sum 2010- 2015 (B)</i>	<i>B as per cent of A</i>
Maruti Suzuki India Ltd.	4.1	18.7	489.7	3069.2	2483.5	80.92
Motherson Sumi Systems Ltd.	0.0	0.6	4.4	29.4	21.2	72.18
Federal-Mogul Goetze (India) Ltd.	0.0	0.2	3.3	22.5	15.8	69.87
Lumax Industries Ltd.	0.0	0.3	2.7	21.9	15.2	69.49
Bosch Ltd.	1.8	3.4	30.5	208.9	138.1	66.11
Hero Honda Motors Ltd.*	0.4	19.6	20.3	991.1	641.9	64.77
Denso India Ltd.**	0.0	1.1		53.5	34.0	63.59
Wheels India Ltd.	0.0	0.1	0.5	3.2	2.0	62.84
Munjal Showa Ltd.	0.3	2.0	6.8	70.0	43.1	61.48
Sona Koyo Steering Systems Ltd.	0.2	0.2	0.8	11.7	6.8	58.16
Jay Ushin Ltd.	0.0	0.3	0.0	6.9	3.4	48.72
India Nippon Electricals Ltd.	0.1	0.0	0.2	1.8	0.7	40.44
Bharat Seats Ltd.	0.0	0.1	0.2	3.1	1.2	38.53
Ashok Leyland Ltd.	0.9	1.1	0.2	75.2	16.2	21.49
Swaraj Mazda Ltd.	0.3	0.6	0.1	5.9	0.3	4.72

* Data aggregated up to 2011, till the foreign promoter exited

** Data available and aggregated up to 2014

Source: Generated from CMIE Prowess.

Variety in Forms of Technology Payments

The identification of technical payments from the related party transactions reported in company disclosures is difficult due to presence of various direct as well as indirect forms in which such payments are made. The Indian Accounting Standard, AS 18, does not mandate any specific format for reporting related party transactions. Only those transactions that pass the materiality test (10% or more of total transactions of same nature) need to be disclosed individually, the rest being aggregated. This complicates the matter, since the payments of a technology variety are not always reported clearly as royalty or license fee, and are reported in various associated or vague forms like technical guidance or support fees, technical consultancy fee, assistance charges, technical services, technology use fees, technician fees, design and engineering charges, testing or trial charges, foreign service engineer fees, transfers under license agreements from enterprise, payments for intangible assets, module purchases, design cost, sample testing charge, testing and calibration expenses etc. These payments may take place apart from the specific royalty/technical fees payments and may be aggregated with other miscellaneous charges while reporting (e.g. under 'other expenses'), even though sizeable amounts may be transferred

through such routes.²² Also, a given company may pay for technology through various routes in a given financial year. Further, various items may be supplied under the broad head of 'intangible asset' or 'intangible property', as discussed earlier.²³ Hence, an accurate assessment of the actual technology transfer is largely marred by these complications and data inadequacies pertaining to the identification of the 'technology transfer payment' itself.

Table 4 highlights a number of instances for the sample companies where different forms of technology related payments have been made by them and which occur with and may exceed the specific royalty payments itself. Again, payments are also made for various vague services by these companies, where the items are not disclosed individually, and may represent payments of a technical nature. Some of these payments (identified as other expenses) may be of high value as well and may represent other routes for resource transfer (see Table 4). Multiple forms of payments may also be resorted to avoid the R & D cess (@5%) levied on payments by companies for import of technology in terms of any foreign collaboration agreement in India.²⁴

Table 4: Illustrative List of Different Type of Technical Payments

Company	Incorporation	Foreign Equity (%)	Year	Royalty	Tech. Related Payments (Rs. Cr.)	Type of Technical Payments
Ford (India) Pvt Ltd	2000	100	2011-12		196.4	* Services received related party transactions (2010-11--Rs. 30.36 Cr.)

²² A study of extent of related party dealings of India's 500 largest listed companies conducted by Business Line found 158 companies reporting high value dealings (annual transactions over Rs. 1,000 crore) with related parties in 2012-13. The study highlighted unusual deals where sizable amounts were transferred under murky heads like data sourcing fees, conference and travelling expenses, subcontracting work to relatives of key managers, aircraft charter payments, and machinery/helicopter hire charges. Royalty payments to promoter entities were dubiously high, particularly for multinationals. ("All in the Family", Bhavana Acharya, 7th April, 2014, *Business Line, The Hindu*)

²³ See Footnote 12; For eg. Toyota Kirloskar Auto Parts Pvt. Ltd. paid royalty under Technical Assistance Agreement for use of certain: "...Intangible property (which) consists of the following : Local content List; Production Drawings; CAD data; Engineering change instructions; Toyota Engineering Standards; Sample Parts; Quality Standards; Inspection Standards; (completed products, raw material and work-in-progress); Contents of Part List; KD Components art List; Disassembled form Drawings; Welding & Painting Manual; and Jig arrangement instructions, gauge arrangement manual, cutting tool layout drawing, operation drawing and accuracy and precision list." (IT(TP)A No. 1462/Bang/2012 M/s. Toyota Kirloskar Auto Parts Pvt. Ltd.)

²⁴ Relevant extracts from sections/clauses of *R&D Cess Act, 1986* (as amended in 1995) and *R&D Cess Rules 1996*: 1. Rate of CESS – Under Section (3) of the said Act, a CESS @ 5 per cent is levied on all payments made towards the import of technology approved by Central Government. (See taxandregulatoryaffairs.wordpress.com)

<i>Company</i>	<i>Incorporation</i>	<i>Foreign Equity (%)</i>	<i>Year</i>	<i>Royalty</i>	<i>Tech. Related Payments (Rs. Cr.)</i>	<i>Type of Technical Payments</i>
Bombardier Transportation (India) Pvt Ltd	1995	100	2011-12		63.7	Design & Service charges
India Yamaha Motor Pvt Ltd	2007	100	2011-12	45.2	36.5	Technical guidance fees - 21.77 Cr.; Technical Knowhow - 14.45 Cr.; and Design and development charges - 0.28 cr.
India Yamaha Motor Pvt Ltd	2007	100	2010-11	33.4	31.5	Technical guidance fees - 10.95 Cr. and Technical Knowhow - 19.30 Cr.; and Design and development charges - 1.24 cr.
Gestamp Automotive (India) Pvt Ltd	2008	100	2010-11		22.8	Technical support service charges
Renault Nissan Automotive (India) Pvt Ltd	2007	100	2011-12	16.3	22.8	* Legal & professional charges - Rs. 15.34 cr.
Continental Automotive Components (India) Pvt Ltd	2007	100	2011-12		22.7	Expenditure in foreign currency towards Research & Development
Gestamp Automotive (India) Pvt Ltd	2008	100	2011-12		21.5	Technical support service charges
Mercedes Benz India Ltd	1994	100	2011-12	24.0	21.4	* Services received related party transaction (not explained)
Bosch Automotive Electronics (India) Pvt Ltd	2008	100	2011-12		18.5	* Consulting, support services etc
Denso (India) Ltd	1984	73.46		25.7	17.6	* Professional & consultancy fees - 17.19 cr
Continental Automotive Components (India) Pvt Ltd	2007	100	2010-11		16.8	Expenditure in foreign currency towards Research & Development
Carraro (India) Pvt Ltd	1997	100	2011-12	14.6	12.3	* Professional fees - 12.32 Cr.
Bosch Automotive Electronics (India) Pvt Ltd	2008	100	2010-11		10.1	* Consulting, support services etc
Renault Nissan Automotive (India) Pvt Ltd	2007	100	2011-12	16.3	7.5	Technical assistance fee
Unipres India Pvt Ltd	2008	100	2010-11	0.4	7.0	Technical Fee - 5.91 Cr.

