DIGEST OF IMPORTANT TRANSFER PRICING RULINGS

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A. APPLICABILITY OF TRANSFER PRICING PROVISIONS

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Other Case Laws

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Relevant Provision

- Section 92(1) of I.T. Act

"92. (1) Any income arising from an international transaction shall be computed having regard to the arm's length price."

FACTS

- The assessee, a wholly owned subsidiary of a company incorporated in Mauritius, namely Vodafone Tele Services (India) Holdings Ltd (VTSHL), had issued 2,89,224 equity shares to its holding company at a premium of INR 8,519 per share over and above its face value of INR 10 pursuant to the fair market value arrived at in accordance with the Capital Issues Control Act 1947.
- Though the assessee was of the view that the transaction did not have an impact on its income and that the transfer pricing provisions were not applicable, out of abundant care and caution, it reported the issue of shares in its Form 3CEB and determined the arms' length price of the issue.
- The TPO adopted the Net asset value as the ALP, amounting to INR 53,775 per share and considered the short fall of INR 1308.91 crore (i.e. difference between NAV and issue price) as a deemed loan and charged 13.50 % interest on the said loan resulting in an aggregate adjustment of INR 1397 crores.
- Aggrieved by the order of the TPO and the consequent draft assessment order, the assessee filed objections with the Dispute Resolution Panel with respect to the valuation exercise adopted by the TPO and not in relation to the jurisdiction and applicability of the transfer pricing provisions which was raised via a Writ Petition before the Bombay High Court. The Bombay High Court dismissed the said petition on the grounds that the assessee had recourse to alternative remedy under the Act, i.e. the DRP and remanded the matter to the DRP for determination of jurisdiction as well.
- The DRP confirmed the additions made by the TPO, consequent to which, the assessee filed a second writ petition before the High Court challenging the jurisdiction of the Revenue authorities to tax an International transaction of issue of shares which did not result in any income under the Act.
- The assessee argued that the sine-qua-non, for application of section 92(1) is, that the income should arise from an International Transaction and since in this case, no income arises from issue of equity shares by the assessee to its holding company, the TP provisions would not apply.

- Further, the assessee also argued that the word 'Income' would have to be understood as defined by other provisions of the Act i.e. Section 2(24) of the Act. A fiscal statute has to be strictly interpreted upon its own terms and the meaning of ordinary words cannot be expanded to give purposeful interpretation. Since, the issue of shares by the assessee to its holding company and receipt of consideration of the same was a capital receipt it could not be brought to tax unless specifically/ expressly brought to tax by the Act.
- It was also argued that the provisions of section 56(2)(vii)(c), being applicable to only residents would not apply in the instant case.

DECISION OF HIGH COURT

- **Jurisdiction to apply Chapter X provisions** – The High Court held that income arising from an International transaction was a condition precedent for applying the provisions of Chapter X
- **Definition of income** – Referring to the definition of income contained in section 2(24) of the Act, the High Court observed that income would not in its normal meaning include capital receipts unless it was so specified and that a taxing statute could not be interpreted on any presumption or assumptions. Share premium had been made taxable by virtue of a legal fiction under section 56(2)(viib) of the Act which provided for taxing premium received in excess of the fair market value but only in case of a resident shareholder.
- The Court held that neither the capital receipts received by the assessee on issue of equity shares to its holding company, a non-resident entity, nor the alleged short-fall between the so called fair market price of its equity shares and the issue price of the equity shares can be considered as income within the meaning of the expression as defined under the Act. Further, in dealing with the contention of Revenue that in respect of bringing the said issue of shares within the purview of transfer pricing under sub clause (c) and (e) of Explanation (i) to Section 92B of the Act, the High Court held that a transaction on capital account or on account of restructuring would become taxable to the extent it impacted income.
- **Potential income –** Against the argument of the Revenue that had the assessee received the ALP of the shares it would invested the same thereby giving rise to income, the High Court held that the entire exercise of charging to tax the amounts allegedly not received as share premium fails, as no tax is being charged on the amount received as share premium.
- **Applicability of Chapter X to issue of shares –** The High Court held that section 92(2) provided for situations wherein AE's enter into arrangement where they were to receive any benefit, service or facility then the allocation, apportionment or contribution towards the cost or expenditure was to be determined in respect of each AE having regard to ALP and therefore the said section would have no application in case of issue of shares where there was no occasion to allocate, apportion or contribute any cost and / or expenses between the assessee and the holding company.
- The Court ruled that if it was income chargeable to tax under the normal provisions of the Act, then alone could Chapter X be invoked and that the transaction at hand, not falling within a statutory exception could not be brought to tax. Arriving at a transaction value on the basis of ALP did not convert non-income to income and that tax could be chargeable only on income, in the absence of which, applying the measure of ALP was unwarranted.
- **Machinery Provision v Charging Section -** Further the High Court also held that Chapter X was not a separate code in itself and in fact was a machinery provision. In the

absence of being a charging section in Chapter X of the Act, it was not possible to construe it as a charging section and that income arising from an international transaction between AEs must satisfy the test of income under the existent charging sections of the Act.

2. Whether TP adjustment can be made in respect of excess share premium paid for investment in equity share capital of AE by re-characterization of equity share capital into loan on the ground that the investment was made at a value in excess of the value of shares as per the Wealth Tax Valuation Rules

Topsgrup Electronic Systems Ltd v ITO [TS-61-ITAT-2016(Mum)-TP]

Other Case Laws

- PCIT v. PMP Auto Components (P.) Ltd. [TS-115-HC-2019(BOM)-TP]
- Aries Agro Ltd. V. DCIT [TS-1201-ITAT-2019(Mum)-TP]

FACTS

- The assessee belonging to the Topsgrup group of companies, which were engaged in the business of providing security services, was incorporated to carry on the business of manufacturing security equipments. However, its business stopped post which it is carrying on the activity of an Investment / holding company. With the view to expand its security business on a global scale, the Topsgrup proposed to invest in Shield Guarding Company Ltd, UK, ('Shield') which was also engaged in the business of providing security service.
- For this purpose, Tops Security Limited ('TSL' or 'Holding company of the assessee') entered into agreement dated 18.7.2007 with its investors viz. India Advantage Fund & Indivision who jointly invested INR 140 crores for acquisition of Shield. Out of the said amount, TSL in the assessee subscribed to 12,46,010 shares (of face value of INR 10/- and premium of INR 990/- resulting in investment of INR 124,60,14,673. On receipt of the said money from TSL, the assessee invested the same in Tops BV Netherlands ('Tops BV'), its wholly owned subsidiary, which was to be an intermediate holding company to acquire 'Shield'. The money received by Tops BV Netherlands was further invested towards acquisition of 'Shield'. The entire transaction was duly supported by a valuation report and was post approval from the RBI.
- The structure of Topsgrup of Companies was as follows: TSL → TESL (100% WOS) → Tops BV (100% WOS) → Tops UK (100% WOS) → Shield. The investment in Tops BV was disclosed in the notes in Form 3CEB but the same was not benchmarked as the assessee was of the view that since the subscription to equity capital did not have any bearing on profitability, TP regulations were not applicable.
- The TPO contended that as per the amended provisions of Explanation (1)(b) to section 92B(2), transactions of capital financing have all along been international transactions. He observed that the AE (viz. Tops BV) got the huge premium due to its special relation with the assessee and the assessee had failed to establish that the AE was capable of raising funds, either by way of loan or share capital. He held that in the absence of this share premium, the AE would have had to take loans from the assessee or on open market which would entail it to pay huge interest costs and that therefore the AE got the funds by way of the above transfer without being charged any interest thereon. Thus, according to the TPO, the premium was nothing but a loan given by the assessee to its AE (vis. Tops BV) in the garb of share premium.
- The TPO then proceeded to compute the book value per share on the basis of Schedule III of the Wealth Tax Act, 1957 and accordingly made an addition of INR 124,17,50,258/-

being the alleged difference in ALP. The TPO made a further adjustment/ addition of INR 18,62,62,539/- being notional interest computed @15% on the aforesaid sum of INR 124,17,50,258/-

- The CIT(A) upheld the order of the TPOs and further held that the ratio of the Bombay High judgments in Vodafone India Services Pvt Ltd [TS-308-HC-2014(BOM)-TP] and Shell India Markets Pvt Ltd [269 ITR 516 (Bom)] did not apply to the assessee as the judgments covered inbound transaction i.e. where asssessee received the amount on issue of shares, whereas the transaction of the assessee was different i.e. an outbound transaction

DECISION OF TRIBUNAL

- The assessee argued that in the absence of income arising out of an international transaction, Transfer Pricing provision do not apply, and the transaction of investment in share capital could not be re-characterized as a loan. Further, the assessee also argued that without prejudice to the above, that in any event since the international transaction had taken place in foreign exchange, the rate for computing notional interest cannot exceed the LIBOR of 5.514%.
- The Tribunal held that "Chapter X begins with section 92(1) of the Act which states that "Any income arising from and international transaction shall be computed having regard to the arms length price." Evidently, therefore, income arising from the international transaction is a condition precedent for computing the ALP and such income should be chargeable to tax under the Act.
- In the absence of such income, benchmarking of an international transaction and computing ALP thereof would not be in order. Consequently, if an international transaction is on capital account and does not result in income as defined under section 2(24) of the Act, the provisions of Chapter X of the Act would not be applicable to such transaction."
- It dismissed the contention of the Revenue, that the transfer pricing provisions would apply to potential income and therefore ought to apply to the impugned investment in shares as the same could lead to capital gains in the future and held that potential income arising from a capital transaction may be considered under Transfer Pricing provisions if it arises from out of the impugned transaction, which was not so in the instant case.
- In respect of the contention of the Revenue the decision of Vodafone India Services (P.) Ltd. was not applicable to the assessee, the Tribunal noted that the said decision of the Hon'ble High Court, at para 42, had observed that it would be applicable to both inbound and outbound transaction – "..It is a re- computation exercise to be carried out only when income arises in case of an International transaction between AEs. It does not warrant re-computation of a consideration received/given on capital account…"
- Further, following the decision of the High Court in of Besix Kier Dabhol SA [TS-661-HC-2012 (Bom)] and the decisions of the Tribunal in Aegis Limited v ACIT [TS-342-ITAT-2015 (Mum) – TP], Parle Biscuits Pvt Ltd v DCIT [TS-127-ITAT-2014 (Mum) – TP], Mylan Laboratories Ltd v ACIT [TS-399-ITAT- 2015 (Hyd) – TP], Allcargo Global Logistics v ACIT [TS-176-ITAT-2014(Mum)-TP], Prithvi Information Solutions Ltd v ACIT [TS-237-ITAT-2014(HYD)-TP], Tooltech Global Engineering Pvt Ltd v DCIT [TS-271-ITAT-2014(PUN)-TP] it held that re-characterization of investment in share capital into loan was not possible under the Transfer Pricing provisions.

3. Whether in case of a domestic company registered as a Tonnage Tax Company, income derived from operating the qualifying ships taxed under the Tonnage Tax Scheme, provision of transfer pricing would not be applicable?

Van Oord India (P.) Ltd. v. ACIT [TS-1105-ITAT-2019(Mum)-TP]

Relevant Provisions

- Section 115VA of the I.T. Act

"Computation of profits and gains from the business of operating qualifying ships.

115VA. Notwithstanding anything to the contrary contained in sections 28 to 43C, in the case of a company, the income from the business of operating qualifying ships, may, at its option, be computed in accordance with the provisions of this Chapter and such income shall be deemed to be the profits and gains of such business chargeable to tax under the head "Profits and gains of business or profession".

FACTS

- The assessee, a domestic company, was engaged in the business of executing dredging contracts. The assessee was registered as a Tonnage Tax Company (TTC) under the Tonnage Tax Scheme (TTS) Chapter XII-G of the Act, and offered to tax shipping income derived from operating qualifying ships as per the mechanism prescribed under the said Chapter.
- During the course of assessment proceedings, the TPO proposed an TP adjustment on account of charter hire/lease charges, paid by the assessee to its AE for leasing one of the ships qualifying under the TTS (during the mobilization and demobilization period). The action of the AO was upheld by the CIT(A).
- Before the Tribunal, the assessee argued that TTS is a self-contained and TP provisions would not be applicable to a TTC whose income is taxable under the TTS. The assessee further argued that section 115VA starts with a non-obstante clause providing that sections 28 to 43C are not applicable to a TTC and accordingly, the income has to be computed as per the computation mechanism provided under the TTS.
- The Revenue argued that the transaction with AE's are to be taxed as per the normal/applicable provisions of the Act and in addition, the said transactions are further governed by TP provisions.

DECISION OF THE TRIBUNAL

- The Tribunal observed that as per the provisions of Chapter XII-G, TTS is a presumptive basis of taxation whereby the taxability of shipping income from qualifying ships depends on the tonnage capacity of the qualifying ships and the number of days for which it has been held.
- For the purpose of determining the income of the TTC, the actual receipts/revenues earned and expenses incurred are not taken into consideration and hence TTC would be liable to pay taxes even in a case where the financial statements reveal a loss on actual operations.
- The Tribunal also observed that the TP provisions envisage a computation of income from specified international transactions of receipt or expenditure with reference to the stated price of such transactions, whereas under the TTS the stated price of the transaction has no relevance to the computation of income of qualifying ships, thus TTS is in complete contract with the TP provisions.
- The Tribunal further observed that section 115VA starts with a non-obstante clause i.e. "Notwithstanding any to the contrary contained in section 28 to section 43….", which imply that income of a TTC has to be computed to the exclusion of section 28. Whereas

in case of an assessee entering into an international transactions with its AE's, the business income and the amount of allowable expenses u/s sections 28 to 43C is required to be determined as per the arm's length principle in light of the machinery provisions under Chapter X of the Act.

