Sami Sabinsa Group Ltd ("Assessee") is engaged in the business of manufacture of herbal and fine chemical extracts also known as nutraceuticals and it was selling to both AEs as well as to non-AEs.

Though assessee had adopted Cost Plus ("CPM") as Most appropriate method ("MAM") for benchmarking the international transaction of sale of herbal products to AEs, it did not object to the use of TNMM by the TPO for the AY under assessment. However, assessee contended that for the comparability analysis, TPO should consider the internal comparables to benchmark the international transaction for the years under consideration. ITAT noted that the transactions in a controlled transaction with a related party and an uncontrolled transactions with unrelated parties would result into more appropriate benchmarking of arm's length price. ITAT further noted that with sufficient data available of internal comparables, TPO should have recourse to internal comparables first and only in case of insufficiency of data, support must be drawn from external comparables. Directs TPO to carry detailed analysis of international transactions using TNMM as MAM stating that with satisfactory details, determination be confined to internal comparables or else analysis be done in accordance with law. Bangalore ITAT remands the entire TP assessment to AO/TPO for de novo consideration with opportunity of being heard provided to the assessee for AYs 2013-14 and 2014-15.

Case Law Update

- Sanctions selection of Foreign AE as tested party - Almatis Alumina Pvt. Ltd [TS-109-HC-2022(CAL)-TP]

Aggrieved by the Hon'ble Tribunal's order, Revenue inter-alia raised the following substantial question of law:

"(a) Whether the Hon'ble Tribunal has committed substantial error in law in considering a foreign AE as tested party as per Indian Transfer Pricing Regulations?"

High Court's Ruling:

Taking note of the following, Hon'ble High Court accepts foreign AE, being least complex party, as tested party:

- The United Nations Practical Manual of Transfer Pricing for Developing Countries, 2013, India Chapter in Regulation 10.4.1.3 it has been stated that the Indian Transfer Pricing Administration prefers Indian comparables in most cases and also accepts foreign comparables in cases where the foreign associated enterprise is less or least complex entity and requisite information is available about the tested party and comparables.
- Regarding Revenue's contention that Indian Transfer Pricing Regulations do not permit use of Foreign AE as tested party, Hon'ble High Court noted Tribunal's reliance on the decision in the case of Deputy Commissioner of Income Tax Vs. Quark Systems (P) Ltd. (2010) 38 SOT 307 (CHD). In the said decision it was held that when substantial justice and technical considerations are pitted against each other, the cause of substantial justice deserves to be preferred, for the other side cannot claim to have a vested right in injustice being done due to some mistake on its part.
- Relied on Hon'ble Madras High Court decision in case of Virtusa Consulting Services [2021] 124 taxmann.com 309 (Madras) wherein it was observed that the definition of Enterprise given in section 92F(iii) and Associated Enterprise as defined in section 92A of the Act, it is evidently clear that the statute does not indicate that 'Enterprise' shall mean the assessee and the 'Associated Enterprise' will mean the other party. The words 'Enterprise' and 'Associated Enterprise' have been used interchangeably.
- Indian Transfer Pricing guidelines issued by the Institute of Chartered Accountants of India vide guidance note on report under Section 92E of the Act and transfer pricing guidelines issued by OECD does not prohibit AE to be a tested party.
- In view of the above and various judicial precedence's, legal principle that can be culled out is that the tested party normally should be the least complex party to the controlled transaction and there is no bar for selection of tested party either local or foreign party

and neither the Act nor the guidelines on transfer pricing provides so. The selection of the tested party is to further the object of the comparability analysis by making it less complex and requiring fewer adjustment.

- Deletes disallowance under Section 10A of the Act wherein the AO alleged excess deduction under Section 10A of the Act based on the profit margin of comparable companies vis-à-vis the assessee's actual profit margin from such services

Facts:

- The Assessee provided IT enabled services to its AEs and received service charges. Operating profit from the rendition of the services was claimed as deductible under Section 10A of the Act by the Assessee.
- The AO in the reassessment proceeding, alleged that excess deduction under Section 10A of the Act is claimed by the Assessee. The AO noted that the Assessee has computed the Arm's Length Price of the international transaction of rendering ITES to its AE under the Transactional Net Margin Method (TNMM) by demonstrating its operating profit margin of 39.62 percent at ALP, which was higher than 16.90 percent of the comparables. The AO accordingly made an addition by disallowing excess deduction under Section 10A of the Act i.e. profit declared by the Assessee minus profit considering margin of comparable companies.
- CIT(A) deleted such addition. Aggrieved, Revenue filed an appeal before Hon'ble Tribunal.

Tribunal's Ruling

Upholding order of CIT(A), Hon'ble Tribunal noted that the AE is not chargeable to tax in India. In other words, the Assessee offered suo-motu higher income in its hands, which was albeit deductible under Section 10A of the Act, without conferring any corresponding benefit to its AEs in terms of higher deduction of expenditure.

