Transfer Pricing

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Niehoff of India Pvt Ltd [TS-409-ITAT-2021(HYD)-TP]

Ruling summary and findings

Hyderabad ITAT ruled that the TPO's domain is only to examine as to whether the payment based on the agreements adheres to the arm's length principle or not. The ITAT confirmed CIT(A)'s order which deleted the ALP adjustment made towards royalty payment for AY 2013-14. CIT(A) had deleted the said ALP adjustment by relying on coordinate bench ruling in Air Liquide Engineering India P. Ltd wherein relying on Hon'ble Delhi HC ruling in EKL Appliances and Delhi ITAT ruling in Ericsson India Pvt. Ltd it was held that royalty payment cannot be disallowed on the basis of the so-called benefit test and the domain of the TPO is only to examine as to whether the payment based on the agreement adheres to the arm's length principle or not. ITAT noted that while disallowing assessee's royalty payments made to the overseas AEs, TPO had applied "benefit test". ITAT observed that such an application of "benefit test", formed subject matter of adjudication in various rulings; and Revenue's arguments supporting the same stood declined. It was further noted that Hon'ble Delhi HC had held that it is not for the department to sit in the armchair of the assessee to incur a particular payment by applying the actual benefit derived. Also considering the fact that assessee had filed all the supportive evidence relating to its royalty payment, ITAT confirmed CIT(A)'s order deleting the adjustment.

C3i Support Services Private Limited [TS-408-ITAT-2021(HYD)-TP]

Ruling summary and findings

Assessee had not reported receivables as an international transaction. Assessee appealed against correctness of lower authority's action of imposing section 271AA penalty of Rs. 28.88 lacs on the pretext of non-reporting of receivables as an international transaction. The case pertained to AY 2012-13, ITAT noted that Revenue fails to dispute that the legislature had inserted Explanation to Section 92B of the Act vide Finance Act, 2012 with retrospective effect from 1.4.2002. Further noted that Clause (i) to (c) in the said Explanation to section 92B included such deferred payment or receivable to form an international transaction for the first time with retrospective effect. Given the same, ITAT noted that the aforementioned retrospective operation only forms sufficient cause of the assessee's failure in not having recorded corresponding transaction for AY 2012-13 in tune with section 92D. Accordingly, ITAT held that "relevant facts and circumstances hereinabove make it clear in very unambiguous terms that the assessee's alleged failure does not attract the impugned penal provision u/s. 271AA of the Act since involving the foregoing "sufficient cause"; Accordingly, Hyderabad ITAT deletes penalty imposed by lower authorities u/s 271AA for assessee for AY 2012-13.

Case Law Update

- Failure to report international transactions prescribed vide amendment in Section 92B of the Act by the Finance Act, 2012 with retrospective effect does not lead to penalty under Section 271AA of the Act - C3i Support Services Private Limited [TS-408-ITAT-2021(HYD)-TP]

Facts:

- The Assessee had duly filed its Form No. 3CEB for AY 2012-13, however not reported outstanding receivable as an international transaction. The said trade receivable had also lead to a TP adjustment in Section 92CA proceedings as well.
- The Assessing Officer imposed and first level appellate authority confirmed the action imposing the penalty under Section 271AA of the Act for its alleged failure in reporting of the said transaction.
- Aggrieved the Assessee preferred appeal before Hon'ble Tribunal.