- None of the methods for determining the ALP u/s 92C could apply to the computation of tonnage income, since tonnage income is based on the weight of the vessel and not on "arm's length price“, thereby resulting in the failure of the computation provisions under Chapter X.
- The Tribunal relied on the co-ordinate bench decisions in case of TAG Offshore Ltd. v. Asstt. CIT [TS-494-ITAT-2014(Mum)] and ACIT v. Shreyas Shipping Services (P.) Ltd. [TS-427-ITAT-2016(Mum)] (dealing with disallowance u/s 14A to a TTC) ; CGU Logistics Ltd. [IT Appeal No. 1053 (Mum.) of 2014 (dealing with the principle that TTS is a complete code in itself) and CIT v. Trans Asian Shipping Services (P.) Ltd. [TS-361-SC-2016] (dealing with the objective of legislating TTS provisions i.e. providing a preferential regime of taxation for shipping companies)
- The Tribunal also relied on the decision of Hon'ble Bombay HC in the case of Vodafone Services (P.) Ltd. v. Union of India [TS-308-HC-2014(BOM)-TP], wherein it was held that Chapter X is a machinery provision and does not contain any charging provisions.
- The Tribunal also observed that DRP in assessee's own case for AY 2013-14 had held that TP provisions does not apply to the assessee to the extent where the income is chargeable to tax under TTS.

- ***<u>Heading</u>***

4. Whether a letter of comfort is not akin to a guarantee (since a guarantee is legally enforceable) and thus not an international transaction?

ACIT v. Tata International Limited [TS-113-ITAT-2020(Mum)-TP]

FACTS

- The assessee, a domestic company, issued a letter of comfort (LOC) to the bankers of its AE's. The assessee did not reported the said transaction as an international transaction in its transfer pricing study report (TPSR).
- During the course of assessment proceedings, the TPO proposed an TP adjustment pertaining to issuance of LOC, by observing that the LOC provided a benevolent advantage to the AE's in obtaining credit facility from its bankers at better terms and thereby the same would be in nature of a guarantee, falling within the purview of international transaction. The TPO benchmarked the LOC by adopting the guarantee fees charged by HSBC Bank to its customers as a comparable under the CUP method. The TPO observed that HSBC Bank charged fees ranging from 0.15% to 3% of the value of guarantee given depending upon the risk involved and accordingly, the TPO adopted 50 % of 3% as the ALP of the impugned transaction.
- Before the CIT(A), the assessee argued that merely an unequivocal statement of intention, expressed by the assessee, not being bilateral, was not a transaction and the LOC was a private affair between the assessee and the lender/banker (not being an AE of the assessee).
- The CIT(A) deleted the adjustment by observing that there is a fundamental difference between a LOC and a guarantee in as much as that in case of an LOC, the party issues only a letter, that a subsidiary or group company, would comply with the term of financial transaction and has no obligation to indemnify, however, in case of a guarantee, the party issuing guarantee is under obligation to the lender which is legally enforceable.

The CIT(A) opined that assessee's transaction had no bearing on the profit, income or loss as the assessee did not incur any cost or expenditure and hence the said transaction did not constitute an international transaction u/s 92B.

DECISION OF THE TRIBUNAL

- Before the Tribunal, the Revenue argued that the assessee had rendered services to its AE by issuing LOC to the lender of its AE and therefore, the issuance of LOC is an international transaction as held by Hon'ble Bombay High Court in case of Everest Kento Cylinders Ltd. [TS-200-HC-2015(BOM)-TP]. Further, the Revenue also argued that pursuant to amendment in Explanation in section 92B, any capital financing, lending on guarantee would be in nature of international transaction. The assessee rebutted the same by arguing that the decision of Everest Kento Cylinders (supra) was not dealing with the aspect as to whether corporate guarantee was an international transaction or not.
- The Tribunal relied on the Karnataka HC decision in case of United Braveries (Holding) Ltd. vs. Karnataka State Industrial Investment and Development Corporation wherein it was held that LOC 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 relied on co-ordinate bench decision in case of The Indian Hotels Company Ltd [TS-977-ITAT-2019(Mum)-TP] which further relied on Karnataka HC ruling in United Braveries (Holding) vs. Karnataka State Industrial Investment and Development Corporation, to hold that LOC did not constitute an international transaction and hence no TP adjustment on the same could be made.

5. Whether a letter of negative lien (i.e. an undertaking for not transferring certain shares) provided by the assessee to the Bankers of its AE (for enabling the AE to obtain loan from the said Bankers) is not akin to a transaction of issuing guarantee. However, since certain comfort was indeed provided by the assessee, adjustment of 0.25% should be made.

Essar Shipping Ltd. v. ACIT (2020) [TS-190-ITAT-2020(Mum)-TP]

FACTS

- The assessee, a domestic company, was engaged in business of shipping operations, crude oil transportation, drilling oil rigs, transportation management services and integrated dry bulk transportation services.
- During the year under consideration, Essar Global Limited (EGL), the ultimate parent company of the assessee had taken a loan from ICICI Bank, Hong Kong Branch and Singapore Branch. The assessee had given a letter to ICICI Bank, wherein it had undertaken not to transfer, assign and dispose of 49% of equity shares in its wholly owned subsidiary namely Essar Logistics Ltd (ELL) without prior written approval of the Bank during the pendency of the loan i.e. a lien was provided on the transfer of shares of ELL.
- The AO concluded the assessment proceedings by holding that the assessee ought to had charged guarantee commission @ 0.50% on the said transaction and accordingly a TP adjustment on this account was made, which was confirmed by the DRP.
- Before the Tribunal, the assessee argued that it had provided a negative lien i.e. it had agreed not to transfer 49% of its stake in ELL without prior consent from the Bank. Accordingly the said negative lien had no bearing on the profit, income, losses, etc. of

assessee and hence it did not come within the purview of international transaction as defined u/s 92B.

DECISION OF THE TRIBUNAL

- The Tribunal observed that the TPO/AO had equated the transaction of providing a letter of negative lien to the Bank, with a transaction of issuing guarantee to the Bank.
- The Tribunal further observed that in case of a guarantee there was a possibility of a liability arising to the guarantor on account of providing the said guarantee. Whereas, in the present case, even if EGL makes a default in the payment of loan to the Banker, there would never be any liability on the assessee for paying any amount since assessee was not a guarantor.
- However, the Tribunal keeping in view the nature of negative lien letter given by the assessee and the fact that certain comfort was indeed provided by the assessee, directed the AO to make adjustment by applying 0.25% to the said transaction instead of 0.50% applied by the AO.

- ***<u>Service PE</u>***

6. Whether a performance guarantee issued by the assesse in furtherance of its service liability towards the products sold by its AE's, would not be construed as issuance of a corporate guarantee and thus would not be considered as an international transaction?

DCIT v. Mastek Limited TS-957-ITAT-2018(Ahd)

Other Case Laws

- ACIT v. KEC International Ltd. [TS-674-ITAT-2019(Mum)-TP]

FACTS

- The assessee, a domestic company, was engaged in the business of development of software/solutions for insurance sectors in overseas market and was undertaking distribution through its foreign AE's.
- In terms of the Distribution Agreement with its AE's, the AE's were responsible for carrying on the function as a distributors and the service liability risk was with the assessee. In furtherance of the service liability, the assessee had issued performance guarantees to the customers of its AE's. In terms of the Distribution Agreement, the foreign AE's retains an arm's length return on the revenue earned from the customer and its operating expenses incurred for its distribution activity.
- The assessment proceeding for AY 2008-09 was concluded by holding that since the AE's did not had any financial backup or credit standing, it had to rely on the performance guarantees and other commitments made by the assessee (to its customers), so as to conclude sales contract with its customers. Accordingly, the AO made an adjustment @ 2% of the gross sales as guarantee fees for the performance guarantee or other comfort provided to the customers of the AE's.
- Before the CIT(A), the assessee argued that the service liability risk was borne by the assessee and the performance guarantee given to the customers of the AE's with respect to the performance of software services was not given on behalf of the AE.
- The AE's were the distributor of the assessee and the AE's did not provide any software services to the customers. The on-site and off-site component were provided by the assessee.

- The CIT(A) observed that the income of the AE had increased due to the performance guarantee given by the assessee, since the AE's were able to fetch better price in the market as the performance of the product is guaranteed by somebody else. Accordingly, out of the profits earned by the AE's certain percentage of it is attributable to the performance guarantee given by the assessee.
- However, the CIT(A) also observed that a performance guarantee and a financial guarantee are entirely different products and therefore, it would not be appropriate to adopt the rates given for financial guarantee for evaluating the performance guarantee. The CIT(A) held that since the AE's were provided 5.5% commission of the total sales, only a small component or certain percentage of the said commission would be attributable to the performance guarantee issued by the assessee. Accordingly, it held that 2% of the commission retained by the AE's i.e. 0.11% of sales (i.e. 2% of 5.5% of sales), would be the ALP of the transaction pertaining to issuance of performance guarantee.
- The CIT(A) also observed that the adjustment should be made only to the sales made by the assessee through its AE's on which the performance guarantee was given by the assessee.

DECISION OF TRIBUNAL

- The Tribunal relied on the decision of co-ordinate bench in case of M/s Suzlon Energy Ltd. vs. ACIT [TS-311-ITAT-2017(Ahd)-TP], wherein it was held that issuance of a corporate guarantees in course of its stewardship activities (i.e. for enabling the foreign subsidiary to obtain a loan for the purpose of construction of a guest house in Europe for the employees of the assessee), would not constitute an international transaction and deleted the TP adjustment.

7. Where the holding companies of the assessee and the company to which the assessee sold its imaging business, entered into a global agreement for the sale of business, since the global agreement did not control the terms and conditions of the actual transaction between the assessee and the buyer, whether the same could not be considered as a deemed international transaction under section 92B(2) of the Act.
CIT v Kodak India Pvt Ltd (2016) 288 CTR 46 (Bom)

Relevant Provision

- Section 92B(2) of the I.T. Act

"(2) A transaction entered into by an enterprise with a person other than an associated enterprise shall, for the purposes of sub-section (1), be deemed to be an international transaction entered into between two associated enterprises, if there exists a prior agreement in relation to the relevant transaction between such other person and the associated enterprise, or the terms of the relevant transaction are determined in substance between such other person and the associated enterprise where the enterprise or the associated enterprise or both of them are non-residents irrespective of whether such other person is a non-resident or not."

FACTS

- The assessee, an Indian subsidiary of Eastman Kodak Co, USA, had, during the relevant assessment year, sold its imaging business to an Indian company viz. Carestream Health India Pvt Ltd, who was in turn a subsidiary of Carestream Inc, USA.
- The TPO treated the same as a deemed international transaction under section 92B(2) of the Act on the basis that the holding company of both the assessee as well as

Carestream India had entered into a global agreement for sale of its business which was prior to the sale of the imaging business.

- Aggrieved, the assessee filed objections before the DRP, wherein the DRP upheld the view of the TPO.
- The Tribunal concluded that on the interpretation of Section 92B(2), as in force during the relevant year (i.e. prior to the amendment in Section 92B(2) with effect from April 1, 2015), the transaction would not be covered by the definition of 'international transaction'. Further, the Tribunal held that even if one was to proceed on the basis that Section 92B(2) of the Act was applicable, the transaction would still not come within the definition of international transaction since the transfer was independently between the assessee and Carestream India done on its own terms and conditions and the global agreement between the holding companies did not control the terms of the sale. The Tribunal also noted that the law relevant to the assessment year in question did not permit the use of 'any other method' as the most appropriate method for determination of ALP and therefore it held that the method used by the TPO was incorrect.

DECISION OF THE HIGH COURT

- The Hon'ble High Court upheld the order of the Tribunal and further held that the question of law raised by the Revenue was academic considering the finding of facts given by the Tribunal i.e. that as per Section 92B(2) prevalent during the relevant assessment year, the transaction would not fall within the definition of deemed international transaction and that the transaction of sale was neither controlled by the holding companies of the assessee nor by Carestream India and therefore would not fall under the definition of international transaction. Accordingly, it dismissed the appeal of the Revenue.

\- ***Construction PE***

8. Whether for the purpose of falling within the term 'associated enterprise' u/s 92A, both the conditions specified u/s 92A(1) and 92A(2) should be fulfilled ?

Veer Gems [TS-7-ITAT-2017(Ahd)-TP] ; [TS-545-HC-2017(GUJ)-TP] and [TS-2-SC-2018-TP]

Other Case Laws

a. Conditions under sub section (1) OR sub section (2) need to be fulfilled

- Kaybee (P.) Ltd. v. ITO [TS-233-ITAT-2015(Mum)-TP]
- Kaybee (P.) Ltd. v. ITO [TS-898-ITAT-2018(Mum)-TP]
- Diageo India (P.) Ltd. v. DCIT (2011) [TS-507-ITAT-2011(Mum)-TP]

b. Conditions under sub section (1) AND sub section (2) both need to be fulfilled cumulatively

- DCIT v. W.B. Engineers International (P.) Ltd [TS-404-ITAT-2015(PUN)-TP]
- Obulapuram Mining Co. (P.) Ltd. v. DCIT [TS-847-ITAT-2016(Bang)-TP]
- Orchid Pharma Ltd. v. DCIT [TS-943-ITAT-2016(CHNY)-TP]
- Shilpa Shetty v. ACIT [TS-885-ITAT-2018(Mum)-TP]
- JCIT v. Suttati Enterprises (P.) Ltd. [TS-234-ITAT-2016(PUN)-TP]
- Page Industries Ltd. v. DCIT [TS-382-ITAT-2016(Bang)-TP]

FACTS

- The assessee, partnership firm, was engaged the business of manufacture and sale, domestic as well as exports, of the polished diamonds. During the relevant previous year, the assessee had entered into certain international transactions with a Belgian entity namely, Blue Gems BVBA. (referred as Blue Gems)
- During the course of assessment proceedings, the AO observed that the assessee had made substantial purchases from Blue Gems. The partners of the assessee are three brothers Shri Piyush M Shah, Mukesh M Shah, Dilip M Shah and their wifes/son, together holding the entire partnership stake. The fourth brother Nareshkumar Shah, along with his wife Surekhaben Shah and his son Mitesh Shah control the entire shareholding of Blue Gems, the fourth brother and his son being directors of the company.
- Hence the AO concluded that Blue Gems was closely related with the assessee and falls within the parameters of section 92A(2)(j) and made reference to the TPO to benchmark the international transactions. Consequently, an TP adjustment of INR 5,22,64,779 was made. On appeal before the CIT(A), the CIT(A) deleted the TP adjustment and consequently held that the question as to whether Blue Gems was an associated enterprise or not became academic in nature.
- The assessee and Revenue filed cross-appeals before the Tribunal since the CIT(A) did not adjudicated on the fundamental question as to whether Blue Gems was an associated enterprise.