<i>Company</i>	<i>Incorporation</i>	<i>Foreign Equity (%)</i>	<i>Year</i>	<i>Royalty</i>	<i>Tech. Related Payments (Rs. Cr.)</i>	<i>Type of Technical Payments</i>
Magna Closures Automotive Pvt Ltd	2009	100	2011-12	1.2	4.3	Design and Engineering charges
Mikuni India Pvt Ltd	2008	100	2012-13	2.3	4.3	License fee for use of know-how - 1.76 cr., Fees for technical services - 1.25 cr.; supervision fees - 1.25 cr.
Fiat (India) Automobiles Ltd	1997	50	2011-12	34.2	3.4	Expenditure in foreign currency towards Research & Development
Fiat (India) Automobiles Ltd	1997	50	2010-11	95.3	3.4	Expenditure in foreign currency towards Research & Development
Mikuni India Pvt Ltd	2008	100	2011-12	1.0	3.0	Fees for Technical Services and License Fees for Use of Know How
Magna Closures Automotive Pvt Ltd	2009	100	2012-13	1.0	2.6	Design & Engg Charges - 2.21 cr. Testing charges - 0.40 cr.
Nemak Aluminium Castings India Pvt Ltd	2010	100	2011-12		2.6	Sample Testing and support service
Mikuni India Pvt Ltd	2008	100	2010-11		2.1	Fees for Technical Services
Mobis (India) Ltd	2005	100	2012-13	77.9	1.1	Other payments-Module purchase-88.59 cr, royalty license fee-71.77 cr to Hyundai Motor (I) Ltd(enterprise having significant influence)
Mando India Ltd	1997	67	2011-12		0.5	Technical fees and Foreign service engineer fees
Mando India Ltd	1997	67	2010-11		0.3	Technical fees and Foreign service engineer fees
NTN NEI Manufacturing (India) Pvt Ltd	2005	96.14	2012-13	4.6	0.3	Testing and calibration & design and drawing charges

* Unclear -- can represent indirect technical service charges

Source: Same as Table 1.

Under given conditions, the accurate assessment of these payments is a difficult task for the revenue authorities. The revenue authorities in India follow the arms-length (dealings at market price) comparability criteria comprising different direct and indirect comparison methods as per the OECD guidelines for evaluating transfer pricing of all related party foreign transactions (tangible and intangible). The technology related payments involve transfer of intangibles (intellectual property) mainly between group entities where each intangible property is unique and not comparable. Hence, the comparable transactions between independent enterprises for similar intangible may be just non-existent or

establishing comparability may be difficult due to absence of all relevant information in public domain.²⁵ Hence, even while royalty payments have been alleged to be an easy route of transferring profits from a high tax country to any tax-haven²⁶, the intangible nature of 'technology know-how' as an asset makes it very difficult to detect such mispricing using the arm's length principle (See *Box 1*).

Box 1: Issues in Evaluating Intangible Assets Transfer

"Where the asset transferred is an intangible, i.e. it cannot be easily defined, formulated or grossed, it is different from others and therefore finding exactly similar asset and thereby establishing arm's length price or royalty rate is extremely difficult. Where a MNE group also licenses or transfers the same or a similar intangible to independent enterprises, establishing arm's length price or royalty rates may not pose many difficulties because CUP method could be applied ... where comparable uncontrolled transactions are not available, establishing arm's length price or royalty rate may not be a straight forward exercise and may require a flexible approach that need not be strictly based on specified transfer pricing methods ... the perfect approach for indirectly bench marking royalty payments is to bench mark the profit margin left in the tested party, after payment of lump sum fee or royalty with the profit margins of comparable uncontrolled companies...TNMM is the most appropriate method for determining the ALP."

Observations of tribunal court in case: *IT(TP)A No. 1462/Bang/2012 M/s Toyota Kirloskar Auto Parts Pvt. Ltd.* (www.indiakanoon.org)

The challenges burgeon when the transactions are clubbed together or are closely linked.²⁷ Usually, in such cases, a broad comparability method TNMM (transactional net margin method) using profit margins is applied due to lack of appropriate comparable controlled transaction. However, this indirect method has its own grave limitations and remains a highly disputed one. In India, several cases of transfer mispricing in royalty payments and

²⁵ In this context, a tribunal court identifies the associated challenges as : "...comparability in the transactions of intangibles depend on variety of factors such as -a. Use of intangible in connection with similar product or process within the same general industry or market; b. Similarity in the profit potentials of the intangible; c. Terms of the transfer; d. Stage of development or commercialization of intangibles; e. Rights to receive updates; f. Cross licensing of improvements in intangibles; g. Uniqueness of concerned intangible ; h. Duration of license; i. Arrangements for sharing of economic and product liability risks; j. Existence of other relationship between parties to the transaction ; k. Type and nature of functions to be performed by parties; l. Licensed territory or geography. "{ IT(TP)A No. 1462/Bang/2012 M/s.Toyota Kirloskar Auto Parts Pvt. Ltd.}

²⁶ "...It is a common practice for multinationals to house their headquarters in low-tax countries and transfer profits there to avoid tax liability. Indeed, royalty payments is a time-tested method of transferring profits..." Raghuvir Srinivasan, "Tax terrorism versus tax haven", *Business Line, The Hindu*, April 12, 2015.

²⁷ "...As per the Indian Income-Tax Act, ideally, the transfer pricing is to be made on a transaction by transaction basis. However, Rule 10A(d) provides that the term 'transaction' includes a number of closely linked transactions. Thus, in (those) cases ...recourse is often had to evaluate transactions following an 'aggregation' principle." {Observations of tribunal court in case: IT(TP)A No. 1462/Bang/2012 M/s. Toyota Kirloskar Auto Parts Pvt. Ltd.}

other intra-firm international transactions have been identified by the revenue authorities and hefty tax adjustments have been imposed recently (*Table 5*). Many such orders face cross-litigations due to disputes in the choice of comparables and the comparability method applied (usually TNMM).

