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34 Chapter Controversial Issues in Transfer Pricing

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SYNOPSIS

Q. 1. In a revenue sharing model, can transfer pricing adjustments exceed the combined/total revenue earned by the assessee and its AE from third party clients?

Ans. Section 92C provides methods for determination of the arm's length price in relation to international transaction. However,

it is interesting to note that in some peculiar situations, as a result of this arm's length price, transfer pricing adjustments plus the income earned by the assessee from the said transaction may exceed the gross revenue earned by the AE from the international transaction. Consider the following illustration a) the AE of the Indian company has obtained a third party contract (say for INR 100) which is subcontracted to the Indian company by the AE b) the AE has retained a portion of the gross revenue as remuneration for its services (say INR 10) c) remaining amount is paid to the Indian company INR 90) d) during the transfer pricing proceedings, taking the Indian company as a tested party, the arm's length price in accordance with the methods prescribed under Section 92C is determined at say INR 105) e) consequently the difference between arm's length price and actual revenue is added to the income of the assessee (INR 105-90 = 15) f) Thus, the transfer pricing adjustments plus the income earned by the assessee from the international transaction (15 + 90 = 105) may exceed the total revenue earned by the AE from third party (i.e., INR 100) giving absurd results.

It is worth noting that Section 92(1) provides that any income arising from an international transaction shall be computed having regards to arm's length price. The words "having regards" may be interpreted in a manner that income arising from international transaction need not necessarily be Arm's length price always. Therefore, it may be possible to argue that other peculiarities like third party uncontrolled revenue may also be kept in mind while determining the income arising from the international transaction. Accordingly, it can be argued that the arm's Jength price should be restricted to total gross revenue i.e. it cannot exceed the gross revenue earned by the AE from third party. In the case of ***Global Vantedge P. Ltd. v. Dy. CIT (2010) 1 ITR 326 (Delhi) (Trib.),*** the Hon'ble Delhi Tribunal upheld the order of the CIT (A) wherein it was held that in a revenue sharing model it cannot be logical to say that the fair amount of revenue to be received by the Indian company should be more than 100 percent of the total revenue earned by both Indian company and its overseas AE. Accordingly, it was held that maximum adjustments should be restricted to the revenue retained by the AE. The said decision of the Hon'ble Tribunal has been

a) upheld by the Hon'ble Delhi High Court in ***CIT v. Global Vantedge (P.) Ltd. [2014] 45 taxmann.com***

475 (Delhi) [Special Leave Petition dismissed – CC 21808/2013]

b) followed in ***Interra Infotech (India) (P.) Ltd. v. ITO [2016] 66 taxmann.com 3 (Delhi - Trib.)***

However, since the above decisions are not strictly in accordance with the transfer pricing rules contained in Rule 10A to Rule 10E of the Income Tax Rule, 1962, it may be possible for the Revenue to argue that the aforesaid decisions as such are per incuriam and thus incorrect. An attempt is being made hereunder to rebut the above contentions of the Revenue:

i. Section 92 of the Act provides that any income arising from an international transaction shall be computed having regard to the Arm's Length Price ('ALP'). It does not provide that the said income shall be computed at the ALP. It is submitted that, the above implies that, the ALP is not conclusive/sacrosanct for the purpose of computing the income arising from the international transaction under Section 92, and that the AO can take into consideration other factors/ material for computing the income of the assessee (eg. the combined/total revenue earned by the assessee and his AE or the gross revenue earned by the AE). Reference may be made to –

- ***Juggilal Kamlapat Bankers & Anr v. WTO & Ors. [1984] 145 ITR 485 (SC),*** wherein in connection with the Wealth Tax Act, 1957 it was held

  "The Expression having regards to balance sheet of such business" in s 7(2) means that WTO while valuing has to take into account the balance sheet – Does not make the Balance Sheet conclusive or binding or decisive of the value of the assets appearing therein"

- ***Rajesh Kumar & Ors. v. Dy. CIT [2006] 287 ITR 91 (SC),*** wherein it was held

  "The meaning of the expressions "having regard to" is well settled. It indicates that in exercising the power, regard must be had to the factors enumerated together therein with all the factors

relevant for the exercise of power" (Quoted ***from India Cement & Ors. v. UOI [1990] 4 SSC 356***)

- ***Gangadhar Banerjee & Co. Pvt Ltd [1965] 57 ITR 176 (SC),*** wherein it was held

  "Moreover, the statute does not say "having regard only" (Quoted ***from CIT v. Williamson Diamonds Ltd [1958] AC 41***)

- ***Delhi Farming and Constion Pvt Ltd v. CIT [2003] 181 CTR 12 (SC),*** wherein it was held

  "The words "having regard to" used in the section do not restrict the consideration only to two matters indicated in the section as it is impossible to arrive at a conclusion as to reasonableness by considering only the two matters mentioned isolated from other relevant factors. It is neither possible nor advisable to lay down any decisive tests for the guidance of the ITO. The only guidance is his capacity to put himself in the position of a prudent businessman or the director of the company and his sympathtic and objective approach to the difficult problem that arises in each case"

- ***DIT v. Morgan Stanley & Co. Inc [2007] 292 ITR 415 (SC),*** wherein it was held

  "The object behind enactment of the transfer pricing regulations is to prevent shifting of profits outside India"

ii. Section 92F(ii) defines ALP as price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions. It is submitted that as self-evident from the provisions of Section 92F (ii) an "ALP" cannot be interpreted to mean a price at which the AE would incur a loss.

iii. However, it is submitted that if as per the Rules the "ALP" is so determined which in effect mean that the AE should enter into a transaction at a loss,

there is a clear conflict between the Act and Rules and in that scenario the Act would prevail over the Rules and would have to yield to the Act i.e. in the above scenario the price determined as per the Rules cannot be considered as the ALP for the purpose of computing the income of the assessee under the Act. In support of the above, reliance is placed on –

- ***CIT v. Minerva Maritime Corporation [1985] 155 ITR 258 (Bom),*** wherein it was held

  "It is to be remembered that the rules cannot curtail or go counter to the main provisions of the relevant sections of the Act"

- ***CIT v. Chemplast Sanmar Ltd. & Ors. [2009] 314 ITR 231 (Mad.),*** wherein it was held

  "The Rules must be consistent with or in conformity with the Act – If there is a clear conflict between a rule and a substantial provision of the Act, the rule must pave way for the provisions of the Act. The rule cannot be contrary to the provisions of the section or the intention of the legislature"

Though, the view taken by the Hon'ble Tribunal in ***Global Vantedge P. Ltd. (supra)*** is upheld by the Hon'ble Delhi High Court and the special leave petition too has been dismissed and though the judgement also seems fair, correct and logical, the same is strictly not in accordance with the Rules and would as such come in the category of a Judge made law. Thus, it would be desirable if the same is codified and appropriate amendments to that effect are made in the Act/Rules.

Q. 2. Whether "Letter of Comfort" amounts to "guarantee", and thereby falls under the definition of 'international transaction' for the application of transfer pricing provisions?

Ans. In international contracts, letters of comfort are often used to assure a contracting party that a parent corporation of the other party to the contract will provide its subsidiary (i.e. the other party to the contract) with the necessary resources to fulfil the contract. However, under international law, a letter of

comfort does not legally oblige the parent corporation to fulfil the obligations incurred by its subsidiary. The objective is to create a morally binding but not legally binding assurance. Despite their non-binding status, letters of comfort nonetheless provide risk mitigation because the parent company is putting its own reputation at stake. Explanation to Section 92B provides that the expression "international transaction" shall include capital financing including any type of long-term or short-term borrowing, lending or guarantee etc. Guarantee is a promise by one party to assume responsibility for the debt obligation of a borrower if that borrower defaults. However, unlike borrowing, lending or guarantee etc. letter of comfort does not have enforceability in law. Hence, applying the principle of "ejusdem generis" it may be possible to argue that a Letter of comfort would not be covered under the purview of "International transaction" and should not be subject to transfer prising provisions.

In ***United Braveries (Holding) Ltd. v. Karnataka State Industrial Investment and Development Corporation (M.F.A. No. 4234 of 2007 (SFC),*** the Hon'ble Karnataka High Court has held that a letter of comfort merely indicates the appellant's assurance that respondent would comply with the terms of financial transaction without guaranteeing the performance in the event of default. The Tribunal in A***CIT v. Tata International Limited [TS-113-ITAT-2020(Mum)-TP]*** and ***The Indian Hotels Company Ltd [TS-977-ITAT-2019(Mum)-TP]*** have relied on ***Karnataka HC ruling in United Braveries (Holding) (supra),*** to hold that letter of comfort does not constitute an international transaction and hence no TP adjustment on the same is warranted. In ***TVS Logistics Services Ltd. v. DCIT [2016] 72 taxmann.com 89 (Chennai - Trib.)***, though it has been held that a letter of comfort is nothing but a guarantee given by the assessee to its AE to avail loan from financial institutions, the addition in the said case was deleted on the ground that giving a letter of comfort did not involve any cost to the assessee.

However, in ***Essar Shipping Ltd. v. ACIT (2020) [TS-190-ITAT-2020(Mum)-TP]***, wherein a letter of negative lien (i.e. an undertaking for not transferring certain shares) was provided by the assessee to the Bankers of its AE (for enabling the AE to obtain loan from the said Bankers), the Tribunal has observed that the same was not akin to a transaction of issuing guarantee. Nevertheless, the Tribunal also held that since certain comfort was

indeed provided by the assessee, adjustment to the extent of 0.25% (as against 0.5% made by TPO) was justified. It may be pertinent to note that the decisions in Tata International Limited (supra), The Indian Hotels Company Ltd (supra), TVS Logistics Services Ltd. (supra) and United Braveries (Holding) Ltd. (supra) were not cited/ considered by the Tribunal in Essar Shipping Ltd. (supra).

Q. 3. Whether outstanding trade receivables from an associated enterprise would fall within the purview of the term 'international transaction'?