Hon'ble Tribunal relies on co-ordinate bench ruling in Honeywell Automation India Limited and Another Vs. DCIT and Another (2021) 62 CCH 0177 (Pune-Trib), wherein case of excessive deduction made by the AO under Section10A(7) read with section 80IA(10) of the Act, similar to the one under consideration, was disapproved.

In case of Honeywell Automation India Limited (supra), Hon'ble Tribunal had held that the expression "arranged" referred to in Section 10A(7) r.w.s. 80-IA(10) of the Act should not be understood in its plain language but the same should be understood in the context in which it is placed in the Section. Existence of a mere agreement to do business was not enough to fulfill the requirement of Section 10A(7) r.w.s. 80-IA(10) of the Act in the context of the words "the course of business between them is so arranged". The arrangement had to be one which was prefaced by an intention to abuse the tax concessions, as per the intendment of the legislature.

- Where cost recoveries are found to be received within reasonable period, then no separate adjustment by way of markup on recoveries is to be made - Amicorp Management India Pvt Ltd [TS-136-ITAT-2022(Bang)-TP]

Facts:

- The Assessee had entered into international transaction being provision of back office support services, reimbursement of costs paid and reimbursement of costs received (i.e. recoveries of expenses);
- The TPO observed that payments made to AE on account of reimbursement were routed through profit and loss account, however the recovery of expenses from the AE was not routed to the profit and loss account. The TPO accordingly imputed a mark-up at 14.72 percent on cost and proposed a TP adjustment;
- While the DRP did not agree with the approach of the TPO, it noted that the Assessee has blocked its working capital and there is some finance cost attached. The DRP opined that a mark-up of 5 percent would be appropriate in such cases.
- The Assessee preferred an appeal before Hon'ble Tribunal.

Tribunal's Ruling

Following coordinate bench decision in the Assessee's own case, Hon'ble Tribunal held as under:

- In the case of transactions of mere reimbursement of third party vendor expenses, where the enterprises do not add any value, there is no necessity to compute any mark-up on such transactions.
- The determination of ALP of reimbursement / recovery transactions under TNMM is not appropriate as such transactions cannot be considered as services / administrative support services, since both the parties have acted as mere facilitators, meaning thereby, both the parties have not performed any value added functions.

- Regarding appropriate benchmarking for such transactions, Hon'ble Tribunal noted that such kind of payments made on behalf of AEs would result in blocking of working capital. Under normal circumstances, the reimbursements are received/paid within a reasonable period. If there is delay in making reimbursements beyond the reasonable period, it will result in providing of or extending credit facility to the AEs. In that case, the Assessee should have been compensated for the "interest cost".
- Accordingly, if the reimbursements have been paid /received within reasonable period, then no transfer pricing adjustment is required, otherwise the same is called for.
- In the event the expenditure incurred, against which reimbursement is made by the AE, forms part of working capital adjustment, no further adjustment is warranted. In other words, reimbursement by the AE / cost recoveries from the AE also needs to be subsumed in the working capital adjustment in order to escape the rigors of adjustments.
- Upholds Resale Price Method as Most Appropriate Method for distributors not undertaking value added function. Regarding availability of the data, TPO has the power to call for relevant information required for its application

Facts:

- The Assessee imports Material Handling Equipment (MHE) from its AE for resale and is engaged in the trading activity and it does not undertake any value addition to the import of MHE, which are resold to unrelated parties. Assessee applied Resale Price Method (RPM) to benchmark its transaction.
- TPO held that RPM cannot be used in the instant case, owing to the fact that there is no information in the public domain of the comparables to compare the functionality of the comaprables selected by the Assessee. The TPO adopted TNMM however considered the very same comparable companies as selected by the Assessee in his search process.
- The CIT(A) confirmed the action of the TPO and sustained the application of TNMM method and rejected RPM Method.

Tribunal's Ruling

Holding RPM as most appropriate method, Hon'ble Tribunal remarked as under:

"In the instant case, the assessee has claimed that it has not carried out any value addition to the products imported by it from its Associated Enterprises. It is also submitted that the functions to be performed by the assessee as a "distributor", which is highlighted by the TPO is normal functions performed in the trade circles even by a non-related party. We notice that the revenue has not negated both these submissions of the assessee. The TPO has rejected RPM for the reason that the details and information necessary for computing margins of comparable companies was not available. The absence of details and information can be no ground to reject RPM as the MAM, as the TPO has powers to call for the necessary details from the comparable companies to ascertain the Gross Profit margin that has to be compared under RPM. Accordingly, we are of the view that RPM is the most appropriate method in the facts and circumstances of the case. Accordingly, we direct the AO/TPO to adopt Resale Price Method as most appropriate method and determine the ALP of the transactions accordingly."