Table 5: Illustrative List of Transfer Pricing Adjustments Levied on Companies by the Revenue Authorities

SN	Company	Year of Assessment	Case number (Tribunal court case no./ city/ year of judgment) @	Foreign Transaction items assessed	Amount of transfer pricing adjustment ordered (in Rs.) by TPO*
1	Hero Honda Motors Ltd.	2006-07	ITA-5130/DEL/2010	Export commission, model fees, royalty payments, purchase of raw materials, spares and components	57,24,42,096
2	Lumax Industries Ltd.	2007-08	ITA No.5252/DEL/2011	Royalty payments, warranty provision , others	3,92,71,137
		2004-05	ITA No.4715/DEL/2010	Royalty , purchases	2,51,88,406
		2008-09	ITA No.4456/DEL/2012	Royalty	5,32,07,016
3	Maruti Suzuki India Ltd.	2005-06	I.T.A. No. 5237/DEL/2011	Royalty for brand name; Advertising, marketing, promotion expenses	248,37,80,296
4	Motherson Sumi Systems Ltd.	2006-07	ITA No. 5061/DEL/2010	Royalty payments	8,79,913
			ITA No. 5062/DEL/2010.		73,96,638
5	Munjal Showa Ltd.	2006-07	ITA NOS. 4675/DEL/ 2010 and ITA No. 4242 /DEL/2011	Import of parts and components, Royalty payments	4,89,58,700
		2002-03	ITA No.4674/DEL/2005	Royalty + technical fees + design and drawing fees	1,55,40,371
6	F A G Bearings India Ltd.	2003-04	I.T.A. No. 745/MUM/2007	Royalty payment (<i>levied on Fag Kugelfischer GmbH, other party</i>)	6,93,000
7	Hindustan Unilever Ltd.	2006-07	ITA no. 7868/MUM./2010	Purchases and sales; royalty	368,79,26,000
8	Merck Ltd.	2004-05	ITA No. 2393/MUM/2009	Purchase of raw materials; technical knowhow fees	2,82,40,086
9	Panasonic Energy India Co. Ltd.	2003-04	ITA NO.45 (AHD)/2009	Royalty payment	3,72,73,513

@ : MUM : Mumbai; DEL: Delhi; AHD : Ahmadabad; *TPO : Transfer Pricing Officer ;

Data source: www.indiakanoon.org, www.itatonline.in

Essentially, the high and rising number of tax disputes globally especially related to the transfer pricing of intangibles (eg. royalty, advertising and marketing fees payments etc.) show that their valuation is an area of growing concern for the tax authorities in India as well as worldwide.^{28, 29} The recent change in policy by CBDT to reduce the incidences of transfer pricing audits by restricting to cases only involving high revenue risk will only lead to far lesser scrutiny (in terms of cases covered or values involved) of such dubious transfers by the revenue authorities and may surely encourage such outflows in future.³⁰

Technology Payments in Perpetuity: Justification & Disputes

An issue which has received much attention in academic and media discussions recently is that of continued payments of substantial values in perpetuity to the foreign parent by many Indian subsidiaries like Maruti Suzuki Ltd., Lumax Industries Ltd., Hindustan Unilever Ltd., Hero Motocorp Ltd etc. over years. The ground for these streams of payments spanning several years remains unclear, and several ambiguities exist in the way the contract terms are designed, revised or practically executed which largely protect such continued channels of transfers over years. Besides, why the Indian partner has not been able to absorb the technology over the period is an obvious issue of concern.

The perpetual payment of royalty or technical fees is ensured by the companies by accounting these payments as a 'revenue expenditure' item instead of a one-time 'capital expenditure' in their balance sheets. This distinction is important since 'capital expenditure' is included in the cost of fixed asset and it increases the earning capacity of a fixed asset. Such payment is generally of a one-off kind where the benefit is derived over several accounting periods. On the other hand, 'revenue expenditure' includes costs that are aimed at 'maintaining' rather than enhancing the earning capacity of the assets. These are costs incurred on a regular basis and its benefit (non-enduring) is obtained over a limited period. For determining whether any expenditure qualifies as revenue or capital expenditure, some broad tests have been laid down by the Delhi High Court. Some of the broad tests outlined are:

²⁸ Valuation of intangible transactions under transfer pricing is a key concern noted by the OECD BEPS Project. " ...As the Action Plan on Base Erosion and Profit Shifting" (BEPS Action Plan, OECD, 2013) has identified that the existing international standards for transfer pricing rules can be misapplied ...The work under Action Plan 8 looked at transfer pricing issues relating to transactions of intangibles (one of the key areas), since misallocation of profits generated by valuable intangibles has contributed to base erosion and profit shifting." OECD/G20 BEPS project (2015).

²⁹ "...On 4 June 2015, the OECD released a discussion draft (*BEPS Action 8: Hard-to-value Intangibles*) in connection with Action 8 on transfer pricing for intangibles... The document states that when determining the price of a transaction involving intangibles, specific features of such intangibles may complicate the search for 'comparables' and in some cases may make it difficult to determine the value of an intangible at the time the transaction takes place..." *EYGlobal Tax Alert* (2015).

³⁰ "Govt. Allays MNCs' tax worries", *Financial Express*, 27th October, 2015.

... (i) the expenditure incurred towards initial outlay of business would be in the nature of capital expenditure, however, if the expenditure is incurred while the business is on-going, it would have to be ascertained if the expenditure is made for acquiring or bringing into existence an asset or an advantage of an enduring benefit for the business, and if that be so, it will be in the nature of capital expenditure, on the other hand, is for running the business or working it, with a view to produce profits, it would be in the nature of revenue expenditure ... v) expenditure incurred for grant of license which accords "access" not technical knowledge, as against "absolute" transfer of technical knowledge and information would ordinarily be treated as revenue expenditure..."³¹

Most of the companies defend their perpetual payments on similar grounds. By accounting their royalty payments under 'revenue expenditure' head, the companies ensure a continual flow of resources to the foreign parent or collaborator over years. The treatment of royalty payments as 'revenue expenditure' has been disputed by the revenue authorities in a number of ITAT cases recently where the royalty payments have been disallowed and have been treated as capital expenditure. Opposing the substantial transfer pricing tax adjustments, companies have counter-argued in several instances that these payments (royalty/technical fees/ other associated payments) have not caused any enduring benefit to the company and are mainly paid for 'technology use' rather than 'technology acquisition' for a particular patent or knowhow to the foreign licensor. Some companies have argued that the technology transferred is obsolete³². Some of these tax disputes are highlighted in Table 6.

Table 6: Disputes on Royalty Payments: Some Cases

SNo	Name of company	Case No./ Year	Assessment Year	Amount involved	Objections raised by TPO or AO
1	Denso India Ltd.	ITA NO. 767/2014/DEL. + ITA 796/ 2014/DEL	2002-03 & 2003-04	Rs. 63.46 lakhs	Treatment of expenditure on royalty as a capital expenditure by AO
2	H-One India Pvt. Ltd.	ITA No. 4031/2009/DELHI	2005-06	Rs. 1.29 crore	Treatment of expenditure on royalty as a capital expenditure by assessing officer - Assessee submitted that it had not acquired any enduring advantage - technical knowhow supplied by H-One Co. Ltd., Japan remained sole and exclusive property of that company during the operation of agreement

³¹ Mentioned in the case of Motherson Sumi Systems Ltd. (2005-06) , www.indiakanoon.org

³² Oracle India ltd. had received master copies of software from its foreign collaborator and has argued that it did not carry any intellectual property. (Oracle India Private Limited vs Commissioner Of Income Tax on 25 November, 2013; ITA NOS. 25/2012, 287/2008, 417/2009, 447/2009, 461/2009, 683/2009, www.indiakanoon.org)