Ans. The meaning of the term 'international transaction' defined in section 92B of the Act has been expanded with the insertion of Explanation, by the Finance Act 2012 with retrospective effect from 1st April, 2002. Clause (1)(c) of the aforesaid Explanation provides that the expression 'international transaction' shall include "*capital financing, including any type of long-term or short-term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business*". The issue which arises for consideration is whether receivables from AE on account of trading transactions would come within the purview of the terms *'capital financing', 'borrowing', 'lending' 'receivable'* contained in clause (1)(c) of the aforesaid Explanation. One possible view is that applying the principles of *ejusdem generis* only monetary borrowing and lending would come within the definition of international transaction. The other view is that clause (1)(c) of the aforesaid Explanation is wide enough to cover even the outstanding receivables due from AEs on account of trading transactions. Further, even assuming that the same fall within the purview of the definition of 'international transaction', the other connected issues which would arise for consideration are as follows:

i. Whether TP adjustment would be warranted on outstanding trade receivables when the sales to AE (resulting in the outstanding receivables) is itself at arm's length price?

ii. Whether TP adjustment would be warranted on outstanding trade receivables when the assessee is a Debt free company?

iii. Whether TP adjustment would be warranted on outstanding trade receivables when the assessee is not

charging any interest on delay in recovering the non-AE receivables?

iv. Whether the TP adjustment on outstanding trade receivables would be subsumed within the working capital adjustment, warranting no further or separate adjustment?

Further, even assuming that TP adjustment would be warranted on outstanding trade receivables, the next question which would arise for consideration is as to what should be the rate of interest (i.e. whether LIBOR/Average cost of total funds/ Short term deposit rate/SBI Prime Lending rate), at which the TP adjustment on outstanding trade receivables ought to be computed.

Contrary and divergent views have been expressed in respect of all the aforesaid issues which are enumerated hereunder:

Favorable Decisions

In the following cases, adjustment of interest on outstanding receivables from AEs was deleted on the ground that (a) the outstanding receivables did not amount to an international transaction, (b) the AE sales (resulting in AE outstandings) was at ALP, (c) the assessee was a debt free company, (d) the assessee was not charging interest from non-AEs (e) the same was subsumed within the working capital adjustment.

No.	Name	Not an International Transaction	Sales at ALP	Debt Free Co.	Not Charging from Non-AE	Subsumed within the Working Capital Adjustment
AY 2012-13 onwards						
1	*DCIT v. CCL Products India Ltd. [2019] 106 taxmann.com11 (Vishakhapatnam)*		✓	✓		

No.	Name	Not an International Transaction	Sales at ALP	Debt Free Co.	Not Charging from Non-AE	Subsumed within the Working Capital Adjustment
2	*DCIT v. CCL Products India Ltd. (AY 2015-16) – [TS-96-ITAT-2020(VIZ)-TP]*		✓	✓		
3	*DCIT v. Bommidala Enterprises Pvt Ltd – [TS-101-ITAT-2020(VIZ)-TP]*		✓			
4	*Mahati Software Pvt. Ltd. v. ACIT – ITA No. 67/Viz/2016*		✓			
5	*Symphony Ltd. v. DCIT – [TS-904-ITAT-2019(Ahd)-TP]*		✓			
6	*Zynga Game Network India Pvt Ltd [TS-141-ITAT-2021(Bang)-TP] (Matter remanded)*					✓
7	*Target Sourcing Services India v. ACIT–[TS-1217-ITAT-2019(DEL)-TP]*		✓	✓		✓
8	*Vossloh Beekay Castings v. ACIT – [TS-146-ITAT-2020(DEL)-TP]*		✓			
9	*McKinsey Knowledge Centre Ltd. v. DCIT –[TS-884-ITAT-2019(DEL)-TP]*			✓		
10	*XL India Business Services Pvt. Ltd [TS-66-ITAT-2021(DEL)-TP]*					✓

No.	Name	Not an International Transaction	Sales at ALP	Debt Free Co.	Not Charging from Non-AE	Subsumed within the Working Capital Adjustment
11	*Gillette Diversified Operations Pvt Ltd [TS-60-ITAT-2021(DEL)-TP] (Matter Remanded)*					✓
12	*Frost & Sullivan India Pvt. Ltd. – [TS-623-ITAT-2019(Mum)-TP]*				✓	
13	*Lily Jewellery Pvt. Ltd [TS-70-ITAT-2021(Mum)-TP]*		✓			
Prior to AY 2012-13						
14	*Kusum Healthcare P Ltd v. ACIT - [TS-412-HC-2017(DEL)-TP]*	✓				✓
15	*Pr.CIT v. Bechtel India Pvt. Ltd. - [TS-591-SC-2017-TP]*			✓		
16	*Pr.CIT v. Bechtel India Pvt. Ltd. (Delhi HC) - [TS-508-HC- 2016(DEL)-TP]*			✓		
17	*CIT v. Indo American Jewellery Ltd. (Bom HC) - [2014] 223 Taxman 8 (Bom)*				✓	
18	*Pegasystems Worldwide India Pvt Ltd v. ACIT - [TS-488- ITAT-2015 (Hyd)-TP]*	✓				

No.	Name	Not an International Transaction	Sales at ALP	Debt Free Co.	Not Charging from Non-AE	Subsumed within the Working Capital Adjustment
19	*Goldstar Jewellery Limited v. JCIT- [TS-14-ITAT-2015(Mum)-TP]*		✓		✓	
20	*Samsung India Electronics (P.) Ltd. v. ACIT [2020] 114 taxmann.com 697 (Delhi - Trib.)*	✓				
21	*CRM Services India (P.) Ltd. v. ACIT [2020] 117 taxmann.com 102 (Delhi – Trib)*		✓			

Reference may also be made to:

- ***PCIT v. Amadeus India (P.) Ltd. [2020] 113 taxmann.com 393 (Delhi) [AY 2011-12],*** wherein the Delhi High Court has held that when the transactions undertaken by the assessee with its AE does not display any pattern which would suggest any arrangement or understanding between the assessee and its AE, the said transaction could not qualify as an 'international transaction' and consequently no adjustment of interest on outstanding receivables could be made.
- ***DCIT v. Progress Software Development Private Limited [TS-135-ITAT-2021(HYD)-TP] (AY 2010-11),*** wherein the Hyderabad Tribunal held that Chapter-X in the Act was a special provision wherein each and every adjustment ought to be made after analyzing the array of comparables, and since the DRP had not indicated the corresponding comparables for benchmarking the transaction of outstanding

receivables, the adjustment of interest on outstanding receivables was deleted by the Tribunal.

- ***Seaways Liner Agencies Private v. DCIT [TS-71-ITAT-2021(HYD)-TP] (AY 2014-15) and ADP Private Ltd v. DCIT [TS-172-ITAT-2021(HYD)-TP] (AY 2015-16),*** wherein the Hyderabad Tribunal deleted the adjustment of interest on outstanding (trade) receivables, as the lower authorities failed to appreciate that outstandings were also due from assessee to AE/some of the receivables from AE had been received within the due date (i.e. credit period). Further, the lower authorities had adopted SBI Short Term Fixed Deposit rates for benchmarking the outstanding receivables denominated in foreign currency without referring to the comparable market rates.

Adverse Decisions

In the following cases, adjustment of interest on outstanding receivables from AEs was upheld at the rate of interest (given below) as the trade receivables were outstanding beyond the credit period (given below)

No.	Name	% of Interest	Credit Period	Remarks, if any
AY 2012-13 onwards				
1	*Bechtel India Pvt. Ltd (Delhi Trib) - [TS-480-ITAT-2017(DEL)-TP]*	LIBOR + 400 points	No findings	The Tribunal relied on the decisions of Ameriprise India Pvt. Ltd. and Techbooks International Pvt. Ltd.
2	*AMD India Pvt. Ltd. [TS-993-HC-2018(KAR)-TP]*	Average cost of total funds	30 days	
3	*Cambridge Technology Enterprises Ltd. v. DCIT [2020] 113 taxmann.com 304 (Hyd – Trib)*	LIBOR + Interest rate	1 to 3 months	The Tribunal observed that only such receivables which are beyond the credit period agreed to by the parties in the agreement

No.	Name	% of Interest	Credit Period	Remarks, if any
				(i.e. 1 to 3 months) and are not factored in the working capital adjustment, should be taken into consideration for computing the TP adjustment.
Prior to AY 2012-13				
4	*Tecnimont Pvt. Ltd. – [TS-880-HC-2018(BOM)-TP]*	LIBOR	60 days	The HC observed that extension of credit period beyond the normal credit period of 60 days would be in substance granting of a loan to its AE.
5	*Logix Micro Systems Ltd. - TS-49-ITAT-2010(Bang)*	Short term deposit @ 5%	Reasonable Period	
6	*Doosan Power Systems India Pvt Ltd [TS-117-ITAT-2021(CHNY)-TP]*	LIBOR + 300 points	Standard credit period that the industry is allowing in the line of the business of the assesse	
7	*Bridal Jewellery Mfg. Co. TS-252-ITAT-2019(DEL)-TP*	LIBOR + 400 points	90 days	
8	*Techbooks International Pvt. Ltd [TS-317-ITAT-2015(DEL)-TP]*	PLR should not be used, since debts in FC	150 days	The Tribunal observed that as per the agreement between the AE's, credit period of 150 days was agreed, and hence interest upto 150 days was already a part of the sale price.

No.	Name	% of Interest	Credit Period	Remarks, if any
9	***Ameriprise India Pvt. Ltd [TS-21-ITAT-2016(DEL)-TP] & [TS-382-ITAT-2015(DEL)-TP]***	No Findings	60 days	The Tribunal observed that since the receivables were realized within the credit period of 60 days, as per the agreement, no adjustment should be made.

