Recent Case Laws in Transfer Pricing

Bangalore Study Group – The Chamber of Tax Consultants

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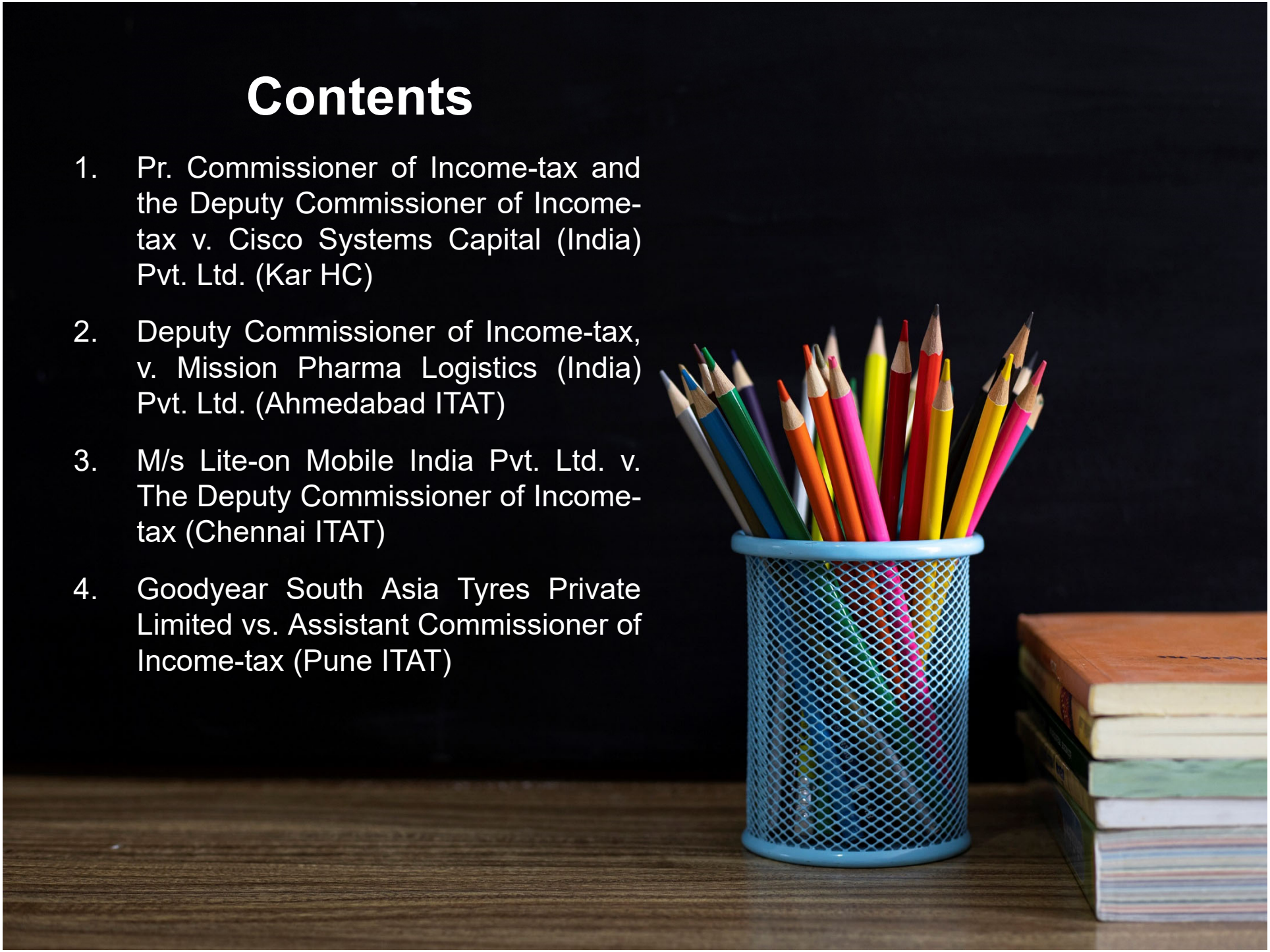


Pr. Commissioner of Income-tax and the Deputy Commissioner of Income-tax v. Cisco Systems Capital (India) Pvt. Ltd. (Kar HC)