DECISION OF TRIBUNAL

- The Tribunal observed that in order to invoke TP provisions, it is essential that the international transaction in question must be between the associated enterprise. Further, section 92A(1) lays down the basic rule that in order to be treated as AE, one enterprise, in relation to another enterprise, should participate, directly or indirectly, or through one or more intermediaries, "in the management or control or capital of the other enterprise" .
- The Tribunal observed that as long as an enterprise participates in any of the three aspects of the other enterprise, i.e. (a) management; (b) capital; or (c) control, these enterprises are required to be treated as AE's, as also is the position when common persons participate in management, control or capital of both the enterprises. However, the expression 'participation in management or capital or control' is not a defined expression and to find the meaning of this expression, recourse to section 92A(2) would be required to be made.
- The Tribunal also observed that the practical illustrations u/s 92A(A) were exhaustive and not simply illustrative as clarified in the Memorandum explaining the provisions of the Finance Bill 2002 which, while inserting the words "For the purpose of sub section (1) of section 92A" in Section 92A(2), observed that "It is proposed to amend sub section (2) of the said section to clarify that the mere fact of participation by one enterprise in the management or control or capital of the other enterprise, or the participation of one or more persons in the management or control or capital of both the enterprises shall not make them associated enterprises, unless the criteria specified in sub-section (2) are fulfilled".
- In view of the same, the Tribunal held that section 92A(2) governs the operation of Section 92A(1) by controlling the definition of 'participation in management or capital or control by one of the enterprise in the other enterprise'.
- The Tribunal also observed that if a particular form of participation in management, capital or control is not recognized by section 92A(2), though resulting in de facto or

even de jure participation in management, capital or control by one of the enterprise in the other enterprise, it does not result in the related enterprises being treated as 'associated enterprises'.

- Accordingly, section 92A(1) and 92A(2) are required to be read together and that as long as the provisions of one of the clauses in Section 92A(2) are not satisfied, even if an enterprise has a de facto participation capital, management or control over the other enterprises, the two enterprises could not be said to be associated enterprises.
- The Tribunal also relied on the decision of coordinate bench in cases of Orchid Pharma Ltd. v. Dy. CIT [2016] 76 taxmann.com 63 (Chennai - Trib.) and Page Industries Ltd. v. Dy. CIT [2016] 159 ITD 680/71 taxmann.com 172 (Bang. - Trib.)
- The Tribunal observed that the Revenue had applied clause (j), (k) and (m) of section 92A(2) while concluding that the assessee and Blue Gems are associated enterprise.
- The Tribunal observed that for the purpose of application of clause (j) of section 92A(2), the assessee should be controlled by an individual or his relatives or jointly by both i.e. relatives and the said individual. However, in the present case, since the assessee was not controlled by an individual, clause (j) was not applicable.
- Further, the Tribunal also observed that clause (k) was not applicable, since the assessee was not controlled by an HUF either and w.r.t clause (m), any other relationship of mutual interest was not prescribed as yet.

DECISION OF THE HIGH COURT

- The HC upheld the order of the Tribunal w.r.t non application of clause (j) of section 92A(2). Further, the HC also observed that though both the entities were partnership firm clause (l) would not be applicable, since nothing was bought on record to demonstrate that Blue Gems was holding not less than 10 % interest in the assessee.

DECISION OF THE SUPREME COURT

- SLP filed by the Revenue against the decision of Gujarat HC was dismissed in limine.

- ***<u>Heading</u>***

9. Selection of Foreign AE as the Tested Party

Favourable Decisions

- Mumbai Tribunal
    - 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)
- Delhi Tribunal
    - Rabnaxy Laboratories Ltd. v. DCIT [TS-883-ITAT-2019(Ahd)-TP]
    - Rabnaxy Laboratories Ltd. v. ACIT [TS-173-ITAT-2016(DEL)-TP]
    - Yahama Motor India Pvt. Ltd. v. ACIT [TS-348-ITAT-2014(DEL)-TP]
- Kolkata Tribunal
    - 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 [TS-302-ITAT-2019(Kol)-TP]
    - ACIT v. ITC Infotech India Ltd. [TS-98-ITAT-2020(Kol)-TP]
- Chandigarh Tribunal
    - IDS Infotech v. DCIT [TS-184-ITAT-2017(CHANDI)-TP]

    - ACIT v. IDS Infotech (TS-58-ITAT-2019 (Chandi) – TP)
- Other Tribunal
    - TNT India Pvt. Ltd. v. ACIT [TS-920-ITAT-2016(Bang)-TP] – Bangalore Tribunal
    - Sutherland Healthcare Solutions Ltd. v. ITO [TS-947-ITAT-2016(HYD)-TP] - Hyderabad Tribunal
    - General Motors India Pvt. Ltd. v. DCIT [TS-215-ITAT-2013(Ahd)-TP] – Ahmedabad Tribunal

Adverse Decision

- Onward Technologies Limited v. DCIT [TS-94-ITAT-2013(Mum)-TP]
- Bekaert Industries (Pvt.) Ltd. v. DCIT [TS-1150-ITAT-2019(PUN)-TP] (relied on Onward Technologies)
- Carraro India (Pvt.) Ltd. v. DCIT [TS-124-ITAT-2019(PUN)-TP] (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.

RATIONALE OF FAVORABLE DECISIONS

- **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.
- **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.
- **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.
- 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."
- Adverse decision in case of Onward Technologies Limited v. DCIT [TS-94-ITAT-2013(Mum)-TP] was dealt in the case of the following favorable decision i.e. i) General Motors India Pvt. Ltd. (supra); ii) Ranbaxy Laboratories (supra), whereby the Ahmedabad Bench and Delhi Bench respectively has observed that since majority of decisions of various Tribunal were in favor of selecting the 'tested party' either from local or foreign party which was further fortified from the United Nation's Practical Manual on

Transfer Pricing for Developing Countries, foreign AE could 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 decision i.e. i) Landis + Gyr Limited (supra) ; ii) Almatis Alumina Pvt. Ltd. (supra) and iii) ITC Infotech India Ltd. (supra), however the Tribunal had not dealt with the said decision.

RATIONALE OF ADVERSE DECISIONS

- Conjoint reading of section 92C(3) and Rule 10B –
    - There could not be a question of 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.
    - Borrowing a contrary mandate of the TP provisions of other countries and reading the same in the Indian context is not permissible.
- None of the favorable decision as mentioned above had been either considered/cited/distinguished (though available at the time of hearing) in any of adverse decisions as mentioned above.

B. Heading

- ***<u>Heading</u>***

10. Whether the assessee can rely on the quotations by Oil World, an organization based in Germany to justify the ALP of the purchase of edible oil from it AE? (Yes, unless the TPO pointed out that quotations of of Oil World, Germany, lacked basis, those quotations were to be considered while determining ALP)

CIT v Adani Wilmar Ltd [TS-114-HC-2014(GUJ)-TP]

OTHER CASE LAWS

- Noble Resources & Trading India (P.) Ltd. [TS-268-ITAT-2016(DEL)-TP] – (Quotations from Solvent Processors Association of India and Platts and Coal Trader International Book).
- SGS India (P.) Ltd. [TS-19-ITAT-2013(Mum)-TP] – (Rates prescibed under FIPB instructions issued by Ministry of Commerce, Government of India).

FACTS

- The assessee, a domestic company, was engaged in the business of manufacturing, refining and trading of edible oil. During AY 2002-03, the assessee entered into an international transaction with one of its AEs for purchase of edible oil. The assessee adopted the CUP method as the most appropriate method to determine the ALP and considered the mean of quotations from 'Malaysia Palm Oil Board (MPOB)' and 'Oil World' as the CUP.
- The TPO accepted the MPOB quotation, but rejected the quotation from Oil World stating that apart from having no statutory authority, Oil World was an independent organization registered in Germany and had nothing to do with the oil prices prevailing in Malaysia.
- CIT(A) deleted the TP addition and observed that Oil World was an authentic independent trade organization providing primary information and quotations of different countries relating to the oil industry, which could not be ignored by the TPO without valid

reasons. Considering the quotations of Oil World, the price paid by the assessee was considered to be at arm's length after granting the benefit of +/- 5% variation.

- The Tribunal upheld CIT(A)'s order accepting the quotation given by Oil World and deleted TP addition of Rs.58.49 lakhs.

DECISION OF THE HIGH COURT

- The Court referring to Rule 10D(3)(c) held that, price publications as long as the same were authentic and reliable, would be relevant material for ALP determination. It noted that Rule 10B of the Rules pertained to CUP method while Rule 10D pertains to 'Information and documents to be kept and maintained under Sec.92D'.
- Further, it held that the price quotations of MPOB were important, however, it would not necessarily mean that the other quotations would lose their significance, unless it was pointed out that such quotations lacked basis.
- The Court observed that TPO's only objection to not consider the quotations of Oil World was that it was an independent entity established outside Malaysia and had nothing to do with the old price prevailing in Malaysia. Against this contention the Court held that *"When the CIT(Appeals) as well as the Tribunal have accepted the reliability and authenticity of the organization and its publication of rate list, such objection of the TPO must be overruled".*

- ***TV channel***

11. Whether CUP would be the MAM for broking services provided by assessee to its AE's, subject to appropriate adjustment for the difference in the functions provided to AE's and Non-AE's (i.e. with respect to reduction of marketing and research cost and high volume and loyalty from AE.)
Whether a TPO ignore the price charged by assessee from its local Indian clients merely because the AE is located outside India.
ACIT v. Morgan Stanley India Company Private Limited [TS-369-ITAT-2020(Mum)-TP]

FACTS

- The assessee, a domestic company, was a broker/dealer of Bombay Stock Exchange and National Stock Exchange having institutional clients, locally and globally. During the year under consideration, the assessee had rendered broking services to its AE's as well as third party clients both in India and abroad.
- The assessee had benchmarked its transaction by adopting TNMM as the MAM in its TP study whereby net margin earned by assessee (i.e. 35.38%) at an entity level was compared with the profit margin earned by comparables (i.e. 21.63%) engaged in similar broking business, thus making assessee's transaction with ALP.
- During the assessment proceedings, the TPO rejected TNMM and computed ALP by applying CUP method, thereby making TP adjustment of INR 1.18 crores. The TPO rejected Indian clients of the assessee as comparable since the AE was located outside India and took into consideration only foreign clients as comparable. The TPO granted adjustment of 30% due to reduction in marketing cost incurred for non AE clients. Thereafter, on appeal, the CIT(A) accepted assessee's contention by accepting all the clients (both Indian and overseas) for CUP and gave additional 10% i.e. total 40% of adjustment on account of reduction in marketing and research cost and increase in volume and loyalty of AE. Consequently, TP adjustment was reduced to INR 658

(however the CIT(A) upheld that CUP should be held as MAM instead of TNMM which is an indirect method)

- During the course of hearing before the Tribunal, the assessee argued that the TPO had granted an adjustment of marketing cost of 0.1076% (approx. 30% of the weighted average rate charged to third party clients), whereas the CIT(A) had granted adjustment of 40% with respect to marketing cost adjustment for significant volume and research cost and granted relief to assessee.
- Further, the assessee argued that the geographical location of the market was of no consequence in judging comparability of an uncontrolled transaction for the purpose of CUP application and that the difference in geographical location could not be reason enough to discard comparables.
- Further, it was also argued by the assessee that the geographical location of service recipients was an irrelevant consideration, since the consulting services provided by the assessee would remain the same whether the service receiver was located in 'X' country or 'Y' as long as the service provider was in India. Thus, the assessee argued that the action of the CIT(A) in granting was right in taking the average brokerage rate charged by assessee to its overseas and Indian clients irrespective of geographical location of service recipients.
- The assessee also argued that if CUP was accepted as the MAM, then a discounting factor of 40% should be applied as an adjustment to brokerage rate charged to all Indian clients, because of the following factors:
    - lesser function performed/ asset utilized and risk assumed by the assessee
    - assessee did not perform any marketing and sales activities while executing trade for its AE
    - levels of other activities such as research, trade relationship etc. were lower in case of transaction with AE's as compared to independent clients
    - while fixing the brokerage rate of AE's (i.e. trusted client of assessee providing substantial volume of business), assessee had considered all the concerned factors.