It may be pertinent to note that though the Hon'ble Delhi High Court in ***Kusum Healthcare P Ltd v. ACIT [TS-412-HC-2017(DEL)-TP]*** was rendered in connection with AY 2012-13 (i.e. prior to the insertion of the clause (1)(c) to Explanation to section 92B of the Act by the Finance Act 2012 with retrospective effect from 1st April, 2002), the Hon'ble Delhi High Court in Kusum Healthcare P Ltd (supra) has in fact considered the aforesaid amendment and has held as under:

> *"9. Mr. Raghvendra Singh, learned counsel appearing for the Revenue submitted that the ITAT overlooked the fact that the expression "international transaction" as defined in Explanation (i)(c) to Section 92B of the Act included "payments or deferred payment or receivable or any other debt arising during the course of business", and therefore, the outstanding receivables could by themselves constitute an international transaction. ..... Mr. Singh submitted that the ITAT erred in disagreeing with the TPO, who had characterised the outstanding receivables as an international transaction by itself which required benchmarking.*
>
> *10. The Court is unable to agree with the above submissions. The inclusion in the Explanation to Section 92B of the Act of the expression "receivables" does not mean that de hors the context every item of "receivables" appearing in the accounts of an entity, which may have dealings with foreign AEs would automatically be characterised as an international transaction. There may be a delay in collection of monies for supplies made, even beyond the agreed limit, due to a variety of factors which will have to be investigated on a case to case basis. Importantly, the impact this would have on the working capital of the Assessee will have to be studied. In other words, there has to be a proper inquiry by the TPO by analysing the statistics over*

> *a period of time to discern a pattern which would indicate that vis-à-vis the receivables for the supplies made to an AE, the arrangement reflects an international transaction intended to benefit the AE in some way."*

Further, the Bombay High Court in ***CIT v. Indo American Jewellery Ltd. [2014] 223 Taxman 8 (Bombay)*** has held as under:

> *"5. On appeal filed by the Revenue, the ITAT upheld the order of CIT(A). While, upholding the order of CIT(A), the ITAT held that interest income is associated only with the lending or borrowing of money and not in case of sale. We express no opinion on the above reasoning of the ITAT and keep that reasoning open for debate in an appropriate case. However, in the facts of the present case, the specific finding of the ITAT is that there is complete uniformity in the act of the assessee in not charging interest from both the Associated Enterprises and Non Associated Enterprises debtors and the delay in realisation of the export proceeds in both the cases is same. In these circumstances the decision of the Tribunal in deleting the notional interest on outstanding amount of export proceeds realised belatedly cannot be faulted."*

It is submitted that though the aforesaid decision of the Hon'ble Bombay High Court in ***Indo American Jewellery Ltd. (supra)*** was rendered in January, 2013 with respect to an assessment year prior to AY 2012-13 and the same has not expressly considered the aforesaid retrospective amendment, in principle the said judgement would be squarely applicable even post the aforesaid amendment, as the principles applicable to Comparable Uncontrolled Price method have remained unchanged even post the aforesaid amendment. Further, none of the aforesaid adverse decisions have taken into consideration the aforesaid two decisions of the Hon'ble Delhi High Court and Hon'ble Bombay High Court in ***Kusum Healthcare P Ltd (supra)*** and ***Indo American Jewellery Ltd. (supra)*** respectively. Considering the above as well as the diverse and contrary views taken on all the aforesaid issues, it would be desirable that a Special Bench of the Hon'ble Tribunal be constituted to resolve the same.

Q. 4. Whether RBI approval/FIPB instructions/Press Note issued by the Government of India can be considered for computing the arm's length price?

Ans. Section 92C of the Act provides various methods for the determination of the arm's length price in relation to an international transaction. There are no explicit provisions in the Act/Rules providing whether or not the above can be considered for the purpose of determining ALP. However, contrary judicial views have been expressed in this regard which are enumerated hereunder:

Decisions wherein RBI approval/FIPB instructions/Press Note issued by the Government of India were considered for determining the ALP

- In ***Sona Okegawa Precision Forgings Ltd. v. Addl. CIT (2012) 49 SOT 410 (Delhi),*** for justifying the royalty paid by the assessee @ 3% on domestic sales, the assessee relied on (i) RBI approval whereby the payment of royalty @ 3% on domestic sales was allowed to be paid for a period of five years. (ii) press note issued by the Government of India, Ministry of Commerce and Industries, Department of Industrial policy & Promotion, issued in 2003, wherein royalty payment @ 8% on export sales and 5% on domestic sales have been referred to be reasonable for the purpose of processing approval of payments. Considering the above, Hon'ble Delhi Tribunal held that the AO had failed to bring any material on record to prove that the payment of royalty @ 3% on domestic sales was not at arm's length and therefore, the payment was held to be justified under the CUP method.

- In ***SGS India Private Limited v. ACIT (ITA Nos. 963 & 3107/Mum/2011*** for AY 2004-05 & AY 2005-06), the Hon'ble Mumbai Tribunal has held that when assessee's payment of license fees @ 3% was in accordance with the FIPB Instructions issued by the Ministry of Commerce, Government of India (which accepted royalty payment @ 5% to 8%), the said international transaction was at arm's length.

The aforesaid decision of Mumbai Tribunal has been upheld by the Hon'ble Bombay High Court in CIT v. SGS India Pvt Ltd [TS-616-HC-2016(BOM)-TP].

Decisions wherein RBI approval was held to be not relevant for determining the ALP

- The Hon'ble Delhi High Court in the case ***CIT v. Nestle India Ltd. (2011) 337 ITR 103 (Delhi)*** has held that the purpose for which such permission is given by the RBI is totally different. The RBI is only concerned with the foreign exchange and, therefore, would look into the matter from that point of view. The RBI, at the time of giving such permission would not keep in mind the provisions of the IT Act and that is the function of the IT authorities.
- Similar view, as above, has also been expressed in ***Sony Ericsson Mobile Communications India (P.) Ltd. v. CIT [2015] 55 taxmann.com 240 (Delhi)***

Note: Both the aforesaid decisions are now pending before the Hon'ble Supreme Court [for ***Sony Ericsson Mobile Communications India (P.) Ltd. (supra)*** see ***CIT v. Haier Appliances India (P.) Ltd. [2016] 73 taxmann.com 300 (SC)*** and for ***Nestle India Ltd. (supra)*** see ***CIT v. Nestle India Ltd. C.A. No. 002589/2012***]

Recently, the Hon'ble Tribunal in ***Carraro India (P.) Ltd. v. DCIT [2019] 104 taxmann.com 166 (Pune - Trib.)***, after considering the views of both the Hon'ble High Court of Delhi and Bombay, has adopted the favourable view taken by the Hon'ble Bombay High Court and has held the royalty payment to be at ALP [since it was below the rate prescribed under Press Note No. 9 (2000 series) issued by Govt. of India, Ministry of Commerce and Industry]

Since divergent views have been expressed by the Hon'ble High Courts/Tribunals in this regard, the issue would now have to be settled by the Hon'ble Supreme Court.

Q. 5. Whether custom data/independent valuation done for obtaining custom clearance, can be considered for computing the arm's length price?

Ans. Section 92C of the Act provides various methods for the determination of the arm's length price in relation to an

international transaction. There are no explicit provisions in the Act/Rules providing whether or not custom data/independent valuation done for obtaining custom clearance, can be considered for the purpose of determining ALP. However, contrary judicial views have been expressed in this regard which are enumerated hereunder:

Decision wherein Custom Data/Valuation was relied upon for the purpose of determining ALP

- In ***Fabula Trading Co. (P.) Ltd v. ITO [2010] 123 ITD 557 (Mumbai),*** the Hon'ble Mumbai Tribunal has held that when the AO fails to demonstrate any discrepancy in the sales and purchase documents maintained by the assessee with the Customs Department, TP adjustment made to the international transaction of export of rough diamonds to AEs, would be liable to be deleted.

- In ***Liberty Agri Products (P) Ltd. v. ITO (2012) 49 SOT 79 (Chennai) (Trib.),*** the Hon'ble Chennai Tribunal has held that the TPO should have compared the price declared by the assessee with the customs tariff rate on date of contract of sale instead of comparing the prices at the date of entry into port. Hence, value adopted by Custom purposes was accepted as ALP.

- Further, in ***Coastal Energy Private Ltd. v. ACIT (2011) 12 ITR 347 (Chennai) (Trib.),*** with respect to the custom data relied upon by the TPO for determining ALP, the Hon'ble Chennai Tribunal observed that the customs authorities assigned values to the imported goods on the basis of scientifically formulated methods and they were responsible for making a fair assessment value of the imported goods. The valuation made by the customs authorities was not an arbitrary exercise and that it depended upon large volume of international data classified according to internationally accepted protocol. Therefore, it was not possible to say that the credibility of the price rate furnished by customs authorities was required to be discounted. It further held that except its own

internationally generated price, the assessee had no *locus standi* to question the credibility of the customs data relied upon by the TPO

- In ***Tilda Riceland Pvt Ltd v. ACIT [TS-47-ITAT-2014(DEL)-TP],*** the Hon'ble Delhi Tribunal accepted the plea of the assessee that CUP method, based on 'daily export port data' compiled by TIPS Software was the most appropriate method for determining the ALP of export of Basmati/non-Basmati rice to AEs. The Tribunal held that information available in the TIPS Software was based on the information publicly available with the Customs Department at different ports and therefore the 'daily export port data' compiled by TIPS Software, would constitute a reasonable source of input for the purpose of applying the CUP method.

  (***Note***: ***Coastal Energy Private Ltd. (supra) & Serdia Pharmaceuticals (India) Pvt. Ltd. (infra)*** were cited by the assessee and ***Serdia Pharmaceuticals (India) Pvt. Ltd. (infra)*** was relied upon by the Tribunal for holding that CUP was more relevant as compared to TNMM but no reliance was placed on the same w.r.t Custom Data)

- In ***DCIT v. C-Dot Alcatel-Lucent Research Centre Pvt. Lt [TS-78-ITAT-2016(DEL)-TP],*** the Hon'ble Delhi Tribunal, deleted the TP adjustment on purchase of equipments by noting that the Customs Valuation Certificates submitted before the lower authorities, stated that the value of the imported equipment was declared truthfully. Consequently, by placing reliance on the co-ordinate bench decision in ***Costal Energy Private Ltd (supra),*** the Tribunal held that customs valuation could be considered for determination of ALP.

