TRANSFER PRICING

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Case Law Update

(a)TP adjustment on account of AMP expenses cannot be made if the revenue fails in showing that there existed any international transaction in respect of such transaction; and (b) Resale Price Method ('RPM') most appropriate in case of distributor companies not performing any value added functions – Acer India Private Limited vs. DCIT [2020-TII-135-ITAT-BANG-TP]

The Assessee is engaged in the business of distribution of laptop, monitors, projector, etc. imported from Associated Enterprise ('AE'). The Assessee had incurred Advertisement Marketing and Promotion ('AMP') expenses and part of the same was reimbursed by its AE. The Transfer Pricing Officer ('TPO'), however, took the view that the Assessee's AMP expenses is more than the average amount spent by other comparable companies and accordingly made adjustment in respect of the said transaction. Further, the Assessee had benchmarked its trading activity by adopting RPM as the most appropriate method. The TPO, however, took the view that the Assessee is not a mere distributor, but is doing value added services in the form of protecting trademark of AE in India by incurring AMP expenses. The TPO accordingly rejected RPM and adopted Transaction Net Margin Method ('TNMM') and proposed an upward adjustment. Dispute Resolution Panel ('DRP') affirmed the view of the TPO.

On appeal, the Hon'ble Tribunal observed as under:

- Adjustment in respect of AMP expenses:

- The revenue needs to establish on the basis of tangible material the existence of international transaction before undertaking benchmarking of AMP expenses.
- Bright Line Test has no mandate under the Act and accordingly, the same cannot be resorted to for the purpose of ascertaining if there exists an international transaction of brand promotion services between the Assessee and the AE.
- In the instance case, since no material has been brought on record to show the existence of International transaction, TP adjustment on account of AMP expenses is unjustified.

- Most Appropriate Method for trading activity
  - Major portion of AMP expenses consists of trade discounts, sales commission and scheme discounts. The actual sales promotion and advertisement expenses constitute only 1.38% of the total sales.
  - Accordingly, the contention of the TPO that the Assessee is doing value added services in the form of protecting trademark of AE in India by incurring AMP expenses is not correct.
  - When there is no value addition and the imported products are sold as is, then RPM is the most appropriate Method.

An arm's length price needs to be determined based on 'Most appropriate Method' considering facts of the case and factors under Rule 10C(2) of the Rules. There cannot be a hierarchy of methods or preference of direct methods over indirect methods – Gulbrandsen Chemicals Private Limited vs DCIT (ITA.No.1215 and 1216/Ahd/2017)

The Assessee is engaged in the business of manufacturing of chemicals. The Assessee sold finished goods to AE as well as non-AE. In the Transfer Pricing study, the Assessee adopted internal TNMM as the most appropriate method. The TPO rejected internal TNMM and instead applied CUP method to benchmark the transaction. The TPO compared the average FOB price per unit charged to AE vis-à-vis those charged to non-AE and proposed an upward TP adjustment. CIT(A) largely upheld the approach of the TPO.

On appeal, Hon'ble Tribunal deleted the TP adjustment following coordinate Bench ruling in Assessee's own case in preceding year wherein CUP method was rejected and Internal TNMM was accepted. In doing so, Hon'ble Tribunal upheld the following principles:

- When comparing the prices of products sold to AE vis-à-vis independent parties, it is not sufficient to compare the prices de hors the economic circumstances in which the respective AE and non AE transactions take place.
- Factors specified under Rule 10C(2) should be considered when determining suitability of a method of determination of ALP in a particular fact situation.
- In the instance case, there were crucial variation between AE and non-AE transaction in the payment term, volume sold, impact of other related party transactions, etc. and accordingly, comparability under CUP ceases to be relevant. Further, no reliable and accurate adjustment can be made in respect of these variations.

Profit Split Method cannot be considered as most appropriate method for benchmarking Royalty payment when the Assessee only leverages on the use of technology from the AE and does not contribute any unique intangibles to the transaction. - Toyota Kirloskar Auto Parts Pvt. Ltd., vs. DCIT [IT(TP)A No.1915/Bang/2017 & IT(TP)A No. 3377/Bang/2018]

The Assessee is engaged in the business of manufacture of automotive front axle, rear axle and propeller shaft. The AE provided the Assessee technical know-how, which includes process know-how, designs & drawings to manufacture transmission units and axles & propellers, shafts and engine assembly. The Assessee paid Royalty (5% on sales) to the AE for using the said technology / technical know-how. The Assessee claimed this transaction was closely linked to the manufacturing operation and accordingly TNMM was applied as most appropriate method, aggregated with other transaction.

The TPO, however rejected TNMM and adopted Profit Split Method ('PSM') as most appropriate method to benchmark payment of Royalty. In doing so that TPO alleged that the useful economic life of bundle of technologies transferred for start-up and operationalizing the whole business has lapsed. The Royalty now is being paid for technical upgrades. As per the TPO, the ALP of such technology cannot be assessed on net margin level analysis. Further, CUP cannot be used due to lack of relevant information. The TPO proceeded to apply PSM as under and made a TP adjustment:

Net Profit Margin of the Assessee (A)	7.87%

Net Profit Margin of Comparable Companies (B)	5.89%
Excessive Profits (C= A-B)	1.98% of sales
Royalty Payable considering 50:50 split between Assessee and AE	0.991% of sales

The DRP upheld the approach of the TPO. Aggrieved, the Assessee filed an appeal before Hon'ble Tribunal.

Hon'ble Tribunal noted that in earlier years the co-ordinate bench preferred TNMM over CUP (upheld by HC), however in AY 2013-14 for the first time Revenue sought to apply PSM on the ground that economic life of the technology has expired. Hon'ble Tribunal observed that there was no basis for the TPO / DRP's conclusion that the useful economic life of the technology would be only 5 years. Further, passage of time cannot be the basis to discard TNMM. Rejecting PSM, Hon'ble Tribunal observed "In the present case the Assessee leverages on the use of technology from the AE and does not contribute any unique intangibles to the transaction."

Other Updates:

The Central Board of Direct Taxes of India vide Notification No. 23/2020/F.No. 370142/31/2019-TPL dated 6 May 2020 has notified amended Rule 44G of the Rules dealing with application and procedure for giving effect to Mutual Agreement Procedure ('MAP'). Rule 44H of the Rules has been omitted pursuant to such amendments.

The amended Rules inter-alia specifies the Competent Authority of India shall call for relevant records and additional details or hold discussions with such authorities or Assessee or representative, to understand the actions taken by the income-tax authorities; the resolution arrived at shall be communicated to the Assessee in writing and the Assessee acceptance or non-acceptance of the resolution in writing to the Competent Authority in India within thirty days of receipt of the communication. The amended Rule also specifies that the Competent Authority shall endeavor to arrive at a mutually agreeable resolution within an average time period of 24 months. CBDT has also revised Form 34F for making application to Competent Authority for invoking MAP.