DECISION OF THE TRIBUNAL

- The Tribunal dismissed the appeal of the Revenue, since the Revenue was not able to controvert the findings of the CIT(A). The relevant findings of the CIT(A), which are taken into consideration by the Tribunal are as follows:
    - If CUP method was applied, then appropriate adjustment was required to be made for all differences.
    - TPO had made adjustment only for the marketing function by making adjustment considering part of marketing cost and had not made any adjustment to research activities on the premise that the AE would get research related services from the assessee. – This action was rejected by the CIT(A), since it was based on assumption/possibility and not on facts.
    - CIT(A) held that it was settled commercial principle that when volume increases the price decreases, taking into consideration the high volume of business profit of AE to the assessee which was 15% of assessee's total volume of business and the other highest non-AE client account was only 3.7% of total business volume.
    - TPO had already considered an adjustment of 0.1076% on account of marketing cost (i.e. approx. 30% of average brokerage charged to all independent clients), as against the plea of the assessee that a discounted factor of at least 50% should be applied. – CIT(A) in order to meet ends of justice to both the parties,

held that for comparability purpose, all the independent entities i.e. domestic as well as overseas should be considered and a discounted factor of 40% as adjustment should be applied on account of reduction in marketing and research cost and increase in volume and loyalty of AE.

- ***Heading***

12. In case of distribution or marketing activities when goods were purchased from associated entities and sales were effected to unrelated parties without any further processing, whether, Resale price method ('RPM') would be the most appropriate method to determine ALP of said transaction?

CIT v L'Oreal India Pvt Ltd [TS-376-HC-2014(BOM)-TP]

FACTS

- The assessee was engaged in the business of manufacturing and distribution of cosmetics and beauty products and had exclusive rights to import, manufacture, market, distribute and sell branded products, consumer products and professional products relating to the L'Oreal Group. It had two segments – the manufacturing segment and the distribution segment.
- The TPO accepted the ALP declared by the assessee in relation to the manufacturing segment which was benchmarked under the Cost Plus Method, but made an addition in respect to the distribution segment.
- The assessee used the Resale Price method as the most appropriate method for the distribution segment and had selected comparables distributing FMCG products, but which were not in the same line of business of the assessee i.e. cosmetics.
- The TPO rejected the RPM and proposed to use the TNMM method on the ground that the degree of similarity in the FAR analysis was not sufficient for the RPM method and that the gross profit margins could not be relied on due to difference in the products.
- The CIT(A) and the Tribunal ruled in favour of the assessee holding that the Resale Price Method is the most appropriate method as it is based on the functions performed and not on similarity of the product distributed.

DECISION OF THE HIGH COURT

- The Court upheld the order of the Tribunal and affirmed that RPM method was one of the standard methods in case of distribution or marketing activities. It relied on the OECD guidelines which states that in case of distribution or marketing activities where goods were purchased from AEs and sold to unrelated parties without further processing, then, RPM method could be adopted.

- ***Heading***

13. Call Centres not functionally comparable with KPO service provider. Supernormal profits indicating functional dissimilarity would require further analysis.

Rampgreen Solutions India Pvt Ltd v CIT [TS-387-HC-2015(DEL)-TP]

FACTS

- The assessee, a wholly owned subsidiary of vCustomer, USA, was engaged in providing voice-based customer care to its AE's clients falling under the category of Call Center Services in the ITES sector for which it was remunerated on a cost plus basis. To justify the arm's length price of the international transaction, the assessee adopted the

Transactional Net Margin Method which was accepted by the TPO. The operating margin of the assessee was 14.83 percent and the operating margin of the comparable companies was 15.74 percent which was within the acceptable range as provided in second proviso to Section 92C of the Income-tax Act, 1961 ('the Act').

- However, the TPO rejected the benchmarking conducted by the assessee and proceeded to determine his own comparable companies selecting 8 companies in total aggregating to a operating margin of 28.96 percent, including Vishal Information Technology Ltd ('Vishal') and Eclerx Services Ltd ('Eclerx'). The assessee was of the view that Vishal and Eclerx could not be considered as comparable as they were engaged in the providing KPO services which was functionally not comparable to the Call Centre services it provided.
- Aggrieved by the order of the TPO, the assessee filed objections before the DRP which accepted certain contentions raised by the assessee but upheld the inclusion of Vishal and Eclerx in spite of functional dissimilarities.
- Subsequently, the assessee preferred an appeal before the Tribunal, wherein it was held that both Vishal and Eclerx were engaged in providing ITeS and once it fell within that category then no sub-classification was permissible. The Tribunal held that KPO is a term given to the branch of BPO services where apart from processing of data, knowledge is also applied and therefore upheld the inclusion of the comparable companies.
- The assessee argued that even though companies providing KPO services were covered under the broad umbrella of Information Technology Enabled Services, they could not be compared to low end / BPO service providers

DECISION OF THE HIGH COURT

- The Court noted the nature of services provided by Voice Call Centers were low end in nature and akin to customer support and processing of routine data and that KPO services involved a higher level of skill and knowledge such as analytical services, market research, legal research, and engineering and design services. It also noted that both Voice Call Centers and KPO service providers would be employing IT based delivery systems but the characteristics of services, functional aspects, business environment risks and quality of human resource employed would be materially different.
- The Hon'ble HC emphasized the importance of functional analysis in determining the level of comparability and the fact that adjustments should be made for any material differences between comparables. Accordingly, it held that the view adopted by the Tribunal was contrary to the rationale of determining ALP using comparables and held that treating the entities to be comparable only for the reason that they use Information Technology for delivery of their services would be erroneous as the characteristics of services provided by Vishal and Eclerx were dissimilar to the services provided by the assessee.
- The Hon'ble HC also noted the observations made in the decision of the Special Bench of the ITAT in the case of Maersk Global Centers India Pvt Ltd [TS-74-ITAT-2014(Mum)-TP], expressing its reservation on the view taken by the Special Bench on the issue of comparability of BPOs and KPOs. It however upheld the findings given therein in relation to the exclusion of Vishal and Eclerx on account on different business model and nature of services performed, respectively.
- It further held that one cannot seek to exclude comparable companies mainly on the ground that they earned supernormal profits. However, it was clarified that in cases the supernormal profits indicated functional dissimilarity it would be necessary to undertake

further analysis to eliminate the possibility of high profits resulting on account of any material dissimilarity between the tested party and the chosen comparable.

- Additionally, the Court addressed another vital point of conflict in relation to the standard of comparability in the TNMM method. It negated the view of the Tribunal and the DRP which stated that broad functionality was sufficient and it was not necessary to make further effort to find a comparable entity providing services of similar characteristics as the tested entity.

  Note:

  - The Apex Court has granted SLP against this order of the High Court and fixed the hearing in 2017 – (2016) 76 taxmann.com 287 (SC)
  - The High Court expressed its reservations vis-à-vis the findings of the Mumbai Special Bench in Maersk Global Centres (India) Pvt Ltd v ACIT – [TS-74-ITAT-2014(Mum)-TP], with respect to the issue of KPO v BPO.

- ***<u>Heading</u>***

14. Companies providing non-binding investment advisory services could not be compared to companies providing merchant banking activities

CIT v Carlyle India Advisors Pvt Ltd [TS-44-HC-2013(BOM)-TP]

FACTS

- The assessee was engaged in providing investment advisory and related support services to its group company in Hong Kong. It adopted the TNMM method as the most appropriate method and arrived at a final set of 5 comparable companies having an average operating margin of 18.97 percent. The assessee had earned an operating margin of 15.02 percent which was within the 5 percent range allowable under the Act.
- The TPO conducted a fresh search and identified 8 comparable companies out of which only one company was a common comparable with the companies selected by the assessee. Accordingly, the TPO made an adjustment which was affirmed by the DRP.
- Aggrieved by the order of the DRP, the assessee filed an appeal before the Tribunal. The Tribunal held in favour of the assessee on the ground that the comparable companies selected by the TPO were not functionally comparable with the functions performed by the assessee as some of the companies chosen by the TPO were engaged in investment banking and merchant banking services which is not the same as investment advisory services. Investment banking and merchant banking services involved assisting in financing capital requirements, underwriting of issues, loan syndication, providing venture capital and mezzanine financing amongst other activities which was not comparable to the work done by the assessee which was restricted to research activities.
- The Tribunal also noted that the TPO had not given any reason for rejecting the comparable companies selected by the assessee and relying on the decision of Addl. CIT v. Maersk Global Service Center India (P.) Ltd. [2011] 133 ITD 543 / 16 taxmann.com 47 (Mum.), held that if the TPO does not reject a comparable on the ground of functional incomparability, then the AO / Revenue could not take a plea of functional incomparability of the comparable companies.

DECISION OF THE HIGH COURT

- The Court upheld the order of the ITAT and ruled in favour of the assessee.

C. Heading

- ***Heading***

15. Company engaged in software development services cannot be compared with companies

- **providing wide array of services**
- **engaged in diverse activities**
- **engaged in software products having IP and not providing software development services**
- **engaged in software products and software services**
- **engaged in diverse field of bioinformatics and related fields**

Company engaged in sales & post sale support service cannot be compared with companies

- **providing seismic research activity**
- **engaged in infrastructure consultancy services**
- **engaged in engineering consultancy, project management services and architectural consultancy**
- **engaged in civil engineering and architectural consultancy**
- **providing consultancy in the field of engineering infrastructure field**
- **rendering high-end technical services**
- **engaged in engineering design services**
- **involved in huge engineering turnkey projects**

ACIT v. Comverse Network Systems India Pvt. Ltd. [TS-264-HC-2020(P & H)-TP] & [TS-261-HC-2020(P & H)-TP]

FACTS

- The assessee, a domestic company, was a wholly owned subsidiary of Comverse Network Systems Inc. USA, engaged in the provision of sales and post-sales support services, software development services, professional and maintenance services to its AEs.
- The TPO considering the functional profile of the assessee, aggregated transactions pertaining to software development services, professional (i.e. customization, configuration etc.) services and maintenance (i.e. trouble shooting) services, into a single segment i.e. software development segment.
- Thus, the TPO benchmarked the following two segments namely i) software development segment and ii) sales and post-sale support services segment, by carrying out a fresh search for both segments having results a under:
- Software development segment:-
    - The TPO sought inclusion of Avani Cincom Technologies Limited ; Celestial Labs Limited ; Infosys Limited ; Kals Information Systems Limited ; Wipro Limited for AY 2008-09 and E-Infochips Bangalore Limited ; Infinite Data Systems Private Limited for AY 2010-11
- Sales & post sale support service:-
    - The TPO proposed inclusion of Alphageo India Limited ; Mahindra Consulting Engineers Limited ; Kirloskar Consultants Limited ; Stup Consultants Limited ; Semac Private Limited and exclusion of Himachal Futuristic Communication Limited for AY 2008-09. Further, the TPO sought inclusion of

Engineers India Limited ; IBI Chamatur Engineering and Consultancy Ltd ; RITES Limited and TCE Consulting Engineers Ltd for AY 2010-11.

DECISION OF THE TRIBUNAL & HON'BLE P&H HIGH COURT

- The HC observed that the Tribunal rejected the comparable selected by the TPO for both the segments and for both the years, by citing functional dissimilarity, huge size, ownership of intangibles etc. (comparable wise reasons discussed below) and apart from generally challenging the rejection of comparables, no grounds of perversity in the order of the Tribunal was bough to notice of the Court by the Revenue. In view of the same, the HC dismissed the appeal the appeal of the Revenue.
- W.r.t software development segment -
  - Avani Cincom Technologies Limited – This company was rejected on account of being functionally dissimilar, as it was engaged in software product company having IP and not providing software development services.
  - Celestial Labs Limited – This company was rejected since it was engaged in diverse field of bioinformatics and related fields in addition to the ERP solutions and hence was functionally dissimilar to the software development segment of the assessee.
  - Infosys Limited - This company was rejected on grounds of functional dissimilarity as it was a market leader and engaged in diverse activities including software services and software products, on account of owning Intangibles and high brand value.
  - Kals Information Systems Limited – This company was excluded on account of being functionally dissimilarity as it was engaged in both software services and software products.
  - Wipro Limited –This company was excluded on grounds of functional dissimilarity as it was engaged both in software products and software development services, owned Intangibles and undertook R&D.
  - E-Infochips Bangalore Limited - This company was excluded on grounds of functional dissimilarity, since it was engaged in development of software as per specific requirement of client and the functional profile of the said company did not indicate that ITeS was included in the software development segment.
  - Infinite Data Systems Private Limited - This company was excluded on grounds of functional dissimilarity, since provided a wide array of services like technical consulting, design and development of software maintenance, system integration, implementation etc. and quantitative details of sales from these individual sectors were not available.
- W.r.t Sales & post sale support service:-
  - Alphageo India Limited – The Tribunal excluded this company on ground of functional dissimilarity as it was engaged in providing seismic research activity such as 2D and 3D seismic services for design and preplanning of 2-D and 3-D surveys, seismic data acquisition.
  - Mahindra Consulting Engineers Limited - The Tribunal excluded this company on ground of functional dissimilarity as it was engaged in infrastructure consultancy services.
  - Kirloskar Consultants Limited – This company was excluded on ground of functional dissimilarity as it was engaged in engineering consultancy, project management services, architectural consultancy.

- Stup Consultants Limited - This company was excluded on ground of functional dissimilarity as it was involved in profession of civil engineering and architectural consultancy.
- Semac Private Limited – This company was excluded on ground of functional dissimilarity as it was engaged in providing engineering consultancy services which was absolutely different from the sales and post sales support services rendered by the assessee. Further, the Tribunal observed that that the requirement of human resources competence for providing consultancy in the field of engineering was all together different from the manpower required for providing sales and post sales support services.
- Engineers India Limited - The Tribunal held that the assessee provided support services to its AE in respect of sale of software by AE and that bug fixing was also a part of post sales support services, which could have been treated partly as function of technical nature, however the same could not be compared with consultancy provided in the field of engineering infrastructure field provided by this company.
- IBI Chamatur Engineering and Consultancy Ltd – The Tribunal excluded this company as it was functionally dissimilar, since it was involved in huge engineering projects which were turnkey in nature.
- RITES Limited – The Tribunal excluded this company since it was rendering high-end technical services and being a Govt. of India undertaking which were incomparable with the low-end sale and post sale services rendered by the assessee.
- TCE Consulting Engineers Ltd – The Tribunal directed exclusion of this company on grounds of being functional dissimilarity since along with engineering design services, this company was engaged in activities that extend from concept to engineering and segmental details for the same were not available.