- In ***Fresenius Kabi Oncology Ltd [TS-1446-ITAT-2018(DEL)-TP],*** the Hon'ble Tribunal, deleted the TP adjustment on purchase of machine from its AE, since the Customs Authorities had not disputed the declared import price of the said machine.

- In ***Rohm and Haas India Pvt Ltd v. ACIT [TS-926-ITAT-2019(Mum)-TP]***, the Hon'ble Mumbai Tribunal, by placing reliance on the co-ordinate bench decision in Tilda Riceland Pvt Ltd (supra), has remanded the matter for determination of ALP of import of raw material and export of finished goods by using the data available in the TIPS software under the CUP method.

- In ***Dow Chemical International Pvt Ltd v. ACIT [TS-491-ITAT-2020(Mum)-TP]***, the Hon'ble Mumbai Tribunal, by placing reliance on the decision of Rohm and Haas India Pvt Ltd (supra), has remanded the matter for determination of ALP of import of raw material goods by using the data available in the TIPS software/database under the CUP method.

  (***Note***: In all the aforesaid decisions no other adverse/ favourable decision qua Custom Data/Valuation was cited)

Decisions wherein Custom Data/Valuation was rejected for the purpose of determining the ALP

- In ***ITO v. Panasonic India Pvt. Ltd. (2010) 6 ITR(T) 502 (Delhi) (Trib.)***, the Hon'ble Delhi Tribunal has held that Custom valuation cannot be used for TP purposes as no specific rules of law for the same exist in the statute.

- Also, in ***Serdia Pharmaceuticals (India) Pvt. Ltd. v. ACIT (2011) 44 SOT 391 (Mum.) (Trib.)***, it has been held that the acceptance of the import price by Custom authorities does not imply that the import price must be accepted to be at arm's length from transfer pricing perspective, and that the taxpayer has to justify the arm's length price by following the mechanism prescribed in the transfer pricing regulations.

- In ***Mobis India Ltd v. DICT [TS-235-ITAT-2013(CHNY)-TP]***, the Hon'ble Chennai Tribunal rejected the plea of the assessee that valuation under the Customs Valuation Rules, 2007 made by the Customs Authority of the raw material and material

parts purchased from its AEs, should be taken as a proper comparable and therefore the price at which the assessee purchased the aforesaid materials would be at arm's length. The Tribunal observed that the valuation by the Customs authority was as per Customs Rules, 2007 which were not relevant for the purpose of transfer pricing under the Income-Tax Rules and further, the purpose of valuation by the Customs Authority was to determine any undervaluation and therefore the same would not fit with the scheme of transfer pricing analysis under the Income Tax Act.

- In ***Fuchs Lubricants (India) Pvt. Ltd. v. DCIT [TS-92-ITAT-2014(Mum)-TP],*** the Hon'ble Mumbai Tribunal rejected the plea of the assessee that no TP adjustment on the import of raw materials should be made as the same had already been examined by the Customs Authorities, who had found the price of the raw materials to be lower than arm's length price. The Tribunal held that that the value of import of raw material accepted by the Custom Authorities could not be accepted as arm's length price as per the provisions of Income Tax Act.

  (***Note***: In all the aforesaid decisions, no other adverse/ favourable decisions qua Custom Data/Valuation was cited)

Since divergent views have been expressed by the Hon'ble Tribunals in this regard, the issue may now have to be settled by the Special Bench of the Hon'ble Tribunal.

Q. 6. Whether amortization/depreciation/impairment of Goodwill would be considered as a non-operating items in computing the Profit Level Indicator while applying TNMM for determining ALP for transfer pricing purposes?

Ans. TNMM is inter alia one of the most appropriate methods prescribed under rule 10B of the Income Tax Rules, 1962 whereby the net profit margin realised by an enterprise from an international transaction entered into with an associated enterprise are compared with the net profit margin realised by other enterprises from

a comparable uncontrolled transaction. Rule 10B(2) further provides that the comparability of an international transaction with an uncontrolled transaction shall be judged inter alia with reference to the functions performed, assets employed and risks assumed by the respective parties to the transaction. Rule 10B(3) provides that an uncontrolled transaction shall be comparable to an international transaction if (i) none of the differences, if any, between the transactions being compared are likely to materially affect the price of cost charged or paid or the profits arising some such transactions in the open market or (ii) alternatively, reasonably accurate adjustments can be made to eliminate the material effects of such differences.

It is submitted that goodwill, at least in India, is one of those rare assets which are not commonly found in the financials of companies for the simple reason that goodwill simplicitor is generally recorded in the books of accounts in connection with and in consequence of events such as amalgamation, merger, acquisition of the business or undertaking, etc. The aforesaid events are not ordinary or regular events, in fact, the same are often referred to in common parlance as extra-ordinary events. Consequently, any amortization of goodwill or write off/impairment of goodwill would tantamount to an extraordinary item being uncommon and non-recurring/non-regular in nature. Thus, when one compares, the net profit margin of an enterprise which has claimed amortization of goodwill or write off/impairment of goodwill with other comparables it would be imperative to eliminate the effect of the aforesaid non-recurring/extraordinary items on the net profit margin of the said enterprise by ignoring/not considering the amounts of amortization/impairment of Goodwill debited in the profit and loss account.

Reference may be made to ***Nokia Solutions and Networks India (P.) Ltd. v. ACIT [2019] 111 taxmann.com 389 (Delhi –Trib.),*** wherein it was held:

> *"15. ….*
>
> *'87. Further reading of the notes forming part of the accounts vide schedule 14 incorporated at page No .971 of the paper book coupled with entries in scheduled 5 at page No. 966 thereof show that there is an exceptional circumstances during the year, i.e. the company has written off Goodwill, which arose on account of merger of Lanco Global Systems Inc.*

88. In view of the vast functional diversity of this company as is evident from the "offerings of the LGS service and solution" to be found at page No. 935 of its annual report coupled with the fact of the exceptional circumstance occurred during the year, we are of the considered opinion that this company is not a good comparable with the assessee and on that score it has to be excluded from the final set of comparable companies for the present year under consideration.

Further, reference may also be made to following cases wherein depreciation on goodwill was excluded from operating expense while computing operating margin as the same did not form part of the financials of the comparables and also the same was held to be extraordinary/non- operating:

- ***ACIT v. Diversity India P Ltd dated 03-01-2018 [TS-85-ITAT-2018 (Mum)]*** – wherein it was held

  "3…The FAA observed that the assessee had furnished complete reconciliation of alleged discrepancies referred to by the TPO, that the MS account, drawn up by the TPO was incorrect, that while allocating the expenses under the head amortisation (₹ 6.35 crores) an amount of ₹ 5.23 crores was treated as non-operating expenditure by the assessee, that the TPO had considered the entire depreciation (₹ 7.03 crores) as operating expense without assigning any reason thereof, that the depreciation included non operating depreciation expense of ₹ 5.23 crores also, that the assessee had paid ₹ 56.04 crores for purchasing a business unit from Hindustan Lever Limited, that the purchase price included payment towards goodwill (₹ 29.51 crores) and payment for intangible commercial benefits (₹ 18.17 crores), that the assessee had amortised the said expenditure and had claimed depreciation on it, that the depreciation on such assets was not an operational expense, that it was an extraordinary item, that such an item was not part of the financials of the comparables, that the assessee had rightly claimed that the same were non operational in nature. ……

  5…so, we are of the opinion that there is no need to interfere with the order of the FAA. Confirming the

same, we decide effective ground of appeal against the AO."

- ***ST-Ericsson India Pvt. Ltd v. DCIT dated 03-07-2018 ITA No.609/Del./2015 –*** wherein it was held

  "16…Perusal of the order passed by ld. DRP available at page 2681 relevant portion at page 2691, shows that amortization of goodwill is an extraordinary item and is not pertaining to the regular operation of the assessee, and hence non-operating in nature. So, in these circumstances, we direct the TPO to verify the facts and treat the amortization of the goodwill as non-operating expenditure in order to compute the operating margin of the assessee. So, ground no. 7 is determined in favour of the assessee."

Further, Rule 10TA(j) of the Income Tax Rules, 1962 [forming part of the Safe Harbour Rules] defines operating expenses to mean cost incurred during the course of its normal operations but excluding extraordinary expense. Relevant extract of Rule 10TA(j) is reproduced hereunder:

"(j) "operating expense" means the costs incurred in the previous year by the assessee in relation to the international transaction during the course of its normal operations including costs relating to Employee Stock Option Plan or similar stock-based compensation provided

for by the associated enterprises of the assessee to the employees of the assessee, reimbursement to associated enterprises of expenses incurred by the associated enterprises on behalf of the assessee, amounts recovered from associated enterprises on account of expenses incurred by the assessee on behalf of those associated enterprises and which relate to normal operations of the assessee and depreciation and amortisation expenses relating to the assets used by the assessee, but not including the following, namely: –

(i) interest expense;….

(v) extraordinary expenses;…"

AS 5 - Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies (Para 4.2) issued by ICAI defines the term extraordinary expense as under

> *"4.2. Extraordinary items are income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and, therefore, are not expected to recur frequently or regularly."*

It is submitted that, events such as amalgamation/merger (resulting in depreciation/amortisation of Goodwill), shut down of undertaking (which may result in impairment/write off of Goodwill), demerger, acquisition of business, etc. are clearly distinct from ordinary activities of any enterprise and as such are not expected to recur frequently or regularly. In other words, the aforesaid events, are extra-ordinary events. It goes without saying that a) recording of goodwill as an asset in the books of accounts (generally as a mere consequence of difference in the consideration paid and the value of the net assets of a business acquired); b) its consequent amortization/depreciation debited in the Profit and Loss Account and c) the subsequent write off/impairment of goodwill (which may arise say due to discontinuance of the undertaking) - can only arise out of exceptional circumstances/ extra-ordinary events and therefore, the amortization/impairment of goodwill are also extra-ordinary expenses which ought to be excluded from operating expenses while computing the PLI.

