

TRANSFER PRICING

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The Taxation & Other Laws (Relaxation & Amendment of Certain Provisions) Bill, 2020 – TP updates

The Taxation & Other Laws (Relaxation & Amendment of Certain Provisions) Bill, 2020 passed by Lok Sabha, seeks following amendments relevant from Transfer Pricing perspective.

- Proposes insertion of Section 92CA(8) and Section 144C(14C) of the Act w.e.f. 1st Nov. 2020, which states that the Central Government may make a scheme in respect of faceless TP Assessment for disposal of TP cases and faceless DRP proceedings for disposal of objections filed before DRP, respectively, so as to impart greater efficiency, transparency and accountability in line with faceless assessment scheme. Necessary directions in this regard may be made by the Central Government by 31 March 2022.

- The Bill proposes to insert new Section 144B of the Act legislating the faceless assessment scheme notified on 13th August 2020 with certain modifications which enables eligible assesses to approach DRP. Also, specifies the procedure for completion of faceless assessment post receipt of DRP directions issued under Section 144C(5) of the Act.

Case Law Update

Submitting Form 35A with the scanned copy of the signature is a procedural defect and curable in nature. Overturns DRP's order in treating the Form 35A as non-maintainable -Rivendell PE, LLD vs. Asst. CIT [2020-TII-117-ITAT-MUM-INTL]

Facts:

- The Assessee, a non-resident company got the original DRP objections in Form 35A signed by one of its Director available at United States of America and filed the scanned copy on 19.01.2018 to meet the deadline. The original documents were received by the consultant on 22.01.2018.
- The DRP treated objection as non-maintainable observing that submitting verification form with the scanned copy of the signature is as good as submitting of unsigned paper since the scanned copy of the signature has no legal sanctity.
- The DRP observed it is obvious that the person scanning signature in this manner was other than the original signatory and hence if this is allowed as a mode of validation of the document, then anyone can act on behalf of some other person by scanning others signature, which is not acceptable.
- DRP rejected the Assessee's urge on the curability of the lapse, if any, and request to consider the original one citing that the documents were not verified as per the procedure laid down.

Tribunal's Ruling

The Hon'ble Tribunal noted Form 35A cannot be refused to be accepted, due to a procedural lapse. Held that:

- Even it is a defect in the eyes of law, it is procedural defects and curable in nature;
 - The Assessee had its reason for filing the Form No. 35A with the scanned signature of alternate Director;
 - Notes that the furnishing of the scanned papers and replacing them with original hard copies or soft copies, if any, is now not new to the Department. Draws support from MSM Satellite (Singapore) Pte. Ltd. vs. JCIT (2016) 75 taxmann.com 216 (Mumbai);
 - Observes that when the Revenue is accepting the e-filing of documents then the rejection of the Form 35A submitted by the Assessee is unsustainable in the identical issue.
- (a) Rules on treatment of Asset Impairment for PLI computation; (b) Allows adjustment for custom duty and capacity utilization for manufacturing activity – Imsofer Manufacturing India Pvt. Ltd vs. DCIT [ITA No. 1049 / Del / 2016]

Facts:

The TPO proposed an upward TP adjustment modifying TNMM analysis conducted by the Assessee by:

- (a) Considering provision of impairment of assets as an operating expense for computing PLI of the Assessee;
- (b) Disregarding economic adjustment i.e. custom duty and capacity utilization adjustment;
- (c) Rejecting one of the comparable company namely Candico India Limited citing persistent losses.

Appeal filed by the Assessee before CIT(A) was unsuccessful.

Tribunal's Ruling

The Hon'ble Tribunal observed the following:

- Provision of impairment of assets ought to be considered non-operating expense for computing PLI of the Assessee as:
 - o It is not a depreciation charge not amortization of fixed assets but a provision made to the carrying amount of the fixed assets which is reversible in nature;
 - o It is not regular business expenditure since it is not recurring in nature and is not related normal business operation;
 - o Cannot be said to be related to the international transaction of the Assessee.
- Allows adjustment for custom duty as the Assessee has imported 100 percent of its raw material whereas the average import in the case of the comparable companies is only 0.56 percent. Appreciates that non-cenvat-able custom duty may materially impact the transaction value vis-à-vis comparable companies;
- Directs TPO to allow adjustment for capacity utilization as relevant data-points are available in the financials of comparable companies. Cites Assessee's submission that average capacity utilization of comparable was 71 percent vis-à-vis Assessee's 45 percent.
- Directs inclusion of Candico India Limited as the said company has incurred losses in only 2 out of 3 financial year. Relies on Hon'ble Bombay High Court decision in ITA No. 2222 of 2013.

Sets aside TPO-orders absent sufficient opportunity to Assessee to respond to Show cause notice - M/s. Coastal Energy Pvt. Ltd. vs. Asst. CIT / Addl. Jt. CIT [Hon'ble Madras High Court in W.P. Nos.34618, 34626, 34630, 34644, 34656, 34660, 34665 & 34668 of 2019]

Facts:

- The first notice issued by the TPO was dated 26.08.2019, in response to which details were submitted by the Assessee on 12.09.2019.
- Show cause notice was issued thereafter on 29.10.2019 and reply thereto on 31.10.2019.
- The order of the TPO has been passed on 01.11.2019 within a day of the reply having been filed.
- The Assessee filed a writ petition before Hon'ble High Court on several grounds, including the bar of limitation. However, before the Hon'ble High Court the petitioner specifically restricted its challenge to the aspect of violation of principles of natural justice, giving up all other grounds raised.