- The HC relied on its HC ruling in case of PCIT v Equant Solutions India Pvt. Ltd. [TS-1124-HC-2019(P & H)-TP], Bombay HC in the case of CIT vs. PTC Software [TS-788-HC-2016(BOM)-TP] and in PCIT v. Barclays Technology Centre India Pvt. Ltd. [TS-787-HC-2018(BOM)-TP] and by the Karnataka HC in case of PCIT v. Softbrands India Pvt. Ltd. [TS-475-HC-2018(KAR)-TP], wherein the Tribunal's decision on comparables selection was upheld in absence of perversity in Tribunal findings, pointed out by Revenue.

- ***<u>Heading</u>***

16. Transfer pricing adjustment is permissible only on transaction with associate enterprise and not on entire turnover

Alstom Projects India Ltd v ACIT [TS-205-ITAT-2013(Mum)-TP]

Related Case Laws

- CIT v. Phoenix Mecano (India) (P.) Ltd. [TS-460-HC-2017(BOM)-TP]

FACTS

- The assessee was inter alia engaged in business in the power sector. During AY 2006-2007, the power segment of the assessee had made a turnover of Rs. 891.21 crores with an operating profit to sale margin of 6.06 percent. In the said segment, the assessee had four transactions of purchases from its AE aggregating to Rs. 69.32 crore.

- The TPO decided to benchmark the transactions and accordingly arrived at an operating profit to sales margin of 6.44 percent considering 12 comparable companies and re-computed the margin of the assessee at 6.03 percent. Accordingly, the TPO made an adjustment of Rs. 3.83 crores on the basis of the entire turnover of the segment, since the adjustment was over and above the 5 percent benefit permitted under section 92CA of the Act.
- The assessee contended that even if the TPO proposed to make an adjustment he should have done so only in respect of the international transactions entered into with the AEs and not on the entire turnover.
- The assessee contended that the adjustment to be made on the international transactions was limited to Rs. 32 lakhs and in support of the same filed a detailed working to illustrate the computation. Since the adjustment of Rs. 32 lakh with respect to international transactions amounting to Rs. 69.32 crores fell within the 5 percent benefit, the assessee contended that the addition should be deleted.

DECISION OF TRIBUNAL

- The Tribunal held in favour of the assessee by stating that TP adjustment is permissible only on transactions undertaken with AEs. With regards to the application of the 5 percent safe harbour, the ITAT held that since the computation furnished by the assessee, correctly demonstrated the possible adjustment and that the said adjustment was within the 5 percent range, which was not disputed by the Revenue, no addition was to be made.
  Note: This is one of the very few cases wherein instead of setting the matter to the file of the TPO to compute the adjustment vis-à-vis AE transactions, the Tribunal deleted the addition
- The same view has been upheld in a large number of decisions of the Bombay High Court as well viz. CIT v Goldstar Jewellery Design Pvt Ltd – [TS-486-HC-2016(BOM)-TP], Hindustan Unilever Ltd [TS- 538-HC-2016(BOM)-TP], CIT Vs. M/s. Tara Jewellers Exports Pvt. Ltd. [TS-481-HC-2015(BOM)-TP] CIT V. Pedro Araldite Pvt. Ltd. [TS-586-HC-2015(BOM)-TP], CIT V. M/s. Thyssen Krupp Industries Pvt. Ltd. [TS-590-HC-2015(BOM)-TP] and CIT V. M/s. Summit Diamond (India) Pvt. Ltd. (ITA No. 1647 of 2013).

- ***<u>Designs</u>***

17. AMP expenses could not be considered as an international transaction in the absence of any agreement, arrangement etc., merely on the basis of the Bright line Test.

Maruti Suzuki India Ltd [TS-43-HC-2010(DEL)] & [TS-93-SC-2010]

FACTS

- The assessee, Maruti Suzuki India Ltd (MSIL), was engaged in the manufacture of passenger cars in India. It was a subsidiary of Suzuki Motor Corporation (SMC). A license agreement was entered into between MSIL and SMC in October 1982 by which, MSIL was permitted to use the co-branded trademark 'Maruti-Suzuki' on certain vehicle models. The assessee incurred certain AMP expenses towards promotion of its brand.
- A reference under section 92CA(1) was made by the AO to the TPO for determination of arm's length price for the international transaction undertaken by the assessee with Suzuki in the financial year 2004-05. A notice dated 27-8- 2008 was then issued by the TPO to the assessee with respect to replacement of the front logo 'M' by the logo 'S' in

respect of three models, namely, 'Maruti' 800, Esteem and Omni in the year 2004-05, which, according to the TPO, amounted to sale of the brand 'Maruti' to 'Suzuki'. He noticed that Suzuki had taken substantial amount of royalty from Maruti without contributing anything towards brand development and penetration in the Indian market and Maruti had incurred expenditure amounting to Rs. 4,092 crores on advertisement, marketing and distribution activity, which had helped it in creation of 'Maruti' brand logo and due to which Maruti had become the number one car company in India. Computing the value of the brand at cost plus 8 per cent method, TPO assessed the value of the brand at Rs. 4,420 crores and the assessee was asked to show cause as to why the value of Maruti brand should not be taken at Rs. 4,420 crores and why the international transaction should not be adjusted on the basis of its deemed sale to Suzuki.

- The assessee, in its reply, stated that at no point of time, had there been any transfer of 'Maruti' brand or logo to Suzuki, which did not have any right at all to use that logo or trademark; and that it was on account of its large shareholding in the company and because of strong competition from the cars introduced by multinationals in India, that Suzuki had permitted the assessee to use the 'Suzuki' name and logo, so that it could face the competition and sustain its market share, which was under severe attack. It was also submitted that Suzuki had not charged any additional consideration for use of its logo on the vehicles manufactured by Maruti and there was no question of any amount of revenue being transferred from the tax net of Indian exchequer to any foreign tax jurisdiction.
- The jurisdiction of the TPO was, thus, disputed by the assessee in the reply submitted to him. Since the assessee did not get any response to the jurisdictional challenge and the TPO continued to hear the matter on the basis of the notice issued by him, without first giving a ruling on the jurisdictional issue raised by it, writ petition was filed seeking stay of the proceedings before the TPO.
- During pendency of writ petition, the TPO passed final order where he inter alia came to the conclusion that Maruti had developed marketing intangibles for Suzuki in India at its cost and it had not been compensated for developing those marketing intangibles for Suzuki. He also concluded that non-routine advertisement expenditure amounting to Rs. 107.22 crores was also to be adjusted.
- In the circumstance, the assessee amended its writ petition so as to challenge the final order passed by the TPO.

HIGH COURT'S 1ST JUDGMENT (DATED 1ST JULY 2010)

- The expenditure incurred by a domestic entity, which was an associate enterprise of a foreign entity, on advertising, promotion and marketing of its products using a foreign trademark/logo did not require any payment or compensation by the owner of the foreign trademark/logo to the domestic entity on account of use of the foreign trademark/logo in the promotion, advertising and marketing undertaken by it, so long as the expenses incurred by the domestic entity did not exceed the expenses which a similarly situated and comparable independent domestic entity would have incurred.
- If the expenses incurred by a domestic entity which was the associate enterprise of foreign entity, using a foreign brand trademark and/or logo while advertising, marketing and promoting its products, were more than what a similarly situated and comparable independent domestic entity would have incurred, the foreign entity needed to suitably compensate the domestic entity in respect of the advantage obtained by it in the form of brand building and increased awareness of its brand in the domestic market.
- In order to ascertain whether the expenses incurred by the domestic entity, which was an associate enterprise of a foreign entity, on the marketing, promotion and advertising

of its products using the brand trademark/logo of the foreign entity, were more than what a similarly situated and comparable independent domestic entity would have incurred, it would be necessary to identify appropriate comparables for the purpose of comparison of their expenditure with the expenditure incurred by the domestic entity in this regard. Suitable adjustments would have to be made considering the individual profiles of these entities and other facts and circumstances.

SUPREME COURT'S DIRECTION (DATED OCTOBER 1, 2020)

- The TPO who in the meantime, had already issued a show-cause notice was to be directed to proceed with the matter in accordance with law uninfluenced by the observations/directions given by the High Court in the impugned judgment.

FACTS

- The TPO benchmarked AMP expenses by applying the 'Bright Line Test' ('BLT') and compared the proportion of such expenses incurred by MSIL with that incurred by comparable companies. Since the ratio of selling and distribution expenses as a percentage of sales of MSIL was higher than that incurred by the comparable companies, the TPO concluded that the excess must be regarded as having been incurred for promoting the brand 'Suzuki' owned by SMC. Accordingly, he made the adjustment on account of AMP expenses.
- The DRP upheld the addition made by the TPO on account of AMP expenses.
- On appeal, the Tribunal upheld assessment order.
- On appeal to the High Court the assessee contended that once the BLT had been rejected by the decision in Sony Ericsson Mobile Communications India (P.) Ltd. v. CIT the question of there being an international transaction did not arise. Independent of the above, it was submitted by assessee that the revenue had to show the existence of an agreement or an arrangement or an understanding between MSIL and SMC prior to incurring of the AMP expenditure, in terms of which MSIL would incur AMP expenditure in excess of the bona fide requirements of its business in India and thereby may add to the value of the brand of the foreign AE, i.e., SMC. In other words, it was contended that mere incurring of the AMP expenditure would not be considered as an international transaction.

DECISION OF DELHI HIGH COURT (dated Dec 11, 2015) - [TS-595-HC-2015(DEL)-TP]

- Under section 92B(1) an 'international transaction' means-

  (a) a transaction between two or more AEs, either or both of whom are non-resident

  (b) the transaction is in the nature of purchase, sale or lease of tangible or intangible property or provision of service or lending or borrowing money or any other transaction having a bearing on the profits, incomes or losses of such enterprises, and

  (c) shall include a mutual agreement or arrangement between two or more AEs for allocation or apportionment or contribution to any cost or expenses incurred or to be incurred in connection with the benefit, service or facility provided or to be provided to one or more of such enterprises.
- While SMC had a number of 'transactions' with MSIL on the issue of licensing of IPRs, supply of raw materials, etc. which were bench marked, the question remained whether it had any 'transaction' concerning the AMP expenditure.
- The revenue had to show that there existed an 'agreement' or 'arrangement' or 'understanding' between MSIL and SMC whereby MSIL was obliged to spend excessively on AMP in order to promote the brand of SMC.

- Even if the word 'transaction’ was given its widest connotation, and need not involve any transfer of money or a written agreement as suggested by the revenue, and even if resort is had to section 92F(v) which defines 'transaction' to include 'arrangement', 'understanding' or 'action in concert', 'whether formal or in writing', it was still incumbent on the revenue to show the existence of the same between MSIL and SMC as regards AMP spend for brand promotion. In other words, for both the 'means' part and the 'includes' part of section 92B(1) what had to be definitely shown is the existence of transaction whereby MSIL had been obliged to incur AMP of a certain level for SMC for the purposes of promoting the brand of SMC.
- In the instant appeals, the very existence of an international transaction was in issue. The specific case of MSIL was that the revenue had failed to show the existence of any agreement, understanding or arrangement between MSIL and SMC regarding the AMP spend of MSIL.
- The BLT had been applied to the AMP spend by MSIL to (a) deduce the existence of an international transaction involving SMC and (b) to make a quantitative 'adjustment' to the ALP to the extent that the expenditure exceeded the expenditure by comparable entities. It was submitted that with the decision in Sony Ericsson having disapproved of BLT as a legitimate means of determining the ALP of an international transaction involving AMP expenses, the very basis of the revenue's case was negated.
- In other words, the very existence of an international transaction could not be a matter for inference or surmise.
- The OECD Transfer Pricing Guidelines, para 7.13 emphasised that there should not be any automatic inference about an AE receiving an entity group service only because it gets an incidental benefit for being part of a larger concern and not to any specific activity performed.
- (a) The decision in Sony Ericsson had done away with the BLT as means for determining the ALP of an international transaction involving AMP expenses. Therefore, the existence of an international transaction would have to be established de hors the BLT.
- (b) Even the Sony Ericsson judgment made it clear that AMP adjustment cannot be made in respect of a full-risk manufacturer.
- (c) In Sony Ericsson it was held that if an Indian entity has satisfied the TNMM, i.e., the operating margins of the Indian enterprise are much higher than the operating margins of the comparable companies, there was no question of TP adjustment on account of AMP expenditure.
- (d) In Sony Ericson, it was also held that the issue of arm's length price per se did not arise when deduction under section 37(1) is claimed.In the context of the AMP expenses incurred by manufacturer exclusively for its own business, it was arguable that once such expense is allowed under section 37(1), it could not be disallowed for the purpose of Chapter X by attributing some part of the said expenditure to promoting the brand of the foreign AE. The key words as far as section 37(1) was concerned were ’any expenditure...laid out or expended wholly and exclusively for the purposes of the business or profession’.
- It was not for the revenue to dictate to an entity how much it should spend on AMP. That would be a business decision of such entity keeping in view its exigencies and its perception of what was best needed to promote its products.

- ***<u>Headings</u>***

18. Optionally convertible loans given by the assessee to its Irish subsidiary, whereby the assessee lender had either the option for repayment or for conversion of loan into equity at par at any time during the tenure of the loan was in the nature of quasi capital and therefore could not be compared with a simple loan transaction where the sole motivation and consideration for the lender was interest on loans.