<i>SNo</i>	<i>Name of company</i>	<i>Case No./ Year</i>	<i>Assessment Year</i>	<i>Amount involved</i>	<i>Objections raised by TPO or AO</i>
3	Motherson Sumi Systems Ltd.	ITA No. 3728/2009/ DELHI	2005-06	Rs. 84.84 lakhs	<p><i>Expenditure on royalty to the extent of 5% disallowed by treating it as of capital nature by AO</i></p> <p>- AO opined that assessee will have certain benefits of enduring nature out of the payment of running royalty</p> <p>- Assessee not left with any asset or residuary right on termination of agreement</p>
4	Cabot India Ltd.	ITA No. 6622/MUMBAI/2009, C.O> no. 170/MUMBAI/2010, C.O.no..857/MUMBAI/2010	2005-06	Rs. 1.37 crore	<p><i>Raise in rate of royalty unjustified</i></p> <p>- In view of AO “ the assessee has failed to establish that it has received a technological benefit, over and above, the agreement entered with the AE (1990 and 1998) so as to call for a higher rate of royalty now</p> <p>- The only reason for raising royalty rate (made from a reading of the supplementary agreement) is the liberalization regime of the economy rather than any hitherto unextended service to be rendered by the AE to the assessee</p>
5	Lumax Industries Ltd.	ITA no. 4715/Delhi/2010 + ITA no. 6086/Delhi/2010	2004-05 & 2005-06	Rs. 2.51 crore	<p><i>Royalty was treated as unjustified by TPO:</i></p> <p>- No actual receipt of technology by the assessee company from Stanley; royalty agreement was a mere paper document</p> <p>- Stanley had provided full time expatriate employees/qualified engineers to the assessee, no need for it to receive any further technology (also, assessee had made purchases of moulds and designs to the tune of 1 crore)</p> <p>- the claim of the assessee that engineers, etc., visited Japan for getting trained in the technology was incorrect</p> <p>- TPO had raised objection as to why the royalty is being paid each year for the last 20 years</p>
6	Maruti Suzuki India	WP (C) 8990/2011 & CM APPL.20252/2011	2005-06	Rs. 99.3 crore	<p><i>-Royalty payment not found to be at arms-length by the TPO</i></p>

SNo	Name of company	Case No./ Year	Assessment Year	Amount involved	Objections raised by TPO or AO
	Ltd.				-The payment was disallowed as revenue expense, was treated as capital expense item
7	Cabot India Ltd.	ITA No. 8495/MUMBAI/2010,	2006-07	Rs. 1.99 crore	<i>The DR (dispute resolution) contended that expenditure on royalty was a capital expenditure, clear case of technology transfer by the US company</i> - Counsel for the assessee argued that the technology supplied was for the improvement of the same line of business in which the company was engaged for more than 40 years; no advantage of enduring nature was acquired; expenditure on royalty incurred merely to improve its efficiency and profitability
8	Honda Siel Power Products Ltd.	ITA no. 5713/Delhi/2011	2007-08	Rs. 4.83 cr. + Rs. 1.53 cr.	<i>Treatment of expenditure on royalty as a capital expenditure by AO</i>
9	Toyota Kirloskar Auto Parts Ltd.	IT(TP)A No. 1642/Bangalore/2012	2008-09	Rs. 27.23 crore	<i>Arms length pricing being nil , Royalty payment disallowed by TPO:</i> - assessee did not get any tangible commercial benefit in terms of improved profitability even after paying for technology know-how - payments are only to siphon off the profits from India with minimum incidence of tax -the reasonableness of the royalty paid by the assessee is not proved, hence, the ALP of the royalty payment was 'Nil'
10	Keihin Panalfa Ltd.	ITA 3287/Delhi/2011 & 5546/Delhi/2012	2004-05 & 2005-06	Rs. 1.29 crore	<i>Treatment of royalty payment as a capital expenditure by TPO:</i> - TPO held that no royalty was required to be paid as assessee was a contract manufacturer selling its products to another associated enterprise - assessee has argued that the appellant has to be categorized as a routine licensor
11	Eicher Motors Ltd.	ITA no. 533/Indore/1995	1990-91	Rs. 52.23 lakhs	<i>Treatment of royalty payment as a capital expenditure by AO:</i> -royalty was a capital expenditure

SNo	Name of company	Case No./ Year	Assessment Year	Amount involved	Objections raised by TPO or AO
12	Fag Bearings (I) Ltd	ITA no. 793 & 817/Ahmedabad/2006	2002-03	Rs. 44.21 lakhs	<p>eligible for amortisation as per the provisions of Section 35A of the Act since the payment of royalty was for acquisition of patents & copyrights</p> <p><i>Treatment of royalty payment as a capital expenditure by AO.</i></p> <p>-In AO's view, nature of payments show assessee has acquired an asset or advantage of enduring nature</p> <p>- TPO noted that no technology transfer subsequent to renewal of royalty payment agreement; no justification for increase in royalty provided by assessee</p>

Data source: www.indiakanoon.org, www.itatonline.in.

On similar lines, the companies have typically argued in various cases that the said know-how in question had never been purchased by the Indian company and has never become its asset. Apparently, in most cases, the technology remains the sole property of the licensor and the transfer happens under negligible rights of ownership for the licensee where the know-how was to be used by the Indian party for limited specific purposes as prescribed in the agreement. For example, in the dispute involving Honda Siel Cars India Ltd. in 2008-09, {royalty payment order of Rs. 190.88 crore), the assessment officer (AO) had earlier contended that royalty expenditure was of capital nature. However, the Ld. CIT(A) held that it was allowable as revenue expenditure:

"...the assessee obtained only the right to use, during the currency of the agreement, the technical knowhow and information and the intellectual property right relating to the manufacture of Honda cars and did not secure any ownership right over them." ...{I.T.A. No. 5073/Del/2012, Honda Siel Cars India Ltd., 2008-09, indiakanoon.org}

The reason often stated by companies for such continual receipt of technology knowhow is the necessity to keep pace with modern technology advancement or access to updated technologies under liberalisation regime.^{33,34} Many companies explicitly state that they are

³³ "The Automobile industry is one of the fastest growing industries in India, with its rapidly changing technology...The technology provided by foreign companies is slowly absorbed by the Indian Partner, however, to keep pace with their constant advancement it usually needs constant up-gradation. The R&D for upgradation of technology is done by the foreign partner" (Case of Lumax Industries Ltd. Vs Income tax; ITAT No. 4715/Del/2010 and ITA No. 6086/ Del/2010).

not involved in any R&D and are dependent on the foreign collaborator for technology knowhow or assistance and are incapable of surviving or manufacturing without this input (See Box 2). This is indicative of an apparent form of ‘incomplete’ technology transfer.

The possible gain received by the local company in this restrictive set-up remains questionable, especially where no enduring benefit is supposedly received. Interestingly, the requirement for qualifying an outlay as revenue expenditure is that it should be ‘*for running the business or working it, with a view to produce profits*’. The requirement to produce profit is not stringent where even a ‘*view to produce profits*’ stands as a sufficient condition for making such payments. Not surprisingly, using these ambiguities to their advantage, perpetual technology fees have been paid by a number of local affiliated companies to MNE parents or collaborators and the cumulative amounts may add up to substantial values over years.