Hon'ble High Court Ruling

- Hon'ble High Court observed that "Clearly, there has been no effective opportunity extended to the petitioner to respond to the show cause notice and neither has there been any time for the TPO to have applied his mind to the response of the petitioner."
- Setting aside the order of the TPO on the ground of violation of principles of natural justice, Hon'ble Court directs de novo completion of proceeding to be initiated within 4 weeks of uploading of Court order and to be completed within 8 weeks of date of first hearing.
- Clarifies that only portion relation to TP adjustment in the Assessment Order shall be substituted by the order to be passed by the TPO now.

Second innings cannot be given to Assessing Officer to appreciate the same set of facts which were already before him – Asst. CIT vs. M/S. Volvo Auto India Pvt. Ltd. [2020-TII-268-ITAT-DEL-TP]

Facts:

- The TPO determined ALP of management service fees at "NIL" and made upward adjustment.
- The TPO opined that the Assessee did not put forth evidence to show that services were actually received and therefore failed to furnish cost benefit analysis demonstrating benefits derived from services received from AE.
- The Assessee filed additional evidences before CIT(A). The AO / TPO submitted his report on the points raised by the Id. CIT(A) considering nature of additional evidences.
- Based on facts, documents submitted and remand report from TPO / AO, CIT(A) deleted the adjustment of management service fees.
- Department preferred an appeal before the Hon'ble Tribunal.

Tribunal's Ruling

Rejecting Department's request to remand the matter, Hon'ble Tribunal noted that the cost benefit analysis was furnished by the Assessee during the remand proceedings but the AO / TPO did not care to examine the same.

Hon'ble Tribunal observed that "no second innings should be given to appreciate the same set of facts which were already before the Assessing Officer."

Madras HC rules on the manner of determining limitation for passing TPO order under section 92CA(3A)

Recently, the Madras High Court (HC) admitted writ petitions filed by the taxpayer against the order of the Transfer Pricing Officer (TPO) dated 01 November 2019, passed under section 92CA(3) of the Income-tax Act, 1961 (Act).

The taxpayer contended that the provisions of section 92CA(3A) categorically specifies that an order by the TPO may be made at any time "before 60 days prior to the date" on which the order under section 143/ 144 is required to be passed. Accordingly, for AY 2016-17, the TPO order should have been issued any time before 60 days prior to the date of 31 December 2019, by which the period of limitation provided under section 153 expires. Therefore, working backwards, the 60th day prior to 31 December 2019 falls on 01 November 2019 (i.e. by excluding 31 December 2019 and counting 30 days in both November and December) and thus, the time limit for passing the TPO order should have been any time before 01 November 2019. Hence, the taxpayer alleged that the order passed by the TPO on 01 November 2019 is time barred.

The Madras HC accepted the taxpayer's contentions and quashed the TPO order and additions proposed in the order on the ground of limitation.

The above decision is a welcome judgement for taxpayers and is projected to have a wider impact on other similar cases too. Thus, it is likely that the decision may be challenged by the Income tax authorities before the Supreme Court.

Mumbai Tribunal – once the RBI has approved the royalty and technical fee, the payments should be considered to be at arm's length

The Mumbai Bench of Income-tax Appellate Tribunal (the Tribunal) in case of Thyssenkrupp Industries India Pvt. Ltd. (ITA No.2084/Mum/2014 and C.O.94/MUM/2014) has upheld the royalty and technical payment stating that once the Reserve Bank of India (RBI) approval of the payment was obtained, the payment can be considered to be at arm's length. Overall, it has resulted in the deletion of transfer pricing adjustment with respect to the royalty payment.

Payments in the nature of royalty are coming under increasing scrutiny of TPOs, resulting in several appeals filed by taxpayers to defend their royalty payments. In this regard, it may be noted that while various Tribunals have upheld use of RBI or Foreign Investment Promotion Board (FIPB) approved royalty rates/ payments for testing the arm's length nature of royalty transactions, contrary views have also been taken in few cases wherein the Tribunals have held that merely because one regulatory authority specifies the transfer price (say, for the purpose of remittance of foreign exchange), the same cannot partake the character of ALP and thus, the taxpayers cannot be relieved

off the burden of establishing that the transaction was actually undertaken at arm's length, which inter-alia needs to be determined as per the mechanism provided under the provisions of the Act and Rules.

It should also be noted that the contrary rulings as mentioned above, may have implications for the taxpayers from a practical perspective. The implication may arise where the taxpayers are restricted to undertake the transaction at a price/ rate other than a price/ rate as approved by the regulatory authorities (say, RBI/ FIPB) or as laid down by regulations and thus, cannot carry out the same at an arm's length price as determined under the transfer pricing provisions. In such cases, a better view appears to be the one taken by Tribunal in case of Thyssenkrupp Industries India Pvt. Ltd. However, this ruling can be factually differentiated where the regulations only require subject transaction to be undertaken subject to a floor price (and no cap on the price) or where the value of transaction is merely approved by a regulator (without the regulations providing any restriction on price/ rate or any guidance to determine the price/ rate); in such cases taxpayers need to ensure that the price/ rate approved by the regulator also meets the arm's length test.

Hence, given the divergent views been taken by various Tribunals and the aggressive revenue-driven approach typically followed by the tax authorities while scrutinising the cases, it is advisable for taxpayers to maintain proper documentation demonstrating the evidence, need for technical assistance and benefit derived by paying the royalty which would serve as a concrete basis for considering the royalty payments to be at arm's length.