Cadila Healthcare Limited Vs ACIT (2017) TS-241-ITAT-2017(Ahd)-TP

Other Case Laws

- Bialkhia Holdings (P.) Ltd. v. ACIT [TS-118-ITAT-2020(SUR)-TP]

FACTS

- The assessee was engaged in the manufacturing formulations and APIs (Active Pharmaceutical Ingredients). It had advanced an optionally convertible loan to its AE viz. Zydus International Pvt Ltd, Ireland, on 9.10.2007 for an amount of US $ 27 million, as per the terms and conditions of which, it had the option for repayment along with interest (the cumulative interest payable by the borrower was LIBOR plus 290 basis points at the end of the period of the loan) or for conversion of the said loan into equity at par at any time during the 5 year tenure of the loan. On 30 September, 2008, the assessee exercised the conversion option under this arrangement and the loan was converted into equity at par.
- The TPO noted that assessee had not charged or provided for interest on these loans and held that the AE had unduly benefited from this transaction as it had received Rs 9.69 crore as interest and dividend income from various entities to which money was given in the form of loan / capital. Relying on a US Supreme Court decision in Pepsi Cola Bottling Co, he concluded that the character of the instrument was predominantly debt rather than equity and therefore computed interest @ 7.02% on the amount of loan provided. The DRP upheld the addition of the TPO

DECISION OF THE TRIBUNAL

- Considering the facts of the case, the Tribunal observed that the lending in question was in the nature of quasi capital in the sense that substantive reward, or true consideration, for the loan transaction was not interest simplictor on amount advanced but opportunity to own capital on certain favourable terms. Relying on the decision of the coordinate bench decision in Soma Textile & Industries [TS-324-ITAT-2015(Ahd)-TP], wherein it was held that “the considerations for extending a loan simplictor were materially distinct and different from extending a loan which is given in consideration for, or mainly in consideration for, option to convert the same into capital on certain terms which are favourable vis-à- vis the terms available… to an independent enterprise”.
- It held that the right comparable for a transaction of quasi capital was a similar transaction of lending money on the same terms i.e. with an option to convert the loan into capital on materially similar terms, and since the consideration for giving the loan in such case was the opportunity and privilege of owning capital of the borrower on certain favourable terms, comparison should have been done with other loans giving similar privilege and opportunity to the lender. Accordingly, it stated that a quasi-capital transaction could not be compared with a simple loan transaction where sole motivation and consideration for the lender is interest on loans, and therefore concluded that the ALP adjustment was unsustainable.
- With regard to the TPO’s reliance on the US Tax Court decision in Pepsi Cola Bottling Co, it held that the TPO had wrongly referred to it as the US Supreme Court decision, and that in any case, the decision did not relate to ALP determination.

- Vis-à-vis the TPOs contention that since the AE had derived substantial profits, the assessee ought to have charged interest on the loans advanced by it, it stated that the 'benefit' subsequently derived by AE from a transaction was immaterial for ALP determination. Noting that it was not the case of lower authorities that no independent enterprise would not have given an interest free loans even if there was an option, coupled with such a deal, to subscribe to the AE's capital on the terms as offered to the assessee, the Tribunal held that there was not even a prima facie case made out for ALP adjustment.
- Additionally, it also noted that on lapse of assessee's right to exercise the option of converting the loan into equity, the assessee was entitled to interest on the commercial rates, however, it was not the case of lower authorities that interest so charged by the assessee was not at ALP.

- ***Heading***

19. Interest on Outstanding Receivables

Favorable Decisions

No.	**Name**	**Not an International Transaction**	**Sales at ALP**	**Debt Free Co.**	**Not Charging from Non-AE**
	AY 2012-13 onwards				
1	DCIT v. CCL Products India Ltd. [TS-342-ITAT-2019(VIZ)-TP]		✓	✓	
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	Target Sourcing Services India v. ACIT– [TS-1217-ITAT-2019(DEL)-TP]		✓	✓	
7	Vossloh Beekay Castings v. ACIT – [TS-146-ITAT-2020(DEL)-TP]		✓		
8	McKinsey Knowledge Centre Ltd. V. DCIT –[TS-884-ITAT-2019(DEL)-TP]			✓	
9	Frost & Sullivan India Pvt. Ltd. – [TS-623-ITAT-2019(Mum)-TP]				✓
	Prior to AY 2012-13				
10	Kusum Healthcare P Ltd v ACIT - [TS-412-HC-2017(DEL)-TP]	✓			
11	Pr.CIT v Bechtel India Pvt. Ltd. - [TS-591-SC-2017-TP]			✓	
12	Pr.CIT v Bechtel India Pvt. Ltd. (Delhi HC) - [TS-508-HC- 2016(DEL)-TP]			✓	
13	CIT v Indo American Jewellery Ltd. (Bom				✓

No.	Name	Not an International Transaction	Sales at ALP	Debt Free Co.	Not Charging from Non-AE
	HC) - [TS-3-HC-2013(BOM)-TP]				
14	Pegasystems Worldwide India Pvt Ltd v ACIT - [TS-488- ITAT-2015 (Hyd)-TP]	✓			
15	Goldstar Jewellery Limited v. JCIT– [TS-14-ITAT-2015(Mum)-TP]		✓		✓
16	Samsung India Electronics (P.) Ltd. v. ACIT [TS-5-ITAT-2020(DEL)-TP]	✓			

Adverse Decisions

No.	Name	% of Interest	Credit Period	Remarks, if any
1	Tecnimont Pvt. Ltd. – [TS-880-HC-2018(BOM)-TP]	LIBOR	60 days	The HC has 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.
2	Logix Micro Systems Ltd. - TS-49-ITAT-2010(Bang)	Short term deposit @ 5%	Reasonable Period	
3	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.
4	Bridal Jewellery Mfg. Co. TS-252-ITAT-2019(DEL)-TP	LIBOR + 400 points	90 days	
5	Techbooks International Pvt. Ltd [TS-317-ITAT-2015(DEL)-TP]	PLR should not be used, since debts in FC	150 days	The Tribunal had 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.
6	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.
7	AMD India Pvt. Ltd. [TS-993-HC-2018(KAR)-TP]	Average cost of total funds	30 days	

20. Whether Transfer Pricing adjustment in respect to interest free loan given by F Co. (assessee) to I Co. (subsidiary) would not be justified interalia on the ground that the same would lead to base erosion under section 92(3) of the Act, since the rate of tax in the hands of F Co. was lower than the rate of tax in the hands of I Co?

Instrumentarium Corporation Ltd v ADIT (IT) [TS-467-ITAT-2016(Kol)-TP]

Relevant Provisions

- Section 92(3) of the I.T. Act

"(3) The provisions of this section shall not apply in a case where the computation of income under sub-section (1) or sub-section (2A) or the determination of the allowance for any expense or interest under sub-section (1) or sub-section (2A), or the determination of any cost or expense allocated or apportioned, or, as the case may be, contributed under sub-section (2) or sub-section (2A), has the effect of reducing the income chargeable to tax or increasing the loss, as the case may be, computed on the basis of entries made in the books of account in respect of the previous year in which the international transaction or specified domestic transaction was entered into."

FACTS

- The assessee, a company incorporated in Finland was engaged in the business of manufacturing and selling medical equipment. It had a wholly owned subsidiary in India viz. Datex Ohmeda India Pvt Ltd India ('Datex India') which acted as its marketing arm. During Financial Year 2002-03, the assessee and its subsidiary entered into an agreement, which was duly approved by the RBI, whereby the assessee advanced an interest free loan of Rs. 36 crore to Datex India. The assessee had filed an application before the Authority for Advanced Rulings with a view to obtain adjudication on whether it was required to comply with the Transfer Pricing provisions contained in the Act and charge Datex India interest as per the principles of the ALP. The AAR observing that the assessee was bound to comply with the provisions of Section 92 to 92F of the Act, refrained from adjudicating on whether the assessee was to charge interest as per ALP principles as this aspect fell under the bar contained in Proviso ii to Section 245R(2) which provides that the AAR was to reject applications where the questions raised involved determination of fair market value of any property.
- Despite the findings made by the AAR, the assessee neither filed its income tax return nor responded to the notices issued under Section 148 and 142(1) of the Act, as a result of which the AO proceeded to treat Datex India as the representative assessee and proceeded to finalize assessment under section 144 read with Section 147 of the Act. The AO observed that the assessee had granted an interest free loan to Datex India during the prior year as well. Accordingly, concluding that the interest free loan was not at ALP, he proceeded to make an addition of interest on the said loan adopting the average PLR of the State Bank of India for FY 2002-03 i.e. 10.87 percent as the ALP.
- As regards assessee's argument regarding Indian tax base erosion, the AO contended that since Datex India was a loss making company right from the beginning, i.e., not making profits and paying taxes thereon, the payment of interest by Datex India would only enhance the losses and the loss of revenue will be merely notional. The AO therefore concluded that in this case, the non-application of arm's length principle would result in a real loss for the Indian tax revenue, and not the other way round.
- Aggrieved, the assessee filed an appeal before the CIT(A), wherein the CIT(A) upheld the order of the AO.
- Accordingly, the assessee filed an appeal before the Hon'ble Tribunal

- The assesse argued that the provisions of transfer pricing could not be invoked in a situation wherein the consequence of making an ALP adjustment would lead to erosion of domestic tax base i.e. a) that in the event that interest free loans from foreign parent company were subjected to ALP adjustment, the Indian tax base would stand eroded by 26.75% of such an adjustment (tax benefit of 36.75% on reduction or deductibility of interest expense in the hands of Datex India less 10% withholding tax on interest payable) and b). it would increase the loss incurred by Datex India which could be subsequently carried forward and set off against future profits. Therefore, applying the provisions of section 92(3) of the Act, and CBDT circulars No. 12 and 14 of 2001, the TP provisions should not apply to the transaction in dispute.
- CBDT Circular No 12 of 2001 provides that the transfer pricing provisions "have been enacted with a view to provide statutory framework which can lead to computation of reasonable, fair and equitable profit and tax in India so that the profits chargeable to tax in India do not get diverted elsewhere by altering the prices charged and paid in intra-group transactions leading to erosion in our tax revenues"
- Circular No 14 of 2001 provides that "that newly substituted section 92 is intended to ensure that profits taxable in India are not understated (or losses are not overstated) by declaring lower receipts or higher outgoings than those which would have been declared by persons entering into similar transactions with unrelated parties in the same or similar circumstances"
- The assessee also relied on Australian Tax Office ruling, which held that no ALP adjustments are to be made where the non-resident company grants interest free loans to a loss making domestic company.
- That the second proviso to Section 92C(4) of the Act was not applicable to the case of the assessee, as no payment was made by Datex India.
- Other contentions: (i) grant of interest-free loan was in the nature of a shareholder service; (ii) commercial expediency of the interest-free loan could not be disregarded; (iii) interest free loan being treated as interest- bearing amounted to re-characterization, which was not permissible; and (iv) notional income could not be brought to tax.

DECISION OF THE TRIBUNAL

- The Tribunal held that Section 92(3) of the Act, refers to computation of income in the hands of the assessee in respect of whom income is being computed under Section 92(1) of the Act and does not contemplate taking of a holistic view, considering lowering of overall profits / increasing overall losses, not only for the assessee but in respect of all AEs (taxable in India) taken as a whole. It held that on a plain reading of Section 92(3) of the Act, what is to be seen is impact on profits or losses for the year in consideration itself, rather than taking into account the impact on taxes for the subsequent years and since the tax shield available to Datex India as a result of accumulated losses, if any, could only affect income of the subsequent years, which were not relevant for the purpose of Section 92(3) of the Act, the contention of the assessee was to be dismissed.
- Further, it held that that the amount by which assessee's income was increased by way of ALP adjustments was not available for deduction in the hands of Datex India. It disagreed with assessee's contention that if an altogether new income was brought to tax in the hands of the assessee, consequent to an ALP adjustment, corresponding deduction was required to be given to Datex India as there was no specific legal provision enabling such a corresponding deduction under the transfer pricing legislation. Thus, it held that if the transaction in the instant case was accepted without an ALP adjustment, it would result in base erosion to the extent of taxability of interest in the hands of the non-resident taxpayer.

- As regards reliance on CBDT circulars, it opined that the same only stated the intent of the legislature and was not an order, direction or instruction to the field authorities to the effect that Section 92 of the Act was not to be applied when overall tax incidence in India, in respect of the parties involved in the international transaction, decreases.
- The reference to the second proviso of section 92C(4) of the Act was unwarranted, as it applies to situations distinct from those prevailing in the instant case. It held that the proviso constituted a bar against lowering of the non-resident AE's income as a result of lowering the deduction in the Indian AE's hands, rather than as enabling a higher deduction in the Indian AE's hands as a result of increasing the non- resident AE's income.
- It dismissed the assessee's reliance on the Australian Tax Office ruling, observing that under Australian law, computation of income based on ALP was discretionary while it was mandatory under Indian tax laws.
- Vis-à-vis the other contentions raised by the assessee, it held that:
  - Shareholders activity - The shareholder activity argument had been raised before it for the first time and therefore could not be adjudicated in the absence of facts to support the contention
  - Commercial expediency – It opined the commercial expediency of a loan to subsidiary was wholly irrelevant in ascertaining its arm's length interest. It observed that there was no bar to advance interest free loans, however if the same was covered by the international transactions between AEs, Section 92 would get attracted which mandated determination of ALP.
  - Re-characterisation of loan –that the substitution of zero interest by arm's length interest did not alter the basic character of transaction and that as per Section 92(1) which was a computation mechanism and not an adjustment mechanism even when no income was reported in respect of an item in the nature of income, the substitution of transaction price by arm's length price could be brought to tax as income under Section 92.
  - Notional income cannot be tax – It rejected assessee's reliance on Shoorji Vallabhdas decision as wholly misplaced because that proposition was in the context of tax laws in general, whereas, TP provisions, being anti-abuse provisions with the sanction of the statute, come into play in the specific situation of certain transactions with AEs. It also clarified that assessee could not derive any support from Vodafone decision since consideration for a loan, i.e. interest, is inherently in the nature of income.
- Accordingly, it dismissed the appeal of the assessee.