Often, the local party states that it is a ‘licensed manufacturer’ which manufactures only with the help of foreign collaborator which undertakes all R&D. Technical payment is made to the parent or associated enterprise (AE) and the product is also sold to the same or another AE of that MNC network in various instances. This may qualify the local company as a ‘contract manufacturer’ for the foreign AE since the sales and the payments for technology happen within the same MNE umbrella group³⁵. However, any apt appraisal of transfers within a given global MNE group is largely limited by the separate country-by-country accounting method followed currently as per OECD approach to transfer pricing.³⁶

Significantly, some form of informal control being exercised in technology transfer arrangements by licensor is also evident in several instances. The contracts usually provide a ‘non-transferable, non-exclusive’ right to the local company as a ‘licensed manufacturer’, mostly involve clauses towards confidentiality, and often carry several unfair or murky terms.³⁷ The terms of the agreement often do not allow the licensee any asset or residuary right on the termination of agreement. (See Box 3) The contracts remain heavily tilted in favour of the licensor regarding the renewal of fee, termination of contract or have other

³⁴ See Table 6, Case of Cabot India Ltd. (ITA No. 6622/MUMBAI/2009, C.O. no.170/MUMBAI/2010, C.O.no.857/MUMBAI/2010, 2005-06)

³⁵ The technical payments in some similar cases have been objected by the revenue authorities on the ground that this qualifies the local company as a ‘contract manufacturer’ for the foreign AE (eg., Samsung (I) Electronic Pvt., Ltd--ITA No. 5316/DEL-2011, 2007-08). However, the companies often counter-argue that the two foreign parties are not linked (separate production entities, geographical locations, jurisdiction and market environments).

³⁶ Even though the formulary apportionment method for valuating transfer pricing assesses the operations of a global MNE network in totality, its practical application is not very easy due to various complications.

³⁷ “...TPO came to hold that ‘Suzuki’ trademark of Suzuki Motor Corporation (SMC) was piggybacked on Maruti, the trademark of the assessee... the assessee ought to have been compensated by SMC for use of its trademark ‘Maruti’... as against the AE charging royalty of Rs. 127.195 crore from the assessee”. (Maruti Suzuki India Ltd., ITA no. 5120/Del/2010 & ITA no. 2441/Del/2012, 2006-07).

Box 2: Dependence on Technology from Foreign Collaborator

Toyota Kirloskar Auto Parts

The learned counsel for the assessee submitted that

- the assessee had entered into a commercial agreement with its AE for supply of technical knowhow, technical assistance, training of personnel etc
- the assessee neither undertook any significant research and development activity of its own nor can it procure the technology in the open market due to non-availability of the same in domestic market and is thus totally **dependent** on the AE for the technology.
- the technologies invented by the AE are patented by the AE and cannot be used by others including the assessee without the permission of the AE

Toyota Kirloskar Auto Parts ... vs Assessee on 21 November, 2014, IT(TP)A No1642/Bang/2012, (Assessment year: 2008-09)

Toyota Kirloskar Motor Pvt. Ltd

... royalty is paid to the supplier on locally manufactured products.. makes it clear that the manufacture of such products is dependent upon the Technical knowhow/Technology/Licence/Patent available with the supplier which may be transferred either in the collaboration agreement or which may be inherent in the goods supplied.

Toyota Kirloskar Motor Pvt. Ltd. , C/231/04 and C/949/04

Keihin Panalfa Ltd

...Under a technological collaboration agreement dated 12th September, 1997, Keihin Japan licensed the manufacturing technology and knowhow to Keihin Panalfa Limited (KPL).

- KPL undertakes no R&D activities and owns no intangible assets of its own.
- the assessee has to maintain the quality standards which are ensured by Quality Control Director employed by assessee as deputed by Keihin Japan.
- all the intangibles are owned by the AE and there is no R&D activity and assessee could not produce or sell without the availability of such technology by its AE.

Keihin Panalfa Ltd.; ITA 3287/Delhi/2011 & 5546/Delhi/2012, A.Y.: 2004-05 & 2005-06

LG Electronics India Pvt. Ltd

...The Id. Counsel for the assessee argued that

- without the payment of royalty, the assessee could not have carried on its business and, hence, this transaction should be viewed as an integral part of other transactions including import of raw materials, import of service spare, design and development fee and import of production equipment, etc., so as to qualify for the determination of its ALP under TNMM on entity level.

LG Electronics India Pvt. Ltd ; ITA No.5140/Del/2011, A. Y. 2007-08

...

Reebok India Co.

...the industry in which the appellant operates is highly competitive .

- The appellant, however, does not undertake any significant research and development activity on its own and solely depends upon the associated enterprise for provision of technology.

Reebok India Co., I.T.A. No. 5857/Del/2012, A.Y.: 2008-09

...

Samsung India Electronics Pvt. Ltd

...Royalty is paid by the assessee to SEC Korea for the receipt of technical knowhow and expertise. Royalty payment made by the assessee has "direct nexus" with and is incurred solely for the purpose of the assessee's business. The assessee cannot carry out manufacturing activity without access to the technical know-how and expertise developed by SEC Korea..

Samsung India Electronics Pvt. Ltd., I.T.A. No. 5316/Del/2011, A.Y.: 2007-08

Box 3: Restrictive Agreement Clauses: Some Cases**H-One India Pvt Ltd.**

- technical knowhow supplied by H-One Co. Ltd. Japan remained sole and exclusive property of the company during the operation of agreement

-- I.T.A. No.4031 /Del/2009 Assessment year : 2005-06

FAG Bearings India Ltd.

...the know-how should not be communicated to any person other than the responsible employees of the "Indian Company".

- upon termination of the agreement the Indian Company had to return the Collaborators the said know-how.
- the said know-how had never become an asset of the assessee....(it) was to be used by the assessee for limited and specific purposes as prescribed in the agreement.

-- ITA No. 793 & 817/Ahd/2006: Assessment Year: 2002-03

Motherson Sumi Systems Ltd.

... the assessee become entitled to training facilities by mutual consent and to technical assistance from the engineers of M/s. Sumitomo; for which expenses were to be borne by the assessee.

- it was not entitled to any right or license to use the name of M/s. Sumitomo or any trademark owned by it.
- On the basis of these provisions, it becomes clear that the assessee was not left with any asset or residuary right on termination of agreement and even inventories were to be sold within 150 days.

-- I.T.A No. 3728/Del/09: Asstt. Year - 2005-06

LG Electronics India Pvt. Ltd

... the assessee entered into the Agreement with LG Electronics for supply of technical assistance on perpetual basis.

- A bare reading of this clause points out that it is heavily loaded in favour on the licensor and there is very limited scope for the assessee-licensee to seek termination of the Agreement.

-- ITA No .5140/Del/2011 LG Electronics India Pvt. Ltd.

specific tie-in provisions including the requirement to import goods or technology assistance or payment of other associated charges by the licensee (See Box 4). In many cases, the rates of royalty have been revised upward with little say of the local party even where the same technology is supplied for years³⁸. There are instances where technology contracts are manipulated in other ways as well (See Box 5). Enforcement of such decisions often happens under the strategic influence of the foreign collaborator on the top management of the domestic company.³⁹

Table 7 highlights a number of sample companies which made sizable technology payments even when their import intensity of raw material was quite high. The rationale

³⁸ For example, in the case of LG Electronic India Pvt. Ltd., review of the rate of royalty clause has been stipulated in the agreement (ITA No.5140/Del/2011). In the case of Fag Bearings India Ltd. the TPO noted that "the payment of royalty is not at arm's length and the increase in royalty rates to 5 per cent has not been negotiated by the assessee" (ITA No. 793 & 817/Ahmedabad/2006, Assessment Year: 2002-03).