Tribunal's Ruling

Ruling in favour of the Assessee, Hon'ble Tribunal noted as under:

"3. We have given our thoughtful consideration to rival pleadings against and in support of the impugned penalty and find no reason to sustain the same. We are admittedly in Assessment Year 2012-13. Learned departmental representative fails to dispute that the legislature had inserted Explanation to section 92B of the Act vide Finance Act, 2012 with retrospective effect from 1.4.2002. Clause (i) to (c) in the said Explanation to section 92B of the Act introduced such deferred payment or receivable to form an international transaction for the first time with retrospective effect in other words. This clinching retrospective operation only forms sufficient cause of the assessee's failure in not having recorded corresponding transaction in tune with section 92D of the Act. Learned lower authorities have treated as a fit instance to invoke the impugned penal provision. We therefore hold that the relevant facts and circumstances hereinabove make it clear in very unambiguous terms that the assessee's alleged failure does not attract the impugned penal provision u/s. 271AA of the Act since involving the foregoing "sufficient cause." We therefore direct the Assessing Officer to delete the impugned penalty. Ordered accordingly."

Deletes TP adjustment of notional interest income imputed on interest free debt funding provided to overseas Special Purpose Vehicle - Bennett Coleman & Co Ltd [TS-367-ITAT-2021(Mum)-TP]

Tribunal's Ruling

Considering the overall scenario based on following facts of the case, the Hon'ble Tribunal held that interest free debt funding provided by the Assessee to overseas Special Purpose Vehicle (SPV) cannot be compared to a loan simpliciter and be subject to arm's length price.

Following points were noted by Hon'ble Tribunal in this regard:

- The TPO erred in not appreciating the fact that the alleged loan transaction was given for the purpose of acquiring a controlling stake in company outside India, which was in the same business of the Assessee and hence the transaction was akin to stewardship activity which does not require any benchmarking analysis.

- When the borrower has no discretion of using the funds gainfully, the commercial interest rates do not come into play at all.

- The overseas SPV is, from a commercial perspective, a de facto non-entity and it has come into legal existence only for the furtherance of the interests of the Assessee. The SPV in such a situation is no more than a conduit entity.

- There cannot be a transaction, between the independent enterprises, of interest-free debt funding of an overseas SPV by its sponsorer; if such a transaction between independent enterprises is at all hypothetically possible, the arm's length interest on such funding will be 'nil'.

- No amount of commercial interest, as in a borrowing simpliciter- whether LIBOR based or PLR based, can be attributed to the funding to the SPVs.

- If there has to be an arm's length consideration under the CUP method, other than interest, for such funding, it has to be net effective gains- direct and indirect, attributable to the risks assumed by the sponsorer of the SPV, to the SPV.

In relation the TP adjustment made by the TPO on performance guarantee provided by the Assessee on behalf of SPV, Hon'ble ITAT noted as follows:

- The entire transaction of acquiring another Company was in furtherance of the business interests of the Assessee, finalized by the Assessee much before even the AE in question came into existence.

- The Assessee was de-facto beneficiary of this transaction.

- Under these circumstances, the Assessee cannot be treated as a guarantor but rather as a primary obligor for its own transaction undertaken through the SVP.

- Viewed in totality, the service is not by the Assessee to the SVP, but the other way round. In that case, it cannot have an arm's length price because the beneficiary and the issuer of the guarantee is the same entity.

- In summary, Hon'ble Tribunal remarked "the impugned ALP adjustment must stand deleted on the ground that the clause in question in the agreement dated 30th May 2008 does not constitute a third party guarantee- like a bank guarantee which is taken as a comparable, and, even if it is assumed that it does so constitute a guarantee, the arm's length price of such a performance guarantee, if at all it can be so held to be in character, will not be ascertainable under the CUP method for want of a valid comparable of the similar nature of guarantee. The very foundation and rationale of the impugned ALP adjustment, on the CUP basis, is thus devoid of any legally sustainable basis. We, therefore, delete this ALP adjustment."

Deletes TP adjustment towards hypothetical FCD interest. Holds the same as outside the ambit of Article 11 of India-Cyprus DTAA - Mondon Investments Ltd [TS-384-ITAT-2021(DEL)-TP]

Facts:

- The Assessee, a Cyprus based company has subscribed to 15 percent Fully Convertible Debentures (FCDs) of face value of Rs.100/- each issued by Indian AEs.