21. Any legitimate expenditure (Royalty) for purpose of business carried cannot be disallowed while computing ALP merely because assessee was continuously incurring losses. The TPO was not empowered to question the commercial expediency of the transaction.

CIT v EKL Appliances [TS-206-HC-2012(DEL)-TP]

Other Case Laws

- CIT v. SI Group-India Ltd. [TS-525-HC-2019(BOM)-TP]

FACTS

- The assessee, was engaged in the manufacturing and trading of refrigerators, washing machines, microwave ovens, air conditioners, etc. For A.Y. 2002-03 and 2003-04 the assessee declared a loss. The assessee paid royalty / brand fee to its Swedish AE for the brand Kelvinator" @ 0.5% of net sales (later revised to 1 %)

- Considering the perpetual losses suffered by the assessee, the TPO concluded that though there was an increase in turnover, the royalty payment had not benefited the assessee and that the assessee failed that to demonstrate the actual benefit derived by it by using the brand name Hence, the TPO held that the royalty payment for the impugned years was unjustified and ought to be taken as "nil".
- The CIT (A) and ITAT decided in favour of the assessee.
- Aggrieved, the Revenue filed an appeal before the Hon'ble High Court

DECISION OF TRIBUNAL

- The Court held that "it is not necessary for the assessee to show that any legitimate expenditure incurred by him was also incurred out of necessity.
- It is also not necessary for the assesse to show that any expenditure incurred by him for the purpose of business carried on by him has actually resulted in profit or income either in the same year or in any of the subsequent years.
- The only condition is that the expenditure should have been incurred 'wholly and exclusively" for the purpose of business and nothing more".
- Rule 10B(1) (a) does not authorise disallowance of any expenditure on the ground that it was not necessary or prudent for the assesse to have incurred the same or that in the view of the Revenue the expenditure was un-remunerative.
- The disallowance was not possible on the ground that in view of the continued losses suffered by the assesse in business, he could have fared better had he not incurred such expenditure.
- Also the assesse had furnished copious material and valid reasons as to why it was suffering losses continuously. Full justification supported by facts and figures was given to demonstrate that the increase in three employees cost, finance charges, administrative expenses, depreciation cost and capacity increase have contributed to the continuous losses. No material was placed on record by the revenue to show that these were incorrect figures or that reasons for the lasses were not genuine.
- Accordingly, it deleted the adjustment made by the TPO.

D. Heading

- ***<u>Heading</u>***

22. When the payment of royalty to AE's, forms part of the operating cost under the entity level TNMM accepted by the TPO, a separate benchmarking for payment of royalty to AE's would not be warranted.

Kaypee Electronics & Associates (P.) Ltd. v. DCIT [TS-414-HC-2018(KAR)-TP]

FACTS

- The assesse had entered into international transaction viz., i) purchase of raw material, ii) sales, iii) purchase of fixed assets and iv) payment of royalty.
- As regards the royalty payment - the assessee had entered into a Technology Collaboration Agreement (Agreement) with the said AE for manufacturing electronic components by using technology, enterprise and know how of the AE, marketing, selling the same under the Brand name of the AE, in India and abroad. As consideration, the assessee had paid royalty @ 8% on sales to the said AE in terms of the Agreement (i.e. approx. INR 4.39 crore).

- During the course of assessment proceedings the AO referred the matter to the TPO for benchmarking the royalty payment. Though all other international transactions were accepted to at ALP under TNMM (i.e. the margin of the assessee was accepted to be at ALP), the TPO held that payment of Royalty @ 8% on sales was not justified as there was no value addition made by the AE and accordingly determined the ALP in respect of royalty payment at approx. INR 2.75 crore, which was later confirmed by the DRP.
- The Tribunal disposed the appeal by observing that the only issue under consideration was as to whether the TPO was justified in making the arm's length price adjustment in respect of royalty payment made to AE?
- The Tribunal while rejecting the contention that when TNMM was applied at the entity level, there was no necessity for benchmarking in respect of royalty transactions, observed that on perusal of TPO's order it was manifest that the TPO had picked up the transaction royalty alone for the purpose of benchmarking.

DECISION OF THE HIGH COURT

- Before the HC, the assessee argued that the contention of the assessee i.e. regarding the necessity of separate benchmarking in respect of royalty payment when the TPO had accepted the TNMM at the entity level, was covered by the decision of Sony Ericsson Mobile Communications India (P.) Ltd. v. CIT [TS-96-HC-2015(DEL)-TP] and the decision of the co-ordinate Bench of this court in the case Siemens VDO Automotive Ltd. v. DCIT (TP) [TS-79-ITAT-2017(Bang)-TP]. Further, the assessee also argued that the Tribunal had not heard the ground raised before it pertaining to merits of the TP adjustment on account of royalty payment.
- The Hon'ble HC finding force in the arguments of the assessee, remanded the matter to the Tribunal with a direction to decide the matter afresh (without being influenced by the observations made by the HC as below)
- The HC observed that the Tribunal dismissed the appeal of the assessee without considering the decision of Sony Ericsson Mobile Communications (supra) and Siemens VDO Automotive Ltd. (supra), and thereby the question of law (i.e. whether the Tribunal erred in law in failing to follow the decisions of the co-ordinate bench of the same jurisdiction) was answered in favor of the assessee.
- The HC did not found it not necessary to answer the substantial question of law raised by the assessee (i.e. whether the Tribunal was right is law in upholding adjustment to royalty although such royalty formed part of operating cost under enterprise level TNMM which was accepted by the TPO), since the matter was remanded to the file of the Tribunal for deciding afresh.

- ***<u>Heading</u>***

23. If the payment of royalty is below the rate prescribed under Press Note No. 9 (2000 series) issued by Govt. of India, Ministry of Commerce and Industry, the same could be construed at ALP.

Carraro India (P.) Ltd. v. DCIT [TS-124-ITAT-2019(PUN)-TP]

FACTS

- The assessee, a domestic company, was engaged in the business of designing, manufacturing and marketing mechanical and transmission systems for on-road and off-road vehicles. During the year under consideration (i.e. AY 2009-10), the assessee paid a total royalty of INR 1.01 crore in respect of two agreements viz., INR 26.39 lakhs pertaining to earlier agreement dated 5-4-2001 (i.e. old agreement), which was paid @

2% both for use of technical know-how and brand name; and INR 75.41 lakhs pertaining to agreement dated 1-7-2008 (i.e. new agreement) for use of name and logo of its AE's @ 0.50%.

- During the course of assessment proceedings, the TPO observed that the assessee paid royalty for the use of 'Carraro' brand name, which was part of its own name and all the products manufactured by it legitimately carried the same. Further, the TPO also observed that most of the assessee's customers were Original Equipment Manufacturers (OEM's) and they did not looked for any logo on the components. Accordingly, the TPO held that the there was no justification for payment of royalty under the new agreement and hence determined the ALP of the said payment as NIL. Impliedly, the TPO accepted the payment of royalty under the old agreement at ALP.
- However, at the time of passing the final order, the AO held that the knowledge obtained through the designs/drawings etc. became the property of the assessee and hence, the payment of INR 1.01 crore as royalty was a capital expenditure. Accordingly, the AO concluded the assessment proceedings, by allowing depreciation on the said capital expenditure @ 25% and disallowed the balance payment. On appeal, the CIT(A), deleted the action of the AO in treating the royalty payments as capital expenditure, however upheld the action of the TPO in determining ALP as NIL.

DECISION OF TRIBUNAL

- **W.r.t whether the order of the TPO is binding on the AO**
- The Tribunal observed that on a conjoint reading of the earlier and existing sub-section (4) of section 92CA, it makes it explicitly manifest that whereas under the earlier provision, the report of the TPO was not binding on the AO and the AO could compute the total income of the assessee by just having regard to the ALP determined by the TPO. If the AO was not satisfied with the TPO's opinion on any point determined by the latter, he could deviate from the TPO's order and proceed in his own way.
- However, the FA 2007 substituted sub-section (4) with a new sub-section w.e.f. 01-06-2007 providing that "on receipt of the order under sub-section (3), the AO shall proceed to compute the total income of the assessee under sub-section (4) of section 92C in conformity with the ALP as so determined by the TPO". In view of the same the AO is bound by the order passed by the TPO as he is required to compute total income in conformity with the ALP determined by the TPO.
- **W.r.t determination of ALP of the royalty payments**
- Before the Tribunal, the assessee argued that the royalty paid to its AE was within the range permitted vide Circular No. 5, dated 21-07-2003 issued by the Exchange Control Department of the Reserve Bank of India., which inter alia provided that royalty @ 8% on exports and 5% on domestic sales is permitted under the automatic route, without any restriction on the duration of royalty payments.
- The assessee further argued that as per the Press Note No. 9 (2000 series) dated 08-09-2000 issued by the Government of India, Ministry of Commerce and Industry, which inter alia provides that payment of Royalty upto 2% for exports and 1% for domestic sales is allowed under automatic route on use of trade mark and brand name of the foreign collaborator without technology transfer and thus since the assessee has paid royalty @ 0.5% on sales made in India, the said payment would be at ALP.
- The Tribunal observed that the Hon'ble Delhi High Court in case of Sony Ericsson Mobile Communications India (P.) Ltd. v. CIT 374 ITR 118 has held that payment of royalty as per Reserve Bank of India's automatic route is not per se at ALP, whereas the Hon'ble Bombay HC in case of CIT v. SGS India (P.) Ltd. [ITA No.1807 of 2013] relying on the Press Note No. 9, has held that if the payment of royalty is below the rate

prescribed under Press Note No. 9, the same could be considered at ALP. Accordingly, by relying on the decision of Hon'ble Bombay HC, the Tribunal held that the captioned payments were at ALP.

- The Tribunal further observed that the assessee had paid royalty @2% under the old agreement pertaining to steering axle and accessories for 35 and 55 HP tractors for use of technical knowhow and use of trade mark/brand name. Under the new agreement, the assessee was paying royalty @ 0.5% on total sales for use of name, logo and trade mark.
- Accordingly, under the new agreement, the assessee was also making payment of royalty for use of name, logo and trade mark for the products which were covered under old agreement (i.e. being, steering axle and accessories for 35 and 55 HP tractors)
- In view of the same, the Tribunal observed that double deduction of the royalty payment would not be permissible and accordingly directed the AO/TPO to determine the amount of double deduction which needs to be disallowed.

\- ***<u>Headings</u>***

24. Final assessment order passed under section 143(3) of the Act without passing a draft assessment order as mandated by Section 144C(1) of the Act, was without jurisdiction and liable to be set aside.

International Air Transport Association vs. DCIT TS-62-HC-2016(BOM)-TP-WRIT PETITION (L)NO. 351 OF 2016

Other Case Laws

- Dimension Data Asia Pacific PTE Ltd. v. DCIT [TS-719-HC-2018(BOM)-TP]

FACTS

- The assessee, a foreign company was served with a final assessment order u/s 143(3) dated March 23, 2015 without the AO passing draft order u/s 144C(1) of the Act.
- The assesse had filed an application with the AO under section 154 of the Act, requesting him to rectify the mistake viz. passing of final assessment order without a draft assessment order. The said application was rejected vide order dated April 30, 2015. Further, the AO also issued an order dated September 29, 2015 imposing penalty under section 271(1)(c) of the Act consequent to assessment order dated March 23, 2015.
- Consequent to the impugned assessment order it filed its objection in terms of Section 144C(2) of the Act to the DRP. The DRP refused to pass any direction on the objections as the objections had been filed in respect of a final order under Section 143(3) of the Act and not in respect of the draft assessment order passed under Section 144C(1) of the Act. It held that its jurisdiction was only to entertain objections with regard to draft assessment order passed under Section 144C(1) of the Act and not a final assessment order under section 143(3) of the Act. However, the DRP in its order recorded the fact that the Petitioner was an 'eligible assessee' as defined under Section 144C(15) of the Act.
- Aggrieved, the assesse filed a Writ Petition before the Hon'ble High Court.
- Assessee prayed before the High Court that the assessment order dated 23rd March, 2015 passed by the AO for the assessment year 2012- 13 was completely without jurisdiction and liable set aside and quashed and the consequent orders passed vis-à-vis the rectification application as well as on penalty were also liable quashed and set aside being unsustainable.

DECISION OF THE HIGH COURT

- The Court noted that in view of Section 144C(15) of the Act which defines 'eligible assessee' to whom Section 144C(1) of the Act applies to inter alia mean any foreign company. Therefore, it held that a draft assessment order under Section 144C(1) of the Act was mandated before the AO passed a final order under Section 143(3) of the Act.
- It held that a draft assessment order passed under Section 144C(1) of the Act bestowed certain rights upon an eligible assessee viz. to approach the DRP with its objections to such a draft assessment order to ensure that an eligible assessee's grievances could be addressed before a final assessment order was passed. Therefore, it held that these special rights made available to eligible assessee under Section 144C of the Act were rendered futile, if final order under Section 143(3) of the Act was passed directly without being preceded by draft assessment order.
- In the above view, it held that the assessment order dated 23rd March, 2015 passed by the AO was completely without jurisdiction as it has not been preceded by a draft assessment order. Further, since, the foundational/basic order viz. the assessment order dated 23rd March, 2015 was set aside and quashed as being without jurisdiction, it quashed and set aside the consequent orders passed vis-à-vis rectification application as well as on penalty, being unsustainable.