³⁹ "Decisions on royalty payments are often questionable as these are taken by the top management at the behest of the foreign parents, who have a majority stake in these companies", 'Royalty Treatment', *Business Standard*, May 2, 2014

Box 4: (A) Technical Assistance Agreement (TAA) Related to Import of Good**-- Toyota Kirloskar Motor Pvt Ltd**

...Toyota Motor Corporation decides what Toyota Products would be sold to TKML and having decided that TMC had made it mandatory on the part of the importers to use the technical assistance agreement

- import of Toyota Products is subject to conditions related to the use of TAA.

--- *Commnr. Of Customs (Port), ... vs M/S Toyota Kirloskar Motor Pvt. Ltd.... on 17 May, 2007*

(B) Import of goods related to royalties and licence fees -- Ferodo India Pvt. Ltd

... Royalties and licence fees related to the imported goods is the cost which is incurred by the buyer in addition to the price which the buyer has to pay as consideration for the purchase of the imported goods.

--- *Commissioner Of Customs vs M/S Ferodo India Pvt. Ltd on 21 February, 2008*

Box 5: (A) Royalty on the Variants of the Products -- Honda Siel Power Products Ltd

...Case of the Transfer Pricing Officer is that

-the balance of the royalty has been paid on products which are not specifically mentioned in the Technical Collaboration Agreement entered between the parties "Honda Motors, Japan" and "Shri Ram Power Equipment Ltd.," now called as "Honda Siel Power Products Ltd.," dated 18.10.1985.

-the technical collaboration agreement in question does not authorize payment of "royalty" on the "variants of the products", which are not listed in the Technical Collaboration Agreement (TCA).

-- *Honda Siel Power Products Ltd, ... vs Assessee on 25 July, 2014*

(B) Technical knowhow fee Converted into a Loan -- Goodyear South Asia Tyres Pvt Ltd

- the assessee company entered into a technical assistance and license agreement with its associated enterprise Goodyear Tyre and Rubber Co., USA. on 21.06.1994. In terms of the said agreement, assessee was required to pay a lump sum technical knowhow fee of USD one crore.

- On 11th July, 1996 assessee entered into an agreement with the AE in terms of which the technical knowhow fee payable was converted into a loan which was initially interest-free for the first seven years period and was thereafter re-payable in three branches carrying interest @ 12% per annum.

-- *Goodyear South Asia Tyres ... vs Assessee on 28 November. 2014*

Table 7: Illustrative List of Unlisted Subsidiaries having High Import Intensity of Raw Materials
(above 80%)

<i>Company</i>	<i>Year</i>	<i>Foreign Equity (%)</i>	<i>Royalty+Tech. Related Payments (Rs. Cr.)</i>
Renault Nissan Automotive (I) Pvt Ltd	2011-12	100	23.7
Gestamp Automotive (I) Pvt Ltd	2010-11	100	22.8
Gestamp Automotive (I) Pvt Ltd	2011-12	100	21.5
Bosch Automotive Electronics (I) Pvt Ltd	2011-12	100	18.5
Skoda Auto (I) Pvt Ltd	2010-11	100	14.1
Skoda Auto (I) Pvt Ltd	2011-12	100	12.5
Bosch Automotive Electronics (I) Pvt Ltd	2010-11	100	10.1
Bosch Electrical Drives (I) Pvt Ltd	2011-12	87.65	4.9
Bosch Electrical Drives (I) Pvt Ltd	2010-11	87.65	4.9
Myunghwa Automotive India Pvt Ltd	2011-12	100	1.1
H-D Motor Co (I) Pvt Ltd	2011-12	100	1.0

Source: Same as Table 1

for technology acquisition from parent is surely questionable when indigenisation is not happening and majority of the intermediate products are still being imported even after years of incorporation. These incidences are quite significant and worth investigating from the viewpoint of a developing host economy.

Technological Dependence on Parent Network

As has been discussed above, many foreign affiliated companies explicitly state that they are not involved in any R&D and are dependent on the foreign collaborator for technology knowhow or assistance and are incapable of surviving/manufacturing without this input. This can create a situation of technological dependence on the parent network where the technology gains for the host economy get amply reduced if the local affiliates take very limited initiative towards research and innovation. A similar situation of low involvement in local R&D is evident for sample companies in *Table 8*. The number of companies with unreported or nil R&D expenses (75 cos.) are very high across all 'sales range' groups during 2011-12. Very few companies spend on R&D and most of them spend less than Rs. 5 crore with very few exceptions.

Table 8: Distribution of Sample Firms by R&D and Sales Range

<i>Sales Range</i>	<i>All Companies</i>				
	<i>R&D-NR</i>	<i>R&D-Nil</i>	<i>R&D-<5 Cr.</i>	<i>R&D->5 Cr</i>	<i>Total</i>
Less than 100 Cr.	19	15	3		37
100 - < 500 Cr.	17	9	4	1	31
Above 500 Cr.	9	6	6	3	24
Grand Total	45	30	13	4	92

Note: NR - Not Reported. Source: Same as Table 1

Table 9 presents a similar picture for companies spending on royalty/technical payments. Among companies paying technical fees over Rs. 20 crore, only 5 companies spend more than Rs. 5 crore on R&D and the rest show negligible R&D. For companies making technical payments less than Rs. 20 crore, very few spend beyond Rs. 5 crore and some do

Table 9: Distribution of Sample Firms by R&D, Technical Payments: 2011-12

<i>Sales Range</i>	<i>Technology Payments-5-20 Cr.</i>				<i>Technology Payments->20 Cr.</i>			
	<i>R&D-NR</i>	<i>R&D-Nil</i>	<i>R&D-<5 Cr.</i>	<i>R&D->5 Cr</i>	<i>R&D-NR</i>	<i>R&D-Nil</i>	<i>R&D-<5 Cr.</i>	<i>R&D->5 Cr</i>
Less than 100 Cr.		1						
100 - < 500 Cr.	2	1	1	1	1			
Above 500 Cr.	4	1	2	2		4	4	1
Grand Total	6	3	3	3	1	4	4	1

Note: NR - Not Reported. Source: Same as Table 1

not report any R&D. A few large companies covered in *Table 10* exhibit a very low or stagnant R&D to sales ratio while their technical payments have risen many folds over 1999-2014 period. Overall, a state of perpetual technological dependence is evinced in most cases, where the presence of FDI does not seem to amply encourage the R&D initiatives of local counterparts eventually.