Issue: *Requirement of Draft Assessment Order in Remand Proceedings*

Facts and background

- The Assessee was engaged in the business of leasing and financing. Assessment under section 143(3) r.w.s. 144C of the Act was conducted for AY 2008-09.
- Subsequently, PCIT initiated *suo-moto* revision proceedings u/s 263 of the Act which was challenged before the ITAT.
- ITAT remanded the matter pertaining to the original assessment order passed by the AO for re-adjudication.
- Subsequently, TPO passed an order and thereafter, the AO passed order u/s 143(3) of the Act.
- The Assessee preferred an appeal with CIT(A) on ground that the Assessing Authority has failed to pass draft assessment order which was dismissed.
- Thereafter, assessee preferred an appeal before the ITAT, which was allowed.
- Being aggrieved by the same, the Revenue was before the HC.

Contentions - Assessee vs. Revenue

Assessee	Revenue
• Assessee pleaded applicability of Sec. 144C to any assessment proceedings including remand. • Assessee placed reliance on the judgment of the Hon'ble Delhi HC Delhi in case of DCIT v. JCB India Ltd, wherein, it was held that the requirement of Sec. 144C was not restricted to only first instance. Reliance was placed on various other case laws.	• Revenue highlighted that the mandate of Sec.144C was applicable to 'first instance' of appellate proceedings and not to a case of remand which was second round of appellate proceedings. • Highlighted that there was no such variation in the income or loss returned by the eligible assessee in the second round of re-adjudication and placed reliance on the CBDT Circular No.9/2013 dated 19.11.2013, which mandated applicability of Sec.144C only to instances of any variation income or loss returned by an eligible assessee. • Reliance was placed on Sec. 292B and 292BB in support of contention that such mistake if any, was curable.

Ruling of the High Court

- ITAT held the issue was no more res-integra.
- Noted that Revenue had misinterpreted on the words ‘first instance’ to contend that after remand from the Tribunal, there was no mandate on the part of the AO to pass draft assessment order. The requirement of passing a draft assessment order was mandatory and had to be strictly adhered to, irrespective of the remand order passed by the Tribunal.
- Relied on Delhi HC ruling in JCB India & Gujarat HC ruling in C-Sam (India), wherein, the Court had held that it was mandatory for the AO to pass a draft assessment order under Sec. 144C of the Act prior to issuing the final assessment order even in the case of second round of appellate proceedings.
- Failure to pass a draft assessment order under section 144C(1) of the Act would result in the final assessment order “without jurisdiction, null and void and unenforceable”
- ITAT observed that passing of draft assessment order is quintessential before issuing the final order, breach of the same would result in violation of the principles of natural justice making the order itself void ab-initio.

Deputy Commissioner of Income-tax v. Mission Pharma Logistics (India) Pvt. Ltd. (Ahmedabad ITAT)

Issue: Application of APA terms for year not covered under APA

Facts and background

- Appellant entered into APA commencing from AY 2010-11 and agreed for a specific mark-up.
- The Assessee proposed to apply the terms of Advance Pricing Agreement entered into by and between the appellant and the CBDT to the year under consideration i.e., AY 2007-08 to buy peace and reduce litigation.
- The CIT(A) held in favor of Assessee and applied the APA for the relevant AY.
- The revenue was before the ITAT.
- The ITAT, relying on various case laws held in favour of the Assessee.

Reference Case Laws

Case Law	Decision
Tieto IT Services India Private Limited	"There is no impediment on department in applying the terms and conditions of APA while considering international transactions in the assessment year not covered by the APA, but subject to the condition that the nature of international transactions should be identical in both the situations".
M/s. Abicor Binzel Production (India) Pvt. Ltd.	Where the international transactions entered into by the assessee with its associate enterprises are similar to the international transactions in the succeeding years, then where the APA proceedings have been carried out in the case of assessee and the Board and the assessee have come to a settlement vis-à-vis the manner of computation of arm's length price in the case of assessee in relation to the international transactions with its associate enterprises, we deem it fit to restore this issue also back to the file of Assessing Officer, who shall consider the plea of assessee and shall after obtaining report from the TPO in this regard, decide the issue in accordance with law.
Warburg Pincus India (P.) Ltd.	Though APA may not be of a binding nature, but certainly it has a persuasive value.
Ranbaxy Laboratories Limited	The Tribunal held that even though the APA would be applicable for the year for which it has been entered into but the principles laid down in the APA for the comparability analysis would have a greater persuasive value for past years also if the nature of international transactions and the FAR of the AE and the taxpayer remained the same.