Thus, it is submitted that, in case an assessee opts for Safe Harbour Rules or even otherwise, amortization of Goodwill would be an extraordinary expense and would have to be excluded from operating expense while computing the PLI.

Further, it is submitted that, definitions contained in Accounting Standard 5 issued by ICAI and Rule 10TA forming part of Safe Harbour Rules would also have persuasive value and it may be possible for an assessee to place reliance on the same even though he may not have opted for the Safe Harbour Rules. Reference may be made to judgement of the Hon'ble Delhi High Court in ***Rampgreen Solutions (P.) Ltd v. CIT [2015] 60 taxmann.com 355 (Delhi)*** wherein while holding that the assessee rendering voice call centre services could not be compared to a KPO service provider, *inter alia* reliance was placed on definitions contained in Rule 10TA.

Though, there does not seem to be an adverse judgement in this regard, the favourable judgements, though correct, in my humble view have really not discussed the issue threadbare on first principles and thus a speaking order on the issue would be much welcome.

Q. 7. While selecting the comparable companies, whether companies having high or low turnover should be rejected?

Ans. Rule 10B(2) *inter alia* provides that the comparability of an international transaction with an uncontrolled transaction shall be judged with reference to the functions performed, assets employed and risk assumed by the parties involved.

Since there are no explicit provisions for exclusion of a potential comparable on the grounds of it having extreme high or low turnover, the initial view was that comparables having high or low turnover could not be eliminated on the grounds of turnover unless, there were specific reasons for eliminating the same eg. the alleged comparables were functionally different etc. [Reference may be made to ***Nokia India (P) Ltd. v. DCIT ITA No.242/Del/2010 ; Willis Processing Services (I) (P.) Ltd. v. DCIT [2013] 30 taxmann. com 350 (Mumbai); Calibrated Healthcare Systems India Pvt. Ltd., v. ACIT ITA No. 5271/Del/2012 and Capgemini India (P.) Ltd. v. ACIT [2013] 33 taxmann.com 5 (Mumbai)]***

Subsequently, the Hon'ble Delhi High Court in ***Chryscapital Investment Advisors (India) (P.) Ltd. v. DCIT [2015] 56 taxmann.com 417 (Delhi),*** while adjudicating on the issue "Whether comparables can be rejected on the ground that they have exceptionally high profit margins as compared to the assessee in transfer pricing analysis?", has also observed as under:

> *"33. Such being the case, it is clear that exclusion of some companies whose functions are broadly similar and whose profile - in respect of the activity in question can be viewed independently from other activities-cannot be subject to a per se standard of loss making company or an "abnormal" profit making concern or huge or "mega" turnover company. As explained earlier, Rule 10B (2) guides the six methods outlined in clauses (a)to (f) of Rule 10B(1), while judging comparability. Rule 10B (3) on the other hand, indicates the approach to be adopted where differences and dissimilarities*

> *are apparent. Therefore, the mere circumstance of a company - otherwise conforming to the stipulations in Rule 10B (2) in all details, presenting a peculiar feature - such as a huge profit or a huge turnover, ipso facto does not lead to its exclusion. The TPO, first, has to be satisfied that such differences do not "materially affect the price...or cost"; secondly, an attempt to make reasonable adjustment to eliminate the material effect of such differences has to be made."*

Taking into consideration the aforesaid decision of Hon'ble Delhi High Court in ***Chryscapital Investment Advisors (India) (P.) Ltd. (supra),*** the Hon'ble Delhi Tribunal in ***Fiserv India (P.) Ltd. v. ACIT [2020] 121 taxmann.com 211 (Delhi - Trib.); Cadence Designs Systems (India) (P) Ltd v. DCIT [2018] 89 taxmann.com 443 (Delhi - Trib.); American Express (India) (P.) Ltd. v. DCIT [2015] 64 taxmann.com 280 (Delhi - Trib.) and Rampgreen Solutions (P.) Ltd. v. DCIT [2015] 64 taxmann.com 451 (Delhi - Trib.)*** had held that high turnover could not be a ground for rejection of a company as a comparable if it was otherwise functionally similar to the assessee.

However, the Hon'ble Delhi High Court in ***CIT v. Agnity India Technologies (P.) Ltd. [2013] 36 taxmann.com 289 (Delhi)*** while excluding Infosys Technologies Ltd. from the list of comparables for an assessee engaged in the business of development of software, held as under:

> *"6. Learned counsel for the Revenue has submitted that the Tribunal after recording the aforesaid table has not affirmed or given any finding on the differences. This is partly correct as the Tribunal has stated that Infosys Technologies Ltd. should be excluded from the list of comparables for the reason latter was a giant company in the area of development of software and it assumed all risks leading to higher profits, whereas the respondent-assessee was a captive unit of the parent company and assumed only a limited risk……"*

Relying on the aforesaid decision of the Hon'ble Delhi High Court in Agnity India Technologies (P.) Ltd. (supra), the Hon'ble Bombay High Court in ***CIT v. Pentair Water India (P.) Ltd. [2016] 69 taxmann.com 180 (Bombay)*** while excluding certain comparables from the list of comparables for an assessee engaged in rendering services in the area of engineering, designing & product development, has held as under:

"5. On perusal of the impugned Order passed by the Tribunal dated 23.05.2014, we find that the Tribunal has recorded the reasons for not accepting the said three companies are comparable by stating as follows :

(i) HCL Comnet Systems & Services Ltd:- We find force in the submission of the ld. AR that this company cannot be a comparable as the turnover of this company is 260.18 crores while in the case of the Assessee, the turnover is around ₹ 11 crores only. While making the selection of comparables, the turnover filter, in our opinion, has to be the basis for selection. A company having turnover of ₹ 11 crores cannot be compared with a company which is having turnover of ₹ 260 crores which is more than 23 times the turnover of the Assessee. This company cannot be regarded to be in equal size to the Assessee. We, accordingly, direct the AO to exclude this company out of the comparables.

(ii) Infosys BPO Ltd.:- In this case also we noted the turnover in respect of this Company is ₹ 649.56 crores while the turnover of the Assessee company is around ₹ 11 crores which is much more than 65 times of the Assessee's turnover. We, therefore, do not find any illegality or infirmity in the order of CIT (A) in excluding this Company out of the comparables. Accordingly, we confirm the order of the CIT(A).

(iii) Wipro Ltd.:- After hearing the rival submissions, we noted that the CIT(A) applying the turnover filter has excluded this company out of the comparables. The turnover reported in the case of Wipro Ltd. Is ₹ 939.78 crores while in the case of the Assessee the turnover is around ₹ 11 crores. Therefore, on the basis of the turnover filter itself this company cannot be regarded to be comparable to the Assessee company and accordingly, we do not find any infirmity in the finding of CIT (A) while he excluded this company on the turnover criteria following the decision of this tribunal in:

…..

6. The said findings of the Tribunal in respect of the said three Companies are on the basis of appreciation of evidence on record.

We find no infirmity in the said findings of the Tribunal on that count. In fact, the Tribunal has endorsed the views of the CIT Appeals whilst coming to such conclusions…..

……..

8. In the present Appeal, the Appellant-Revenue has not been able to controvert or deny the data relied upon by the Authorities below to come to such conclusion. The said Companies are no doubt large and distinct companies where the area of development of subject services are different and as such the profit earned therefrom cannot be a bench-marked or equated with the Respondent- Company.

9. Shri Jain, learned Counsel has rightly relied upon the Judgment of the Delhi High Court in the case of CIT v. Agnity India Technologies (P.) Ltd. [2013] 219 Taxman 26/36 taxmann.com 289……"

In ***Obopay Mobile Technology India (P.) Ltd. v. DCIT [2016] 66 taxmann.com 119 (Bangalore - Trib.),*** the Hon'ble Bangalore Tribunal, taking into consideration the decisions of Delhi High Court in ***Chryscapital Investment Advisors (India) (P.) Ltd., (supra)*** and ***Agnity India Technologies (P.) Ltd. (supra)*** and the decision of Bombay High Court in ***Pentair Water India (P.) Ltd. (supra),*** has held as under:

"16. We have considered the rival submissions. The substantial question of law (Question No.1 to 3) which was framed by the Hon'ble Delhi High Court in the case of Chryscapital Investment Advisors (India) (P.)Ltd., (supra) was as to whether comparable can be rejected on the ground that they have exceptionally high profit margins or fluctuation profit margins, as compared to the Assessee in transfer pricing analysis. Therefore as rightly submitted by the learned counsel for the Assessee the observations of the Hon'ble High Court, in so far as it refers to turnover, were in the nature of obiter dictum. Judicial discipline requires that the Tribunal should follow the decision of a non-jurisdiction High Court, even though the said decision is of a non-jurisdictional High Court. We however find that the Hon'ble Bombay High Court in the case of ***CIT v. Pentair Water India (P.) Ltd. [Tax Appeal No.18 of 2015 judgment dated 16-9-2015]*** *has taken the view that turnover is a relevant criteria for choosing companies as comparable companies in determination of*

ALP in transfer pricing cases. In doing so the Hon'ble Bombay High Court has followed the decision of the Hon'ble Delhi High Court in the case of Agnity India Technologies (P.) Ltd. (Supra). There is no decision of the jurisdictional High Court on this issue. In the circumstances, following the principle that where two views are available on an issue, the view favourable to the Assessee has to be adopted, we respectfully follow the view of the Hon'ble Bombay High Court on the issue. Respectfully following the aforesaid decision, we uphold the order of the DRP excluding 6 companies from the list of comparable companies chosen by the TPO on the basis of turnover and size."