Table 10: Illustrative List of Technology Related Payments and Profit Ratio by a Few Large Companies (Million US dollar)

Year	Maruti Suzuki India Ltd.				Hyundai Motor India Ltd.				Honda Cars India Ltd.				Hero Motocorp Ltd.			
	Forex royalty/ technical knowhow	R & D	R & D / Sales	PAT / Sales	Forex royalty/ technical knowhow	R & D	R & D / Sales	PAT / Sales	Forex royalty/ technical knowhow	R & D	R & D / Sales	PAT / Sales	Forex royalty/ technical knowhow	R & D	R & D / Sales	PAT / Sales
1999	17.8	2.8	Neg.	0.1				-0.1	1.3	0.1	Neg.	-0.1	1.8	0.7	Neg.	0.1
2000	24.3	4.8	Neg.	Neg.		Neg.		0.0	1.7	0.1	Neg.	-0.1	4.8	1.0	Neg.	0.1
2001	23.6	5.6	Neg.	Neg.		Neg.		0.1	6.6	0.2	Neg.	Neg.	8.3	1.0	Neg.	0.1
2002	28.4	6.1	Neg.	Neg.		0.2		0.1	6.8	0.4	Neg.	Neg.	8.7	1.2	Neg.	0.1
2003	27.4	4.6	Neg.	Neg.	11.5	0.5	Neg.	0.0	7.8	0.7	Neg.	Neg.	17.8	1.5	Neg.	0.1
2004	19.1	6.2	Neg.	Neg.	26.1	0.9	Neg.	0.1	9.3	0.2	Neg.	Neg.	20.0	2.1	Neg.	0.1
2005	33.8	8.4	Neg.	0.1	48.1	0.9		0.1	11.9	0.2	Neg.	0.1	36.4	3.0	Neg.	0.1
2006	40.9	8.9	Neg.	0.1	54.0	0.8		0.1	21.6			0.1	48.3	3.3	Neg.	0.1
2007	68.4	12.2	Neg.	0.1	63.1	0.9		Neg.	23.0			0.1	58.3	4.1	Neg.	0.1
2008	110.6	9.4	Neg.	0.1	78.7	1.0		Neg.	40.1			Neg.	69.2	4.7	Neg.	0.1
2009	134.2	13.0	Neg.	0.1	66.0	2.2	Neg.	Neg.	36.2			Neg.	63.9	4.6	Neg.	0.1
2010	199.8	24.4	Neg.	0.1	79.1	2.5	Neg.	Neg.	35.3			Neg.	92.0	6.0	Neg.	0.1
2011	449.3	41.1	Neg.	0.1	99.7	2.0		Neg.				-0.1	560.7	6.3	Neg.	0.1
2012	413.3	44.2	Neg.	Neg.	91.7	2.6	Neg.	Neg.	41.9			-0.2	2.1	9.4	Neg.	0.1
2013	484.0	47.1	Neg.	Neg.	79.3	2.9	Neg.	Neg.	50.6			-0.2	9.4	11.0	Neg.	0.1
2014	436.7	41.9	Neg.	0.1	77.7	4.1	Neg.	Neg.	75.1			-0.1	21.2	14.6	Neg.	0.1

Note: Neg. – Negligible, Blank cells – Unreported, Source: CMIE, Prowess.

Is Royalty Payment Used as an Alternative to Dividends for Profit Repatriation?

Even though technology transferred is expected to produce gains to the company in due course, profit making is not a stringent performance requirement in such technology procurement arrangements. Incidentally, *Table 11* shows a number of sample foreign affiliated subsidiaries making losses in both study years, where their number as well as value of losses has risen in 2011-12. Some of the companies are not new (*Table 12*). Around half of the losses (48%) during 2011-12 period was incurred by companies incorporated before 2000.

Table 13 lists various unlisted companies which have been making substantial royalty payments while reporting losses and evading dividend distribution. Similarly, few large unlisted companies like Honda Cars India Ltd. (see Table 10) have reported significant loss values in recent years.⁴⁰ In view of the reported losses and negligible dividend payments by various subsidiary companies in recent years (further illustrated by Table 14), a possible tendency for distribution of profits masked as royalty payments to the MNC parent instead of the dividend route can be suspected.⁴¹

Table 11: Loss Making Unlisted Companies: Distribution by Foreign Ownership

Ownership/PAT	2010-11					2011-12				
	Loss up to 10Cr.	10-50 Cr.	50-100 Cr.	Above 100 Cr.	Total	Loss up to 10Cr.	10-50 Cr.	50-100 Cr.	Above 100 Cr.	Total
	No. of Cos									
Joint Ventures	1			1	2		2			2
Subsidiaries	20	22	1	3	46	16	25	5	6	52
Total	21	22	1	4	48	16	27	5	6	54
	Rs. Cr.									
Joint Ventures	-3.4			-227.1	-230.5		-75.9			-75.9
Subsidiaries	-85.1	-461.7	-73.2	-924.2	-1544.1	-73.8	-631.2	-354.8	-1837.4	-2897.3
Total	-88.5	-461.7	-73.2	-1151.2	-1774.6	-73.8	-707.1	-354.8	-1837.4	-2973.2

Source: Same as Table 1

Table 12: Loss Making Unlisted Companies: Distribution by Foreign Ownership & Year of Incorporation (No. of Cos.)

Ownership/Age	2010-11				2011-12			
	1991-2000	2001-2005	After 2005	Total	Pre-1990	1991-2000	2001-2005	After 2005
	No. of Cos							
Joint Ventures	1		1	2		1		1
Subsidiaries	7	3	36	46	2	10	3	37
Total	8	3	37	48	2	11	3	38
	Rs. Cr.							
Joint Ventures	-227.1		-3.4	-230.5		-43.1		-32.8
Subsidiaries	-399.8	-44.1	-1100.1	-1544.1	-75.4	-1316.7	-64.0	-1441.3
Total	-626.9	-44.1	-1103.5	-1774.6	-75.4	-1359.8	-64.0	-1474.1

Source: Same as Table 1

⁴⁰ Honda Cars India Ltd., Profit After Tax (PAT) for the last four year respectively: Rs. -213 cr., (2010-11); Rs. -604 cr. (2011-12); Rs. -1110 cr., (2012-13); Rs. -480 cr., (2013-14).

⁴¹ "Royalty has become one of the means of profit distribution by a subsidiary to a foreign parent company", 'DIPP meets today to plan curbs on rising royalty outflows at MNC arms', Arun S, *Financial Express*, May 20, 2014.

Table 13: Illustrative List of Unlisted Companies making Losses and Paying Royalty & Tech. Related Payments (Rs. Cr.)

Company	Inc	Foreign Equity (%)	PAT		Royalty		Tech. Related Payments		Dividend	
			2010-11	2011-12	2010-11	2011-12	2010-11	2011-12	2010-11	2011-12
Denso (India) Ltd	1984	73.46	2.0	-72.2	19.9	25.7	0.7	0.4	3.6	0.0
General Motors (India) Pvt Ltd	1994	100	-184.1	-745.8	107.9	92.2			0.0	0.0
Bombardier Transpor-tation (India) Pvt Ltd	1995	100	-73.2	-321.0			37.4	63.7	0.0	0.0
Fiat (India) Automobiles Ltd	1997	50	-227.1	-43.1	95.3	34.2	3.4	3.4	0.0	0.0
Suzuki Motorcycle India Pvt Ltd	1997	100	-3.6	-1.1		8.8	1.2		0.0	0.0
Mando (India) Ltd	1997	67	9.3	-31.1	6.8	10.1	0.3	1.8	0.0	0.0
Yazaki Wiring Technologies India Pvt Ltd	1998	100	-10.9	-32.0	1.4	1.3	1.2	3.3	0.0	0.0
Hi-Lex India Pvt ltd	1998	100	0.5	-5.4	1.1	1.1			0.0	0.0
Skoda Auto (India) Pvt Ltd	1999	100	-13.4	-33.0	14.1	12.5			0.0	0.0
Mitsuba Sical (India) Ltd	2000	99.94	-7.1	-2.3	0.0	8.8			0.0	0.0
NTN NEI Mfg (India) Pvt Ltd	2005	96.14	-14.5	-20.8	1.4	3.0			0.0	0.0
Bestex MM India Pvt Ltd	2006	100	-9.5	-8.3	0.8	0.6	1.0	0.2	0.0	0.0
Goshi India Auto Parts Pvt Ltd	2006	99.96	-5.0	-0.4	4.3				0.0	0.0
India Yamaha Motor Pvt Ltd	2007	100	-632.6	-241.7	33.4	45.2	30.3	36.2	0.0	0.0
Continental Automotive Components (India) Pvt Ltd	2007	100	-34.3	-95.4			16.8	22.7	0.0	0.0
Munjal Kiriu Industries Pvt Ltd	2007	51	-15.6	-31.0	0.8	1.4	0.2	1.3	0.0	0.0
Ahresty India Pvt Ltd	2007	100	-18.2	-26.5		1.1	2.9	3.9	0.0	0.0