M/s Lite-on Mobile India Pvt. Ltd. v. The Deputy Commissioner of Income Tax (Chennai ITAT)

Issue: Management cross-charges

Facts and background

- The assessee was engaged in the business of manufacture and supply of moulded components for telecommunication industry and it had imported raw materials like display window, key pads, etc. from its AEs.
- It had also entered into an agreement with its AE for availing various managerial services for which it paid management fees.
- The assessee has aggregated all transactions with its AEs and has adopted TNMM to benchmark all international transactions, except for a few specific transactions.
- The TPO accepted TP study of the assessee adopting TNMM in respect of all international transactions for AY 2012-13 and AY 2013-14.
- In respect of management services, TPO determined NIL ALP by holding that the assessee did not bring any evidence on record to suggest that it was in need for services on the basis that the assessee did not bring any evidence to prove that AE has rendered such services.
- Before the DRP, it argued that it had demonstrated and justified the payment of the management fee with necessary evidences, including the agreement and the invoices and other e-mail correspondence.
- The DRP upheld the addition of the TPO and held that it was difficult to imagine that such services could have been discussed verbally by the parties and the assessee had not availed any services. It also held that the payment was accordingly disallowed.

Contentions - Assessee vs. Revenue

Assessee	Revenue
• Well settled position in various judicial precedents that the TPO cannot question necessity of incurring of particular expenditure, or the cost benefit ratio of any expenditure incurred by the assessee • The TPO did not dispute genuineness of the payment made but disputed only on the ground that assessee did not demonstrate receipt of services • The TPO held other international transactions to be at arm's length and disputed one element of payment of management fees • The assessee has filed various evidences including agreement between parties, invoices raised by AE and certain e-mail correspondences between two parties.	• The assessee had made periodical payments on monthly basis without any justification for making payment to its AE and had also made a separate payment for Royalty • Generic Agreement - did not outline the exact nature of services that would be provided to the assessee • No clause to protect beneficiary from deficiency in services provided by service provider and possibility of imposing penalties • Allocation keys were mainly based on % of sales and thus there was no link between services actually rendered and fees paid • The assessee was shifting profit to its AE in the guise of payment of management fees without any justification for making such payment • Documentary evidences furnished were not adequate or non-satisfactory to prove actual receipt of services • There was no merit in arguments taken by the assessee that the TPO had made adjustment to management fees only on the basis of necessity of availing such services

ITAT Ruling

- The assessee failed to bring on record any evidences to justify the payment of management fees such as technical specification of services rendered, personnel deployed, correspondence between the parties; e-mails do not depict any evidence of rendering managerial or technical services.
- The AO/TPO have all powers to examine whether a particular expenditure incurred was genuine in nature.
- Differentiated the facts of the case laws relied upon by the assessee stating that the issue being examined was on whether services were availed and whether it was supported by adequate documentation.
- Payment of management fee was to be examined qua evidences without getting into the aspect of operating margin earned by the Assessee and the TP Study maintained.
- Stated that assessee failed to verify the correctness of the cost allocation done by the AE.
- The allocation is based mainly on the percentage of external sales against group sales thereby constituting a fixed charged irrespective of what services are required by the Assessee or their technical specification
- Held that once aggregate transactions of the assessee was tested using TNMM, TPO could not pick few transactions and apply a different method to determine ALP.
- Upheld the actions of the lower authorities.

Goodyear South Asia Tyres Private Limited vs. ACIT (Pune ITAT)

Issue: Management cross-charges

Facts and Background

- For AY 2014-15 and AY 2015-16, the assessee adopted CUP method as the MAM for demonstrating that the international transaction of payment of Regional Service Charge (General/Administration; Financial; Sales/Marketing; IT Services, Production and Tire performance/Issue Resolution; and Purchasing and Materials Management) was at ALP.
- The TPO requested the assessee to furnish evidence for receipt of services, nature of services, basis for computation of payment of services to the AE and benefit derived from such services.
- The assessee furnished a copy of agreement, break-up of services, nature of services and a certificate of independent CA confirming the cost allocation and benefit test documents evidencing receipt of services.