Similar view as above has been expressed by the Hon'ble Tribunal in ***Atos India (P.) Ltd. v. DCIT [73 taxmann.com 304 (Mumbai-Trib)]; Clear 2 Pay India (P.) Ltd. v. ITO [(2018) 95 taxmann.com 284 (Delhi-Trib)]; DCIT v. ABB Global Industries & Services (P.) Ltd. [(2018) 97 taxmann.com 465 (Bang-Trib)]; FCG Software Services (India) (P.) Ltd. v. ITO [(2016) 66 taxmann.com 296 (Bang-Trib.)] and Sysarris Software (P.) Ltd. v. DCIT [(2016) 67 taxmann.com 243 (Bang-Trib)***]

However, the Hon'ble Bangalore Tribunal in ***Scancafe Digital Solutions Pvt. Ltd. v. ITO IT(TP)A No.502/Bang/2015*** and ***Societe Generale Global Solution Centre (P.) Ltd. v. DCIT [2016] 69 taxmann.com 336 (Bangalore - Trib.),*** by placing reliance on the co-ordinate bench decision in Willis Processing Services (I) (P.) Ltd. (supra) have held that turnover is not a criteria prescribed under Rule 10B for selection of comparables and that turnover criteria would not be relevant for service sector where fixed overheads are nominal and the cost of service is in direct proportion to the services rendered. It is pertinent to note that the decision of the Hon'ble Tribunal in Willis Processing Services (I) (P.) Ltd. (supra) was rendered prior to the judgement of the Hon'ble Bombay High Court in Pentair Water India (P.) Ltd. (supra). However, subsequently the Hon'ble Chennai Tribunal in ***Shipnet Software Solutions India Pvt. Ltd. v. DCIT (ITA No.3404/Mds/2016)*** has followed the decision of Hon'ble Bangalore Tribunal in Societe Generale Global Solution Centre (P.) Ltd. (supra) and distinguished the decision of Hon'ble Bombay High Court in ***Pentair Water India (P.) Ltd. (supra)*** on the alleged ground that the said case is applicable only to manufacturing companies and not to service companies. It is submitted that the aforesaid distinction may not be correct as in the case of service companies, the profit may

increase substantially more with the increase in the turnover, as compared to manufacturing companies, wherein the variable cost (which is substantially higher as compared to service companies), would also increase with the turnover) Further, in the aforesaid background, it may be pertinent to note that even **in case of service companies viz. *FCG Software Services (India) (P.) Ltd. (supra)*** and ***Sysarris Software (P.) Ltd. v. DCIT (supra),*** the judgement of Hon'ble Bombay High Court in ***Pentair Water India (P.) Ltd. (supra)*** **has been followed to reject comparables having extreme high turnover.**

However, recently, the Hon'ble Bombay High Court in ***PCIT v. Eight Roads Investment Advisors (P.) Ltd. [2020] 115 taxmann.com 30 (Bombay)*** [without even referring to its earlier decision in in Pentair Water India (P.) Ltd. (supra)] has upheld the order of the Tribunal, wherein the Tribunal has held that where a company was functionally similar, it could not be rejected, only because of its low turnover when such turnover filter was neither applied by the assessee nor applied by the TPO.

As evident from above, contrary views have been expressed qua the relevance of turnover for the purpose of comparability. However, none of the decisions, while coming to the conclusion that turnover is not relevant for comparability have taken into consideration the judgement of Hon'ble Delhi High Court and Hon'ble Bombay High Court in ***Agnity India Technologies (P.) Ltd. (supra)*** and ***Pentair Water India (P.) Ltd. (supra)*** respectively (except in the case of ***Shipnet Software Solutions India Pvt. Ltd. (supra)*** wherein the judgement of the Hon'ble Bombay High Court in ***Pentair Water India (P.) Ltd. (supra)*** seems to have been wrongly distinguished as explained above).

Thus, even if turnover is considered to be a relevant criteria/filter for selecting the comparable companies, the next question which would arise for consideration would be as to what should be the criteria/filter/tolerance range for excluding comparables with high or low turnover. The diverse decisions which deal with the aforesaid issue are enumerated below:

a. Exclusion/Rejection of comparables having turnover which was 10 to 12 times the turnover of the assessee:

- *DCIT v. Nvidiya Graphics (P.) Ltd. [2017] 78 taxmann.com 269 (Bangalore - Trib.) [10 times]*
- *DCIT v. PMC-Sierra India (P.) Ltd. [2016] 74 taxmann.com 110 (Bangalore - Trib.) [10 times]*
- *Misys Software Solutions (India) (P.) Ltd. v. DCIT [2017] 82 taxmann.com 174 (Bangalore - Trib.) [10 times]*
- *ACIT v. Maersk Global Services Centre (I) (P.) Ltd. [2018] 94 taxmann.com 418 (Mumbai) [11 times]*
- *Wissen Infotech (P.) Ltd. v. DCIT [2017] 80 taxmann.com 43 (Hyderabad - Trib.) [12 times]*

b. Exclusion/Rejection of comparables by applying a tolerance range/multiple factor of 10 times on both sides, to the turnover of the assessee [i.e. comparables having less than 1/10th times the turnover of the assessee and comparables having more than 10 times the turnover of the assessee were rejected]:

- *Logix Microsystems Ltd. v. DCIT [2017] 80 taxmann.com 39 (Bangalore - Trib.)*
- *Microchip Technology (India) (P.) Ltd. v. ACIT [2017] 81 taxmann.com 389 (Bangalore - Trib.)*
- *Netscout Systems Software India (P.) Ltd. v. DCIT [2017] 80 taxmann.com 177 (Bangalore - Trib.)*

c. Exclusion/Rejection of comparables by applying a turnover filter of more than 200 crores (i.e. comparables having turnover of more than 200 crores were rejected):

- *Cash Edge India (P.) Ltd. v. ITO [2014] 51 taxmann.com 326 (Delhi - Trib.)*
- *Samsung Heavy Industries India (P.) Ltd. v. DCIT [2017] 84 taxmann.com 154 (Delhi - Trib.)*
- *Acusis Software India (P.) Ltd. v. ITO [2020] 116 taxmann.com 754 (Bangalore - Trib.)*

- ***DCIT v. ABB Global Industries & Services (P.) Ltd. [2018] 97 taxmann.com 465 (Bangalore - Trib.)***
- ***DCIT v. Misys Software (I) (P.) Ltd. [2015] 56 taxmann.com 332 (Bangalore - Trib.)***
- ***DCIT v. Software AG Bangalore Technologies (P.) Ltd. [2015] 64 taxmann.com 458 (Bangalore - Trib.)***
- ***DCIT v. Trident Microsystems India (P.) Ltd. [2015] 60 taxmann.com 218 (Bangalore - Trib.)***
- ***NDS Services Pay-TV Technology (P.) Ltd. v. ADIT [2013] 33 taxmann.com 414 (Bangalore - Trib.)***
- ***Zynga Game Network India (P.) Ltd. v. DCIT [2020] 119 taxmann.com 403 (Bangalore - Trib.)***
- ***Bearing Point Business Consulting (P.) Ltd. v. DCIT [2013] 33 taxmann.com 92 (Bangalore - Trib.)***
- ***Software AG Bangalore Technologies (P.) Ltd. v. ITO [2015] 64 taxmann.com 454 (Bangalore - Trib.)***
- ***Polartech India (P.) Ltd. v. ACIT [2013] 40 taxmann.com 81 (Hyderabad - Trib.)***

In light of the above, considering the fact that contrary judicial views have been expressed as to (i) whether turnover would be relevant for the purpose of comparability analysis and (ii) what should be the relevant turnover filter for excluding comparables with high or low turnover, it would be ideal if a Special Bench of Hon'ble Tribunal is constituted to resolve the issue, else one may really have to wait for an appropriate amendment or alternatively, the Highest Forum to resolve the same. However, till then, w.r.t issue (i) above, it is submitted that the Hon'ble Delhi High Court and Hon'ble Bombay High Court in A***gnity India Technologies (P.) Ltd. (supra)*** and ***Pentair Water India (P.) Ltd. (supra)*** respectively, should hold the field even for service companies notwithstanding the contrary view expressed

by the Hon'ble Bangalore Tribunal in ***Shipnet Software Solutions India Pvt. Ltd. (supra).***

Q. 8. While selecting the comparable companies, whether super profit making companies or extreme low profit making companies i.e. extremes should be rejected?

Ans. Rule 10B(2) provides that the comparability of an international transaction with an international uncontrolled transaction shall be judged with reference to the following, namely.

a) The specific characteristics of the property transferred or services provided in either transaction;

b) The functions performed, taking into account assets employed or to be employed and the risks assumed, by the respective parties to the transactions;

c) The contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions;

d) Conditions prevailing in the markets in which the respective parties to the transaction operate, including the geographical location and size of the markets, the laws and Government orders in force, costs of labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail.

As stated above, whether a company is comparable or not is based on the comparability principles i.e., FAR analysis, contractual terms etc. Thus, whether it is earning beyond industry average or lower than industry average is irrelevant. As a general principle, both loss making unit and high/super profit making unit cannot be eliminated from the comparables list unless, there are specific reasons for eliminating the same (other than the general reason that a comparable has incurred loss or has made super profits) for eg. the alleged comparables are functionally different, have extremely huge turnover or fluctuating margins etc. The aforesaid view has been accepted by the Special Bench of the Hon'ble Tribunal in ***Maersk Global Centres (India) (P.) Ltd. v. ACIT [2014] 43 taxmann.***

com 100 (Mumbai - Trib.) (SB) as well as by the Hon'ble Delhi High Court in ***Chryscapital Investment Advisors (India) (P.) Ltd. v. DCIT [2015] 56 taxmann.com 417 (Delhi),*** the relevant extracts of which are reproduced hereunder:-

- ***Maersk Global Centres (India) (P.) Ltd. v. ACIT [2014] 43 taxmann.com 100 (Mumbai - Trib.) (SB),*** wherein it was held as