Company	Inc	Foreign Equity (%)	PAT		Royalty		Tech. Related Payments		Dividend	
			2010-11	2011-12	2010-11	2011-12	2010-11	2011-12	2010-11	2011-12
Plastic Omnium Varroc Pvt Ltd	2007	100	-8.4	-17.7	0.7		3.3	0.7	0.0	0.0
FMI Automotive Components Ltd	2007	100	9.9	-9.4	1.2	0.9	0.9	0.5	0.0	0.0
Gestamp Automotive (India) Pvt Ltd	2008	100	-33.8	-37.5			22.8	21.5	0.0	0.0
Bosch Electrical Drives (India) Pvt Ltd	2008	87.65	-9.7	-26.7	0.6	0.6	4.3	4.3	0.0	0.0
Sungwoo Gestamp Hitech (Pune) Pvt Ltd	2008	100	-20.8	-23.1		0.5		0.8	0.0	0.0
Nissan Ashok Leyland Powertrain Pvt Ltd	2008	51	-1.3	-10.9			2.7	0.4	0.0	0.0
Unipres India Pvt Ltd	2008	100	-4.8	9.4	0.4		7.0		0.0	0.0
H-D Motor Co (India) Pvt Ltd	2009	100	-20.2	-24.4			0.5	1.0	0.0	0.0

Source: Same as Table 1

Where the removal of caps could have encouraged such royalty outflows, the de-risking of returns by the MNC parent from the Indian market through increasing reliance on royalty over dividend is also possible, given that the royalty payments are calculated on revenues, while dividend income depends on the profitability of local subsidiaries subject to variations in business cycles.⁴² Also, the royalty payments happen to be taxed at lower levels than profits.⁴³ However, such a tendency for negligible dividend distribution hurts

⁴² A study by Business Standard found that over five years (2008-2013) the royalty earnings of 71 MNCs from their Indian subsidiaries have grown at a CAGR of 31.1 per cent while annual growth in their net profit was 10.3 per cent (See 'Royalty bigger than dividend for MNCs', Krishna Kant, *Business Standard*, 18.1.2014; Also see 'Royalty Treatment', Business Standard, May 2, 2014).

⁴³ "Royalties are taxed at source at a rate of 10.56 per cent, and corporate profits at a rate of 42.23 per cent for foreign owned companies", 'The royalties rush', Manu Kaushik, *Business Today*, March 6, 2011 (royalty tax rate has been revised recently to 25 per cent).

the minority shareholders. A consistent decline in MNCs' profit margins has been observed parallel to rising royalty payments in India recently in some cases.^{44,45}

Substantive and persistent technology payments are made by the companies often on the ground of expectation of better performance and productivity attained as a result of the inherent technology transfer.⁴⁶ Why such technology transferred does not get reflected in profits of companies eventually is a realistic question. Its justification in being useful only for running the day-to-day business is certainly inadequate and needs closer scrutiny.

Table 14: Dividend and Technology Payments by Sample Companies

	<i>Type of payment / variable</i>	<i>2010-11 (No. of cos.)</i>	<i>2011-12 (No. of cos.)</i>	<i>Total Cos. in sample</i>
1	PAT negative (showing losses)	48	54	92
2	Paying Dividend	4	2	92
3	Dividend paid is zero or unreported	88	90	92
4	Paying royalty fees in foreign exchange	39	42	92
5	Paying technical fees of some form	15	12	92
6	Paying at least one of royalty or technical fees of some variety	54	54	92

Source: Same as Table 1

The Challenges Ahead

A number of ambiguities surrounding technology transfer via FDI in India have been identified by this study. There are a range of problems related to various aspects of identification of technology payments, overall rationale and the gains through such transactions to the economy. While continuous drain of financial resources has happened

⁴⁴ "...royalty payments for using their parent firms' brand and technology are a cost for the Indian subsidiaries and lower their profitability.....94 per cent of Suzuki's returns from Maruti Suzuki in 2012-13 came in the form of royalty...corresponding ratio was 78 per cent for ABB, 59.4 per cent for Glaxo Smithkline Consumer and 92 per cent for Cadbury India.", 'MNCs' royalty pangs', *Business Standard*, 21.1.2014.

⁴⁵ A minority shareholder in Honda Sael Cars India, Usha International Ltd., has alleged that it has not received any dividend on investment through its 17-year association with Honda Motor Company, while the Japanese parent received income in various ways. ('Shriram mulls taking Honda to CLB', Sharmistha Mukherjee, *Business Standard*, April 13, 2012)

⁴⁶ In a recent case (Cabot India Ltd., ITA no. 6622/MUM/2009, 2005-06), the TPO noted "...the assessee is making operating losses (2005-06).....the business may make profit or losses as a result of acquisition of technology, but when a contention is taken with regard to better performance and productivity achieved by the assessee as a result of acquisition of such technology, then the contention taken cannot stand in total disregard to the performance on record". In another case (Reebok India Co. Ltd., ITA no. 5857/Del/2012) the TPO observed that the technology did not help the assessee in earning better margins over the past three years.

through layered and ambiguous transactions over the years on this account, the grounds on which such payments are justified by the companies are quite vague and many may not pass the test of essentiality. These payments have been objected as being inappropriate in several instances by revenue authorities, and many companies have running transfer pricing cases at present which shows the severity of the issue in the Indian context. The proper appraisal of such transfers involves multiple complexities due to their intangible nature. Owing to lack of appropriate mechanism to assess the extent of actual technology transfer, challenges in their valuation persist. More importantly, the instrument of control in technology transfer being exercised in an informalized way is suggested in several instances where the terms of collaboration are heavily tilted in the favour of the intra-group licensor. The gain for various local affiliates remains vague, limited and doubtful as long as the technology transferred remains an exclusive asset of the licensor.

Given this scenario, there is a need to understand these transactions beyond legal parameters and contractual terms. The provisions and modes under which the transfer of technology takes place from foreign supplier requires to be acknowledged as an issue of proper policy intervention given the underlying crucialities, complexities and resources involved. Also, a thorough assessment is needed to safeguard the economy from any extractive type of resource transfers in the name of perpetual payments for technology. There should be far more transparency in the disclosure of all types of intra-firm technology related payments by companies. Besides, the extent to which such perpetual payments affect growth, profitability and dividend returns to shareholders needs to be assessed.

The extent of gain to the host developing economy like India in using FDI as a source of technology needs cautious appraisal and a reassessment of the current FDI policy is required from this perspective. It is high time the focus should shift from maximising FDI inflows to devising methods which ensure maximising the benefits to the economy from FDI. Unless the basic approach changes, these perpetual payments may continue to hurt the economy without any clear explanation of what they may truly represent.

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