Facts and background

- The TPO disregarded the management cross charges with respect to five out of six services (i.e. it accepted IT services) and determined their ALP at NIL and added back the amount as the TP adjustment. It held so on the basis that:
  - there was no evidence of receipt of services. The e-mails provided only generic information and in the nature of exchange of information; or
  - it was a case of duplicate services; or
  - the assessee did not receive any benefit from such services; or
  - there was no need for services; or
  - these were shareholder services; or
  - though the certificate by the auditor on cost allocation was correct but there was no documentary evidence for establishing the ALP
- Similar issue was assessed by the TPO for AY 2011-12 and AY 2012-13. The DRP too noted that similar TP directions were approved by it for the AY 2012-13 and upheld the order of the TPO. The assessee was thus before the ITAT.
- The ITAT had ruled in favour of the assesse for AY 2011-12 and AY 2012-13.

ITAT Ruling

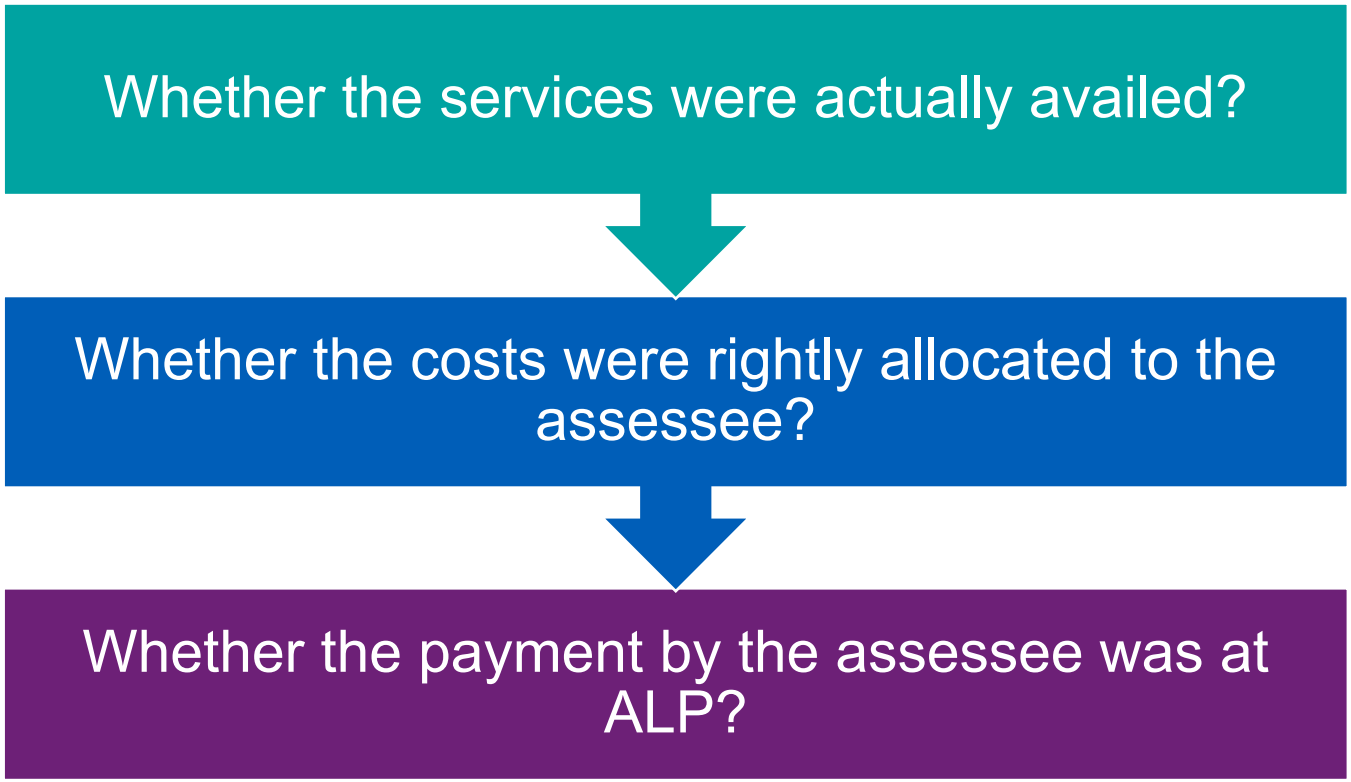
Assessee argued that since the addition was made by the lower authorities on the basis of earlier years, then given that the ITAT had also deleted the additions in the earlier years, the same approach should also be followed by it in the current year.