E. Heading

25. Where the Petitioner was not a foreign company and the TPO did not propose any variation to income returned by petitioner, neither of two conditions of section 144C of the Act were satisfied and therefore the petitioner was not an 'eligible assessee'. Consequently, the Assessing Officer was not competent to pass draft assessment order under section 144C(1) of the Act

Honda Cars India Ltd v DCIT [TS-51-HC-2016 (Del)]

Other Case Laws

- IPF India Property Cyprus (No.1) Ltd [TS-170-ITAT-2020(Mum)-TP]

FACTS

- The assessee, a subsidiary company of Honda Motors Company Ltd, Japan was engaged in the business of manufacture and sale of passenger cars for which it purchased raw materials, spare parts etc from its holding company. Under a technical collaboration agreement, the assessee paid royalty to its holding company.
- The international transaction with its AE was referred to the TPO. However, no TP addition was made to the returned income. Subsequently, the AO disallowed the entire payment made by the assessee for purchasing raw materials, spare parts etc vide a draft assessment order.
- Aggrieved by the draft assessment order, the assessee filed a writ petition before the Honourable High Court
- The assesse contented that :
  a. It wasn't an eligible assessee as defined under section 144C(15)(b) since the TPO had not proposed any variation in income and therefore the drat assessment order was invalid
  b. As per Circular No 3 / 2015, the disallowance under section 40(a)(i) was to be restricted to the net amount and not taken at the gross amount of purchases made i.e.

only on the appropriate proportion of the sum chargeable to tax as per Section 195(1) of the Act

c. The assessment would be time barred as it was to be completed by March 31, 2015 whereas only the draft order was passed which was invalid as contended above.

DECISION OF THE HIGH COURT

- W.r.t the contention (a) above, the Court held that section 144C(1) of the Act provided that a draft assessment order was to made only for an "eligible assessee". "Eligible assessee" was defined to mean any person in whose case the TPO had made a variation to the returned income vide an order under section 92CA(3) of the Act or a foreign company. Noting that the assessee was not a foreign company the Court considered the first part of the definition. Relying on the decision of the Apex Court in P Kasilingam & Others v PSG College of Technology & Ors, it held that the word "means" indicates that the definition is a strict definition with no alternative meaning and since the definition of eligible assessee contains the term means it was to be strictly construed. The Court held that since no variation was proposed by the TPO, the assessee did not fall under the first part of the definition either and therefore the draft assessment order passed was invalid.
- The Revenue conceded contention (b) above and therefore the Court did not adjudicate on the issue.
- With regard to the third contention and in light of the fact that the Court quashed the draft assessment order, it noted that the question of the assessment being time barred was left open and both parties were open to take adequate recourse under the law.

26. References made by AO to TPO for AYs 2011-12 to 2013-14 without giving assessee an opportunity of being heard as required by law despite assessee's objection that the impugned international transaction were not between associated enterprises were liable to be quashed. Further, satisfaction to be arrived at by the AO regarding the existence of the international transaction or specified domestic transaction, even prima facie, was a sine qua non for making the reference to the TPO.

Indorama Synthetics (India) Ltd v Add CIT [TS-501-HC-2016(DEL)-TP]

Relevant Provision

- Section 92CA of I.T. Act

"Reference to Transfer Pricing Officer.
92CA. (1) Where any person, being the assessee, has entered into an international transaction or specified domestic transaction in any previous year, and the Assessing Officer considers it necessary or expedient so to do, he may, with the previous approval of the Principal Commissioner or Commissioner, refer the computation of the arm's length price in relation to the said international transaction or specified domestic transaction under section 92C to the Transfer Pricing Officer.

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FACTS

- The assessee was a widely held public limited company. During the relevant AYs, the assessee, Indorama Synthetics (India) Limited ['ISIL'], entered into transactions of import of raw material from Indorama Petrochem Limited (IPL), a company incorporated in Thailand.

- The assessee filed its return of income declaring 'Nil' income after setting off the brought forward losses. The assessee’s case was picked up for scrutiny and notices under Section 143 (2) and Section 142 (1) of the Act were issued, in response to which it submitted voluminous information/details to the AO.
- During the assessment proceedings, the AO required the assessee to explain why the TP provisions contained in Chapter X of the Act should not be made applicable in respect of transactions of import of raw materials IPL to which the assessee pointed out that IPL was not its AE as defined in Section 92A of the Act as both the companies were separate companies and managed by independent Board of Directors and did not have either direct or indirect control over each other's business.
- Subsequently, the AO, informed the assessee that its case had been referred to TPO, for determination of ALP in relation to the international transactions undertaken by the assessee with AEs.
- Aggrieved, the assessee filed a Writ petition before the Hon’ble High Court.
- The assessee argued that in the instant case with the assessee having taken a specific stand, that it did not enter into any international transaction, the AO was bound to deal with the said objection while issuing an order making a reference of the transaction to the TPO in exercise of the power under Section 92CA (1) of the Act.
- Further, the assessee argued the AO ought to have recorded the reasons stating that it was 'necessary and expedient' to refer the matter to the TPO and that too only after giving the Petitioner an opportunity of being heard.
- The assessee also argued that Instruction No. 15 of 2015 dated 16th October 2015 issued by the CBDT which sets out, inter alia, the procedure to be followed by the AO had to be followed and that the Revenue erred in contending that the same had prospective application.

DECISION OF HIGH COURT

- The Court held that Section 92CA provided for certain jurisdictional perquisites for the making of a reference by the AO to the TPO viz. that the AO had to be satisfied that the Assessee has entered into an international transaction or a specified domestic transaction. Therefore, it held that in the present case, where the Assessee had raised a threshold objection that it has not entered into any international transaction within the meaning of Section 92B of the Act, it was imperative for the AO to deal with such an objection, prior to making a reference.
- It noted that CBDT's Instruction No. 3 of 2003 categorically states that in order to make a reference to the TPO, the AO has to satisfy himself that the assessee has entered into an international transaction with its AE. Therefore, it held that if at that stage, the assessee raised an objection as to the very jurisdiction of the AO to make the reference, then it would be incumbent on the AO to deal with such objection on merits.
- With regard to the applicability of CBDT's Instruction No. 15 of 2015 (which states that AO must provide an opportunity of being heard to the taxpayer before recording his satisfaction or otherwise in 3 situations which covers the case of the Petitioner i.e. The Petitioner had not declared one or more international transactions in the report filed under Section 92E of the Act.), the Court held that since it was a procedural aspect and was intended to the benefit to the assessee, it required to be applied even in the present case where a reference was earlier made by the AO to the TPO on 31st March 2013 and thereafter.

- Accordingly, it set aside the reference made by the AO to the TPO and directed the AO to determine whether or not a reference was to be made to the TPO, for the three AYs in question, afresh after giving the assessee 1an opportunity of being heard in respect of each of the AYs.

F. Heading

\- ***<u>Heading</u>***

27. The TPO would be barred from benchmarking specified domestic transactions when the AO has made a reference to TPO for benchmarking international transactions only

P. N. Gadgil Jewellers (P.) Ltd. v. ACIT [TS-23-ITAT-2020(PUN)-TP]

Relevant Provision

- Section 92CA of I.T. Act

"Reference to Transfer Pricing Officer.
92CA. (1) Where any person, being the assessee, has entered into an international transaction or specified domestic transaction in any previous year, and the Assessing Officer considers it necessary or expedient so to do, he may, with the previous approval of the Principal Commissioner or Commissioner, refer the computation of the arm's length price in relation to the said international transaction or specified domestic transaction under section 92C to the Transfer Pricing Officer.

……
……"

FACTS

- The assessee was engaged in the business of Gems and Jewellery and reported international transactions as well as Specified Domestic Transactions (SDT's) for the year under consideration, which inter alia included transactions such as selling goods to the AE's abroad, payment for purchase of gold and payment of director's remuneration.
- During the course of assessment proceedings, the AO made a reference to the TPO for benchmarking the said transactions in relation to the 'Specified Domestic Transactions' (SDT) only and not the 'International Transactions'.
- However the TPO also benchmarked the international transactions of Corporate Guarantee which was un-referred by the AO and made TP adjustment on this account.
- Before the Tribunal, the assessee argued that the reference to the TPO was merely in respect of the SDT pertaining to director's remuneration and hence in view of section 92CA read with Instruction No.3/2016 of CBDT dated 10.03.2016, the adjustment on account of corporate guarantee should be deleted on the ground of jurisdiction itself.
- The assessee further relied on the decision of the Jurisdictional HC decision in case of Times Global Broadcasting Co. Ltd. v. UOI [TS-178-HC-2019(BOM)-TP], to contend that since SDT pertaining to directors remuneration alone was referred by AO to TPO for benchmarking, TPO could not increase its jurisdiction and proceed to benchmark international transaction pertaining to corporate guarantee.

DECISION OF THE TRIBUNAL

- The Tribunal relied on the decision of jurisdictional HC in case of Times Global Broadcasting Company Ltd (supra) and observed that in terms of section 92CA(1) the

TPO could undertake transfer pricing study only in relation to those transactions which are referred to the TPO by the AO.

- Relevant extracts of the decision of jurisdictional HC in case of Times Global Broadcasting Company Ltd (supra), are reproduced as under:

"17. Inescapable conclusion that we have reached is that in relation to a specified domestic transaction, the TPO can under take transfer pricing study only in relation to those transactions which are referred to him under sub-section (1) of Section 92C of the Act. Sub-section (2A) and (2B) of Section 92C are confined to international transactions and with the aid of any interpretive process, the said provision cannot be applied to empower the TPO to examine any specified domestic transaction not referred to him by the Assessing Officer under sub-section (1). Any other view would be doing violence to the plain language of the statute."

- Considering the fact that jurisdictional issue raised by the assessee was allowed, the Tribunal did not adjudicate on the merits of the benchmarking exercise or quantification of the adjustments.

\- ***Heading***

28. Deduction u/s 10A on additional income offered on account of suo motu TP adjustment, would be allowable, since restriction as placed u/s 92C(4) would be only applicable in a case where the TPO enhances the income of the assessee by virtue of a TP adjustment.

Approva Systems (P.) Ltd. v. DCIT [TS-167-ITAT-2018(PUN)-TP]

Relevant Provision

- Section 92C(4) and first proviso to section 92C(4) of I.T. Act

"(4) Where an arm's length price is determined by the Assessing Officer under sub-section (3), the Assessing Officer may compute the total income of the assessee having regard to the arm's length price so determined :

Provided 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 :"

…..

……

FACTS

- The assessee, a domestic company, was wholly owned subsidiary of Approva US and was providing software development activities and quality assurance services to its AE's on exclusive basis. The assessee was 100% Export Oriented Unit which was captive service provider to its AE's.
- For the year under consideration i.e. AY 2011-12, the assessee had filed return of income declaring certain income after claiming deduction u/s 10B of the Act. W.r.t its international transactions, the assessee selected TNMM as the most appropriate method and had voluntarily offered additional income of INR 64.07 lakhs. The benchmarking exercise of the assessee was accepted by the AO/TPO at ALP. However, the claim of deduction u/s 10B on the suo motu TP adjustment was rejected by the AO.

- The assessee argued that deduction u/s 10B would not be entitled on the TP adjustment which are made u/s 92C(4) of the Act by the AO, however, the assessee would be entitled for the deduction u/s 10B when suo motu TP adjustment are made by the assessee. However, the AO rejected the argument of the assessee and disallowed the deduction u/s 10B pertaining to the suo motu TP adjustment. Further, during the course of assessment proceedings, the assessee revised the claim to deduction u/s 10A
- The CIT(A) held that since the said amount (i.e. suo motu TP adjustment) could not be brought in convertible foreign exchange in India, deduction u/s 10B(3) would not be granted to the assessee.

DECISION OF TRIBUNAL

- The Tribunal observed that u/s 92, any income arising from international transactions should be computed having regard to the ALP principle and the said income which is so computed in respect of international transactions entered into by the assessee is the notional income in the hands of assessee.
- Section 92C(4) provides that where an ALP is determined under sub-section (3), then the AO may compute total income of assessee having regard to the ALP so determined. The proviso therein further, provides that no deduction u/s 10A/10AA or 10B or Chapter VI-A of the Act shall be allowed in respect of such amount of income, by which the total income of assessee had been enhanced after computation of ALP of international transactions.
- However, in the present case, it is not the AO/TPO who had determined the additional income on account of TP adjustment, but the assessee who had suo motu offered additional income on account of TP provisions as business income. U/s 10A, such additional income/business profits is neither export turnover nor the total turnover of assessee but is artificial income is taxable in the hands of the assessee. Accordingly, the said additional income, since not being part of export turnover or total turnover, there could not be any condition for getting the foreign exchange to India.
- Accordingly, the Tribunal observed that once the said additional income has been offered to tax, it forms part of the business profits and thus while computing the deduction under section 10A, the said profits are to be taken into consideration.
- The Tribunal relied on the decision of ITAT Bangalore bench in case of iGate Global Solutions Ltd. [2008] 24 SOT 3 (URO) (Bang.) which was upheld by the Hon’ble Karnataka HC (ITA No.453/2008) the assessee's claim for deduction under section 10A in respect of suo-moto TP adjustment made by the assessee was allowed.
- The Tribunal held that the decision of Mumbai ITAT in case of Deloitte Consulting India Pvt. Ltd. [TS-224-ITAT-2012(Mum)], relied on by the Revenue would not stand because of the ratio laid down by the Hon'ble Karnataka HC on the said issue.
- Further, the Tribunal also observed that though the said decision of Karnataka HC is of non-jurisdictional High Court, the same would be binding on the Tribunal in the absence of any contrary decision of the jurisdictional High Court. [as per the principles laid down by the Hon'ble Bombay High Court in Smt. Godavaridevi Saraf [1978] 113 ITR 589 (Bom.)]