TRANSFER PRICING

CA. Bhavesh Dedhia, CA. Bhavya Goyal,
CA. Shazia Khatri

Section 92A(1) cannot be applied on standalone basis, and has to be essentially considered in conjunction of Section 92A(2) of the Act – Kaybee Pvt. Ltd. vs. Income Tax Officer [ITA No. 2164/Mum/15]

Govind Karunakaram (GK) holds 99.9 percent shareholding in the Assessee. GK is also one of the three directors in Singapore based entity named Kaybee Exim Pte Ltd. ('KE-S'). The Assessee had certain business transactions with KE-S. The Assessee contended that the KE-S cannot be treated as AE as the relationship between the Assessee and KE-S does not satisfy the conditions laid out in section 92A(2) of the Act. The Transfer Pricing Officer however observed that GK participates in the management of KE-S and also hold entire shareholding in the Assessee. Accordingly, the TPO was of the view that the condition of one enterprise participates directly or indirectly or through one or more intermediaries in its management or control or capital as prescribed under clause (a) & (b) of Sub-Section (1) of Section 92A of the Act is satisfied. CIT(A) upheld the said view. The Assessee filed an appeal before Hon'ble Tribunal.

The Hon'ble Tribunal relying on the reasoning in case of ACIT vs Veer Gems [(2017) 77 taxmann.com 127 (approved by Hon'ble High Court in the judgment reported as PCIT Vs Veer Gems [(2017) 83 taxmann.com 271 and department's SLP rejected by Hon'ble Supreme Court in PCIT Vs Veer Gems [(2018) 95 taxmann.16]), Orchid Pharma Ltd Vs DCIT [(2016) 76 taxmann.com 63 (Chennai - Trib.)] and Page Industries Ltd Vs DCIT [(2016) 159 ITD 680 (Bang)] held that "Section 92A(1) cannot be applied on standalone basis, and has to be essentially considered in conjunction of Section 92A(2) – only when it satisfies at least one of the conditions set out therein, it is clear that the relationship between the assessee company and its KE-S cannot be said to be that of the associated enterprises."

Distinguishing negative decisions in Assessee's own case for two years and Diageo India Pvt Ltd Vs DCIT [(2011) 47 SOT 252], Hon'ble Tribunal observed that the those benches did not had any occasion to consider the Memorandum to the related Finance Bill which reflects the legislative intent behind amendment in section 92A(2) with effect from 1st April 2002. The Hon'ble Tribunal noted an amendment in Section 92A(2) which specifically provided that "for the purpose of sub section (1)" restricted the scope of Section 92A(1).

The Hon'ble Tribunal also rejected department's request for constitution of Larger / Special Bench on account of the following:

- It would be an inappropriate parallel exercise as a higher judicial forum has expressed its view on the subject;
- The Hon'ble jurisdictional High Court has admitted appeals of the Assessee for earlier years which were decided against the Assessee and it is only a matter of time that the views of Hon'ble jurisdictional High Court would be available;
- In any case the views of non-jurisdictional High Court will bind the Special Bench, and constitution of special bench will be a meaningless ritualistic exercise.

TP provisions not applicable to the Assessee opting for tonnage tax scheme and a letter for negative lien cannot be equated to guarantee – Essar Shipping Ltd. vs. ACIT (ITA No. 7371/Mum/2017)

The Assessee is engaged in the business of shipping operations, crude oil transportation, drilling oil rigs, transportation management services and integrated dry bulk transportation services. The AO passed draft assessment order comprising certain disallowances and additions to the total income declared by the Assessee. The additions inter-alia included TP adjustments in respect of (a) interest on purchase price of two ships; and (b) alleged

commission income on account of providing letter of negative lien to the lender bank of the AE. Summarized below are key facts and Tribunal decision in this regard:

- Interest on purchase price of two ships:

  - The Assessee purchase ships from the AE at the total price of USD 148 million. The TPO determined the ALP of the transaction at USD 145.5 million (disallowing namely the mobilisation and demobilisation charges paid for ships). The excess payment was treated as advance by the Assessee to the AE and interest income was imputed thereon. DRP upheld the addition.

  - The Hon'ble Tribunal noted that the Assessee offered its income as per tonnage taxation scheme under Chapter XII-G of the Act. The Ships so purchased were qualifying ships as per tonnage tax provision.

  - Relying on coordinate bench decision in case of Van Oord India Private Ltd. vs. ACIT, Hon'ble Tribunal held "Tonnage Tax Scheme, as per Chapter XIT-G of the Act, is a separate code by itself in as much as it provides a self-contained changing provision as well as 'method of computation of income in the chapter, and, the method of computation of income under TTS is not dependent on receipt or expenditure of the assessee…. The provisions of chapter X have been invoked to alter an expenditure, namely the mobilisation and demobilisation charges paid for a qualifying ship, an item which has no bearing on the income as computed under Chapter XIIG and accordingly the provisions of Chapter X have no application in computing the income of the assessee chargeable to tax as per Chapter XII-G of the Act….. in our considered view, the transfer pricing regulations do not apply to the assessee to the extent of operations carried out through operating qualifying ships where the income is taxed under TTS."