ITAT observed that:

- Question of rendering services is independent every year which is to be proved on the basis of positive evidence for every year.
- Availing of services in the previous year would not per se lead to the inference of availing services in the current year.
- Factum of availing services needs to be established independently every year.
- Crucial differentiation in the current year was the change in the MAM of testing the transaction – whereas for earlier years, the assessee had aggregated the same with other transactions, in the current year it had tested the transaction independently using CUP.
- When two or more transactions are aggregated, excess of price charged in respect of one transaction gets automatically adjusted against the shortfall in respect of other transactions.
- When the transaction is evaluated independently and not aggregated, such a set-off is not permissible and the transaction should independently pass the muster of ALP, else would be subject to adjustment.

ITAT Ruling

The determination of ALP primarily required examination of three factors as to



Whether the services were actually availed?

Evidence of availing the services -

- Referred to various clauses in the agreement which specified the nature and classification of services in detail.
- Referred to the various e-mails submitted by the assessee under each of the services and analysed the nature of services referred to therein.
- Basis the detailed analysis as above, it concluded that there remained not even an iota of doubt that the assessee did receive such services from its AE.

Duplication of services -

- The TPO had alleged duplication of services – for e.g. technical assistance was received under the agreement and was also received under a sperate technical know-how agreement.
- The ITAT referred to the nature of services provided under the agreement and under technical know how agreement. It observed that more routine day to day services were rendered under the former whereas it received technical information under the latter and hence distinguished the general nature of services availed vis-à-vis the specific services availed from AE.
- Accordingly held that there was no duplication of services as was canvassed by the TPO.

Whether the services were actually availed?

Did the Assessee derive benefit from the services?

- Assessee was the best judge to decide if any particular service were required for carrying on its business.
- The TPO could not step into the shoes of the assessee and decide if there was any need for services.
- Evidence of availing services forecloses the examination by the TPO whether such services were needed or not or whether any benefit was derived or not.

Whether the services were in the nature of shareholder services?

- The TPO made reference to shareholder services in a generic sense and not specifically spelt out which services were shareholder services.
- The services did produce an effect on the assessee company and hence could not be considered to be a shareholder activity.

Whether the costs were rightly allocated?

- Referred to the definition of “Cost” and the manner of allocation specified in the Agreement.
- Held that basis the above, it was evident that the assessee’s share in the overall regional services cost was based on actual services provided and availed by it and was on adhoc basis .
- Certificate from the auditor of the AE also outlined the basis of allocation in line with the Agreement, the correctness of which was not disputed by the TPO.
- Assessee also placed a detailed note on cost allocation before the TPO outlining the mark-ups charged by the overseas AEs.

Whether the payments to AE were at ALP?

- Rejected the CUP method adopted by assessee noting that in determining the ALP, assessee took the actual transaction with its AE itself as a benchmark for comparison, whereas the application of the method pre-supposed existence of atleast two transactions viz., the controlled and the uncontrolled transaction.
- Also rejected TPO's ALP determination observing that TPO did not apply any prescribed method whilst determining the ALP of the transaction at NIL value.
- Rejected the additional ground proposed by the assessee to strike down the addition since no method was applied by the TPO noting that this would mean reviving the assessee's methodology for determination of ALP, which was not sustainable as above.
- To resolve the logjam, it applied the CPM noting that the since the auditor's certificate mentioned about cost allocation, this would be the MAM.
- Since there was no comparable uncontrolled transaction, it assumed a hypothetical transaction with zero as the minimum value and compared the same with the effective mark-up of around 2.52% charged by the AEs. Held that since this was within the tolerance range of 3% as per second proviso of Sec.92C(2) of the Act, the amount paid by the assessee was deemed to be at ALP.

Questions?

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