> *"98. …….After taking into consideration this guidance provided in OECD Transfer Pricing Guidelines and on analyzing the decisions rendered by the Division benches of this Tribunal on this issue after taking into consideration inter alia the T.P. Regulations in India as discussed above, we are of the view that the potential comparables cannot be excluded merely on the ground that their profit is abnormally high. In our opinion, the matter in such case would require further investigation to ascertain the reasons for unusual high profit and in order to establish whether the entities with such high profit can be taken as comparables or not.*
>
> *99. The question No. 2 referred to this Special Bench is as to whether, in the facts and circumstances of the case, companies earning abnormally high profit margin should be included in the list of comparable cases for the purpose of determining arm's length price of an international transaction. ….. In generality, we are of the view that the answer to this question will depend on the facts and circumstances of each case in as much as potential comparable earning abnormally high profit margin should trigger further investigation in order to establish whether it can be taken as comparable or not. Such investigation should be to ascertain as to whether earning of high profit reflects a normal business condition or whether it is the result of some abnormal conditions prevailing in the relevant year. The profit margin earned by such entity in the immediately preceding year/s may also be taken into consideration to find out whether the high profit margin represents the normal business trend. The FAR analysis in such case may be reviewed to ensure*

that the potential comparable earning high profit satisfies the comparability conditions. If it is found on such investigation that the high margin profit making company does not satisfy the comparability analysis and or the high profit margin earned by it does not reflect the normal business condition, we are of the view that the high profit margin making entity should not be included in the list of comparable for the purpose of determining the arm's length price of an international transaction. Otherwise, the entity satisfying the comparability analysis with its high profit margin reflecting normal business condition should not be rejected solely on the basis of such abnormal high profit margin. Question No. 2 referred to this special bench is answered accordingly"

- ***Chryscapital Investment Advisors (India) (P.) Ltd. v. DCIT [2015] 56 taxmann.com 417 (Delhi),*** wherein it was held as

  "44. In light of the above findings, this Court concludes as follows:

  a. The mere fact that an entity makes high/extremely high profits/losses does not, ipso facto, lead to its exclusion from the list of comparables for the purposes of determination of ALP. In such circumstances, an enquiry under Rule 10B(3) ought to be carried out, to determine as to whether the material differences between the assessee and the said entity can be eliminated. Unless such differences cannot be eliminated, the entity should be included as a comparable……."

Reference may also be made to the judgement of the Hon'ble Delhi High Court in ***PCIT v. Nokia Siemens Network India (P.) Ltd. [2019] 111 taxmann.com 445 (Delhi)*** and the Special Bench decision of the Hon'ble Tribunal in ***Dy. CIT v. Quark Systems (P) Ltd. (2010) 38 SOT-307 (SB) (Chd.) (Trib.)*** wherein it has been held that a company which is functionally comparable, cannot be rejected merely because it is a loss making entity.

Thus, as evident from above, a company which is functionally comparable cannot be excluded merely on the ground that it has earned an extremely high margin or that it has incurred loss. However, in ***Schneider Electric IT Business India (P.) Ltd. v. ACIT [2020] 113 taxmann.com 215 (Bangalore - Trib.),*** the Hon'ble Tribunal has rejected a comparable on the ground that it had earned unusually high margin. Further, in the following cases, super normal profits/unusually high margin of the comparable in addition to the fact that it was either functionally dissimilar or had high turnover/fluctuating margins/abnormal trend in profitability, have been considered to reject the comparable

- ***Banc Tec TPS India (P.) Ltd. v. ACIT 2020] 117 taxmann.com 979 (Mumbai - Trib.)***
- ***DCIT v. Convergys India Service (P.) Ltd. [2020] 118 taxmann.com 241 (Mumbai - Trib.)***
- ***ITO v. Zenta (P.) Ltd. [2020] 116 taxmann.com 331 (Mumbai - Trib.)***
- ***M Modal Global Services (P.) Ltd. v. ACIT [2019] 112 taxmann.com 67 (Mumbai)***
- ***DCIT v. CGI Information Systems and Management Consultants (P.) Ltd. [2019] 111 taxmann.com 443 (Bangalore - Trib.)***
- ***DCIT v. Ivy Comptech (P.) Ltd. [2019] 109 taxmann.com 235 (Hyderabad - Trib.)***
- ***Q Logic (India) (P.) Ltd. v. DCIT [2014] 52 taxmann.com 225 (Pune - Trib.)***

It would be pertinent to note that all the aforesaid decisions deal with cases where the arithmetic mean was used to determine the arm's length price. However, subsequent to insertion of Rule 10CA to the Income Tax Rules, 1962 (by Notification Notification No. 83/2015 [F.No.142/25/2015-TPL] dated 19th October, 2015), the range concept has been introduced for determining the arm's length price. Under the range concept, a transaction is considered at arm's length if its value falls within the range beginning from 35th percentile of the dataset (i.e. the list of comparables) and ending on 65th percentile of the dataset and therefore, naturally all the extreme comparables (i.e. having low margin or high margin), would automatically stand excluded/considered, in as much as

that the arm's length price would be determined by taking into consideration only the values ranging from 35th percentile of the dataset to the 65th percentile of the dataset. Thus, in view of the above, it is submitted that even post the above amendment w.e.f AY 2015-16 no separate treatment would be required to be given to extreme comparables (i.e. having extreme low margin or extreme high margin) as the same would be automatically considered under the range concept.

However, it is submitted that when the TPO has himself excluded certain comparables (which are otherwise functionally similar) from the list of the comparables on account of extreme low profit margin/losses, it may be argued that comparables (even if functionally similar to the assessee) having extreme high margins ought to be excluded from the list of comparables. Reference may be made to the decision of the Hon'ble Hyderabad Tribunal in ***M/s. Infor (India) Pvt. Ltd. v. ACIT [I.T.A.No.1689/Hyd/2019],*** wherein the Hon'ble Tribunal has excluded a comparable having extreme high margin on the ground that the TPO himself had excluded comparables having low margin/loss. Relevant observation of the Hon'ble Hyderabad Tribunal in M/s. Infor (India) Pvt. Ltd. (supra) are reproduced hereunder:

> *"6.4.1. We have considered the rival submissions and observe that Cybage Software Pvt. Ltd., though comparable company, the margin declared by the Cybage Software Pvt. Ltd. is abnormally high which is as much as 68.17% in the year under consideration and average margin is at 66.27%. The Ld. TPO has excluded the loss companies and also the companies which are with lowest margins as argued by the Ld.AR and which was not disputed by the department. Following the same analogy Cybage Software Pvt. Ltd. required to be excluded. The TPO or DRP has not gone into the reasons for such huge margins. …… therefore we direct the TPO/AO to exclude Cybage Software Pvt. Ltd. from the final list of comparables."*

Q. 9. Whether tax exemptions u/s 10A, 10AA, 10B or deduction under Chapter VIA can be allowed on voluntary transfer pricing adjustment suo-moto made by the assessee?

Ans. Section 92C (4) provides that where an arm's length price is determined by the Assessing Officer under subsection 92C(3), the Assessing Officer may compute the total income of the assessee having regard to the arm's length price so determined. First

proviso to section 92C(4) states that no deduction under section 10A or section 10AA or section 10B or under Chapter VI-A shall be allowed in respect of the amount of income by which the total income of the assessee is enhanced after computation of income under this sub-section. The issue that arises for consideration is that in case, the Assessee re-computes its ALP of the transactions entered into with its AEs and accordingly offers income for tax, whether the exemption under 10A on such additional voluntarily offered income would be allowed notwithstanding the first proviso to section 92C(4)?

In ***iGate Global Solutions v. ACIT (2007) 112 TTJ 1002 (Bang.) (Trib.),*** the taxpayer after computing the ALP in relation to its international transactions, made an upward adjustment to its income and claimed tax holiday on its total income. The Hon'ble Bangalore tribunal held that such upward adjustment by the tax payer is not an enhancement due to determination of ALP by the AO; hence tax holiday shall be available on such voluntarily increased income and observed as under:

> *"..From the memo explaining the provisions of Finance Bill 2006 as well as from the literal meaning of the word 'enhanced' , it is clear the income increased, as a result of computation of arms length price, then such increase is not to be considered for deduction under section 10A. In the instant case, the assessee himself has computed the arms length prices and has disclosed the income on the basis of arms length prices. It is not a case, where there is an enhancement of income due to determination of arms length price. Hence, it is held that assessee was entitled to deduction under section 10A in respect of income declared in return of income on the basis of computation of arms length price."*

The aforesaid decision of Bangalore Tribunal has been upheld by the Hon'ble Karnataka High Court in ***CIT v. iGate Global Solutions Ltd (ITA No. 453/2008)***

However, in the case of ***Deloitte Consulting v. Dy. CIT/ ITO (2012) 137 ITD 21 (Mum.) (Trib.),*** the assessee chose to file revised return of income for AY 2004-05 and 2005-06 offering the TP adjustment (consequent to ALP of marketing expense being suo-moto determined as Nil) as income and claimed exemption under section 10A. For AY 2006-07, in the original return of income itself, the assessee had suo-motu made the adjustment of ALP,

increased its income and filed its return of income and claimed exemption under section 10A. It relied on the decision of the Hon'ble Bangalore Tribunal in the case of ***I-Gate Global Solutions Ltd. (supra)*** and argued that the issue was covered and that the assessee should be granted exemption under section 10A, for the assessment years 2004-05, 2005-06 and 2006-07. On a query from the Bench, the assessee admitted that no fresh form no. 3CEB had been filed. The Hon'ble Tribunal agreed with the contention of the DR that the decision of the Hon'ble Tribunal in ***I-Gate Global Solutions Ltd. (supra)*** was not applicable as in that case, the assessee determined the ALP and made an upward revision in its return of income and whereas in the case of hand, ALP was not revised. The Hon'ble Tribunal further observed that the income arising out of the adjustment was not derived by the undertaking from export and hence the assessee was not entitled to deduction under section 10A. Similar view has also been adopted in ***Agilisys IT Services India Pvt Ltd v. ITO [TS-198-ITAT-2015(Mum)-TP]*** and the issue is now pending before the Hon'ble Bombay High Court [see ***Agilisys IT Services India Pvt Ltd v. ITO (Income Tax Appeal No. 1309 OF 2015)***]

However, following, the judgement of the Karnataka High Court in ***iGate Global Solutions Ltd (supra)***, a favourable view has been taken in the following cases (without considering the aforesaid adverse decisions of the Mumbai Tribunal)