- Later these debentures were converted into zero percent FCDs and additional zero percent FCDs were subscribed by the Assessee.

- The TPO held that the conversion and additional subscription at zero percent was made without assigning any reason and therefore charged interest at the rate of 15 percent applying internal CUP.

- CIT (A) upheld the adjustment holding that the word “interest paid” includes “interest payable”

- Aggrieved the Assessee filed an appeal before the Hon’ble Tribunal.

Please note, the Article 11 of India-Cyprus DTAA reads as follows:

“ARTICLE 11

INTEREST

1. Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.”

The Hon’ble Bombay High Court in CIT v. Pramerica ASPF II Cyprus Holding Limited (ITA No. 1824 of 2016) has held that taxability in a case where the article is worded in the aforesaid manner, can only be fastened on receipt of interest income.

Tribunal’s Ruling

Relying on various rulings, the Hon’ble Tribunal upheld as under:

- The word “paid” cannot be extended to “payable” in respect of interest under Article 11 of Indo-Cyprus DTAA;

- Only the interest income chargeable to tax under the Act or DTAA, as appropriate can be subject matter of transfer pricing in India.

- (a) Treatment of amortization of goodwill and non-compete fee for TNMM computation; and (b) ALP of purchase of fixed assets cannot be determined at “NIL” - DHR Holding India Pvt Ltd [TS-370-ITAT-2021(DEL)-TP]

Treatment of amortization of goodwill and non-compete fee

Facts:

- Under the head ‘Provision of Marketing Support Services’, the Assessee had acquired certain business operations from a third party. Pursuant to the acquisition, the Assessee recognized a part of the purchase price as goodwill and non-compete fees in its financial statement.

- The Assessee considered these expenses as non-operating expenses as these did not pertain to the provision of services to the AEs. However, the TPO included them for the purpose of tested party margin’s computation leading substantial reduction in Net Cost Plus margin from provision of services to the AEs.

Tribunal’s Ruling

Noting amortization of goodwill and non-compete fee should be considered as non-operating in nature, Hon’ble Tribunal observed as under:

- Rule 10B(1)(e) of the Rules only costs incurred in relation to international transaction of provision of services to the AEs should be considered in computation of operating margin;

- Similar proposition is laid in the OECD Transfer Pricing Guidelines;

- On identical circumstances, Coordinate Bench in Imsofer Manufacturing India Pvt. Ltd (ITA No. 5158/DEL/2015 and 1049/DEL/2016) and Ericsson India Ltd ITA No. 168/DEL/2015; and the TPO in subsequent A.Ys has considered amortization of goodwill and non-compete fees as non-operating expenses.

ALP for purchase of fixed assets

Facts:

- The Assessee had purchased certain fixed assets (used for installation of equipment at customer's premises), from the AEs which were capitalized in the books of accounts of the Assessee and its related operating cost, i.e. depreciation, was charged to the profit and loss account.

- Assessee has used TNMM analysis to benchmark the arm's length nature of this transaction under aggregate basis with trading segment.

- The TPO though accepted margin under trading segment at arm's length, he determined the ALP of purchase of fixed assets at Nil.

- While framing the final assessment order, the AO even disallowed the claim of depreciation considering NIL arm's length price by the TPO

Tribunal's Ruling

Deleting the TP adjustment and directing the AO to allow the claim of depreciation, Hon'ble Tribunal observed as follows:

"31. In our considered opinion, equipment would not have been imported at NIL price even in an independent scenario. Moreover, we do not find that the TPO has applied any method to benchmark the said transaction, which action of the TPO is in violation of Rule 10B of the Income Tax Rules. We find that while treating the purchase of capital goods as NIL, the TPO failed to provide any comparable data which would have suggested that the arm's length price for the purchase of capital goods can be NIL. In our understanding, no third party would have sold such goods free of cost. In our considered opinion, arm's length price could be lower or higher but cannot be NIL, as the goods have been imported."