- ***ACIT v. GS Engineering & Construction India (P.) Ltd. [2018] 93 taxmann.com 154 (Delhi - Trib.) [AY 2009-10]***
- ***DCIT v. GS Engineering & Construction India (P.) Ltd. [2018] 100 taxmann.com 66 (Delhi - Trib.) [AY 2010-11]***
- ***Austin Medical Solutions Pvt Ltd v. ITO [TS-348-ITAT-2015(Bang)-TP]***
- ***Sumtotal Systems India (P.) Ltd. v. DCIT [2017] 88 taxmann.com 897 (Hyderabad - Trib.)***
- ***QX KPO Services Pvt Ltd v. ITO [TS-1300-ITAT-2018(Ahd)-TP]***

Further, in the following cases, after noting the adverse view taken by the Mumbai Tribunal in ***Deloitte Consulting Ltd (supra)***, the Hon'ble Tribunal has taken a favourable view by

following the Karnataka High Court in ***iGate Global Solutions Ltd (supra)***

- ***Approva Systems (P.) Ltd. v. DCIT [2018] 92 taxmann.com 82 (Pune - Trib.)***
- ***A T Kearney India Pvt Ltd v. ACIT [TS-593-ITAT-2019(DEL)-TP]***
- ***DCIT v. EYBGS India (P.) Ltd. [2020] 117 taxmann.com 294 (Bangalore - Trib.)***

Though Deloitte's appeal (supra) was admitted by the Hon'ble Bombay High Court [see ***Deloitte Consulting India Pvt. Ltd. v. ACIT (Income Tax Appeal No. 1616 of 2012)***], the same now stands withdrawn as the assessee has opted for the Vivad se Vishwas scheme. One now really hopes that the Hon'ble Mumbai Tribunal will choose to follow the favourable judgement of the Hon'ble Karnataka High Court in ***iGate Global Solutions Ltd (supra)*** in the absence of any other contrary judgement of any other High Court.

Q. 10. Whether the foreign AE can be taken as a tested party?

Ans. The transfer pricing legislation in India does not provide any guidance qua the concept/choice w.r.t. the 'tested party'. In order to understand the concept of tested party one may refer to the transfer pricing legislations of developed countries eg. US Internal Revenue Services (where the principles of transfer pricing have been in use for a long time and act as a guiding force for all the developing economies)/OECD Transfer Pricing Guidelines 2010/United Nations Transfer Pricing Manual 2013/ India's commentary in United Nations Practice Manual on Transfer Pricing for Developing Countries (2014 and 2017 version). However, contrary judicial views have been expressed qua the issue as to whether the foreign AE can be taken as a tested party by considering/ignoring the above. The same are enumerated below:-

In the following cases, selection of foreign AE as tested party was accepted

Favourable Decisions

- ***Virtusa Consulting Services (P.) Ltd. v. DCIT [2021] 124 taxmann.com 309 (Madras)***

- ***Majesco Software and Solutions India Pvt Ltd [TS-710-ITAT-2020(Mum)-TP]***
- ***CWT India Private Limited v. ACIT (TS-544-ITAT-2019 (Mum)-TP)***
- ***ITO v. WNS Global Services Pvt. Ltd. (TS-474-ITAT-2018 (Mum)-TP) & [TS-131-ITAT-2020(Mum)-TP]***

  (Adverse decision of co-ordinate bench in case of Onward Technologies not cited/considered)
- ***Ranbaxy Laboratories Ltd. v. DCIT [TS-883-ITAT-2019(Ahd)-TP]***
- ***Ranbaxy Laboratories Ltd. v. ACIT (2016 68 taxmann.com 322 (Delhi – Trib))***
- ***Yahama Motor India Pvt. Ltd. v. ACIT (2014 50 taxmann.com 444 (Delhi-Trib))***
- ***Development Consultants Pvt. Ltd. v. DCIT [TS-3-ITAT-2008(Kol)]***
- ***Landis + Gyr Limited v. DCIT [TS-518-ITAT-2016(Kol)-TP]***
- ***Almatis Alumina Pvt. Ltd. v. DCIT (2019 107 taxmann.com 305 (Kol – Trib))***
- ***ACIT v. ITC Infotech India Ltd. [TS-98-ITAT-2020(Kol)-TP]***
- ***IDS Infotech v. DCIT [TS-184-ITAT-2017(CHANDI)-TP]***
- ***ACIT v. IDS Infotech (TS-58-ITAT-2019 (Chandi) – TP)***
- ***IMS Health Analytics Services Pvt Ltd [TS-514-ITAT-2020(Bang)-TP]***
- ***TNT India Pvt. Ltd. v. ACIT [TS-920-ITAT-2016(Bang)-TP] – Bangalore Tribunal***
- ***Sutherland Healthcare Solutions Ltd. v. ITO (2017) 77 taxmann.com 305 (Hyd) – Hyderabad Tribunal***
- ***General Motors India Pvt. Ltd. v. DCIT (2013) 37 taxmann.com 403 (Ahd) – Ahmedabad Tribunal***

In the following cases, selection of foreign AE as tested party was rejected

Adverse Decisions

- ***Onward Technologies Limited v. DCIT (2013) 36 CCH 0046 (Mumbai Trib)***
- ***Bekaert Industries (Pvt.) Ltd. v. DCIT 2019 109 taxmann.com 405 (Pune-Trib)*** (relied on Onward Technologies)
- ***Carraro India (Pvt.) Ltd. v. DCIT 2019 104 taxmann.com 166 (Pune-Trib)*** (relied on Onward Technologies)
- ***GKN Driveline (India) Ltd. v. DCIT [TS-297-ITAT-2018(DEL)-TP]*** – In principle the Delhi Tribunal has accepted that a foreign AE could be accepted as a tested party, however due to non-availability of financial & FAR details of the AE's, the Tribunal has rejected selection of foreign AE as tested party in this case.
- ***IZMO Ltd [formerly Logix Microsystems Ltd] [TS-75-ITAT-2020(Bang)-TP]***
- ***Nivea India Private Limited [TS-209-ITAT-2020(Mum)-TP]***

Rationale of Favourable Decisions

- ***Reliance on US Internal Revenue Services*** – Section 1.482-5 of the US Transfer Pricing Regulations provides that in most cases, the tested party will be the least complex entity of the controlled taxpayers and will not own valuable intangible property or unique assets that distinguish it from potential uncontrolled comparables. Thus, in a sense, the tested party would have lesser risk as compared to the other transacting party or the real entrepreneur.
- ***Reliance on OECD Transfer Pricing Guidelines 2010*** - As a general rule, the tested party is the one to which a transfer pricing method can be applied in the most reliable manner and for which the most reliable comparables can be found, i.e. it will most often be the one that has the least complex functional analysis.

- **Reliance on United Nations Transfer Pricing Manual 2013** - The tested party normally should be the less complex party to the controlled transaction and should be the party in respect of which the most reliable data for comparability is available. It may be the local or the foreign party. If a taxpayer wishes to select the foreign associated enterprise as the tested party, it must ensure that the necessary relevant information about it and sufficient data on comparables is furnished to the tax administration and vice versa in order for the latter to be able to verify the selection and application of the transfer pricing method.

- **Reliance on India's commentary in United Nations Practice Manual on Transfer Pricing for Developing Countries (2014 and 2017 version) –** "Para 10.4.1.3. The Indian Transfer Pricing administration prefers Indian comparables in most cases and also accepts foreign comparables in cases where the foreign associated enterprise is the less or least complex entity and requisite information is available about the tested party and comparables."

Rationale of Adverse Decisions

- On conjoint reading of section 92C(3) and Rule 10B, substituting the profit realized by the Indian enterprise from its foreign AE with the profit realized by the foreign AE from the ultimate customers for the purposes of determining the ALP of the international transaction of the Indian enterprise with its foreign AE – is not permissible.

- Borrowing a contrary mandate of the TP provisions of other countries and reading the same in the Indian context is not permissible.

Comparison of Favourable and Adverse Decisions

- Adverse decision in case of ***Onward Technologies Limited v. DCIT (2013) 36 CCH 0046 (Mumbai Trib)*** was dealt with in the following favorable decisions viz. i) ***General Motors India Pvt. Ltd. (supra)***; ii) ***Ranbaxy Laboratories (supra),*** wherein

the Ahmedabad Bench and Delhi Bench respectively of the Hon'ble Tribunal have observed that, since majority of decisions of various Tribunals were in favor of selecting the 'tested party' either from local or foreign party which were further fortified from the United Nation's Practical Manual on Transfer Pricing for Developing Countries, a foreign AE can be selected as the tested party.

- Further, the adverse decision in case of ***Onward Technologies Limited (supra)*** was cited by the Revenue before the Tribunal in the following favorable decisions i.e. i) Landis + Gyr Limited (supra) ; ii) Almatis Alumina Pvt. Ltd. (supra) and iii) ITC Infotech India Ltd. (supra). However, the Tribunal has not dealt with the aforesaid adverse decision.

- Adverse decision in case of ***Carraro India (Pvt.) Ltd. (supra)*** was distinguished by the Mumbai Tribunal in Majesco Software and Solutions India Pvt Ltd (supra) on the ground that the United Nations Manual on Transfer Pricing was not brought to the notice of the Bench in the case of ***Carraro India (Pvt.) Ltd. (supra).***

- Adverse decision in case of ***Nivea India Private Limited (supra)*** was distinguished by the Mumbai Tribunal in Majesco Software and Solutions India Pvt Ltd (supra) on the ground that in the said case, the assessee therein had failed to substantiate that the foreign AE was a less complex entity.

- None of the favorable decisions as mentioned above have been either considered/cited/distinguished (though available at the time of hearing) in any of adverse decisions mentioned above.

Thus, in light of the above, it is submitted that notwithstanding the lack of explicit provisions to that effect in the Indian TP legislation, a foreign AE may be taken as tested party so long as it is the least complex party and the data of the foreign comparables are available in public domain.