- Alleged commission income on account of providing letter of negative lien to the lender bank of the AE:

  - The Essar Global Limited (EGL), the ultimate parent company of Assessee had taken loan from foreign branch of ICICI bank. In this regard, the Assessee has undertaken not to transfer, assign and dispose of 49% of equity shares in Essar Logistics Ltd (ELL) without prior written approval of lenders during pendency of loan. In other words, i.e. a negative lien was provided on transfer of shares.

  - The TPO / AO held such negative lien as equivalent to a guarantee and alleged a commission income @ 0.5 percent. DRP upheld the said approach.

  - The Hon'ble Tribunal after considering detailed arguments held that a negative lien on transfer of shares cannot be equated to guarantee. Hon'ble Tribunal appreciated the fact that in case of any loan repayment default, there will be no liability on Assessee for paying any amount since Assessee is not a guarantor. However, considering totality of the facts, Hon'ble Tribunal retained the adjustment applying rate of 0.25 percent to the said transaction.

In view of omission of clause (i) of Section 92BA of the Act, the penalty under Section 271BA of the Act for failure to furnish report in respect of such transactions also does not survive – M/s SKM-UMSL JV vs ITO (ITA no. 229/Ctk/2019)

The Assessee is a Joint Venture and engaged in the business of contract works and filed its return of income electronically on 30 Sept. 2017. During the course of assessment proceedings, on an enquiry from the AO, the Assessee furnished Accountant's Report in Form no. 3CEB in respect of Specified Domestic Transaction under clause (i) of Section 92B of the Act. The Assessing Officer initiated and levied a penalty under Section 271BA of the Act. The Assessee agued before the CIT(A) that there was no malafide intention behind it and non-filing of audit report is only a technical default and, therefore, no penalty can be levied. However, CIT(A) dismissed the appeal and upheld the order of the AO.

The Hon'ble Tribunal while adjudicating the issue noted that the provision of clause (i) of Section 92BA of the Act has already been omitted by the Finance Act, 2017 with effect from 1 April 2017. Relying on coordinate Bench decision in case of Textport Overseas Pvt. Ltd. (ITA No.1722/Bang/2017), Hon'ble Tribunal observed that with the omission of clause(i) of Section 92BA of the Act, it would be deemed that it was never been on the statute. Thus, deleting the penalty under Section 271BA of the Act, Hon'ble Tribunal observed "we are of the considered opinion that when the transactions related to the assessee falls under the clause(i) of Section 92BA of the Act, which has already been removed by the Finance Act, 2017 w.e.f. 01.04.2017, therefore,

the imposition of penalty u/s.271BA of the Act for failure to furnish the report in prescribed Form No.3CEB in terms of provisions of section 92E of the Act, does not survive at all."

Draft Assessment Order not required to be issued in case there is no variation in income (prior to 1 April 2020). Consequently, Final Assessment Order is time barred. – IPF India Property Cyprus (No. 1) Ltd. vs. DCIT [ITA No. 6077/Mum/2018]

In this case of a non-resident Assessee, there was no variations in the returned income and the assessed income. The controversy related to only the tax rate. While the Assessee had claimed taxation @ 10 percent under Article 11(2) of the India Cyprus DTAA, the AO brought the income to tax @ 40 percent denying treaty benefit. The AO issued a draft assessment order followed by final assessment order post DRP proceedings.

The Hon'ble Tribunal on the legal issue noted that in the light of provisions of Section 144C(1) of the Act as there is no variation in the income of the Assessee, the draft assessment order in this case would not be required. The Hon'ble Tribunal also noted that "While the Finance Bill proposes to make the issuance of draft assessment orders in the case of eligible assessee mandatory even when there is no variation in the income or loss returned by the assessee but then this amendment is with effect from 1st April 2020."

On second legal aspect of assessment proceedings being time barred, Hon'ble Tribunal held "The mere issuance of draft assessment order, when it was legally not required to be issued, cannot end up enhancing the time limit for completing the assessment under section 143(3). We, therefore, uphold the plea of the assessee on this point as well. The impugned assessment order is indeed, in our considered view, time barred. We, accordingly, hold so."

Other Update

Organization for Economic Cooperation and Development ('OECD') issued final recommendations regarding the arm's length treatment of various financial transactions among related parties.

On 11 February 2020, OECD as part of BEPS Action Plan 8-10, issued final report regarding the arm's length treatment of various financial transactions among related parties. The Report represents the first time that guidance on financial transactions is included in the OECD Transfer Pricing Guidelines which may contribute to consistency in the application of transfer pricing principles on such transactions. The Report covers guidance around vide range of key financial transactions - intercompany loans, cash pools, financial guarantees, hedging transactions and captive insurers.

The Report lays strong emphasis on "accurate delineation" of a transaction and a burden on the taxpayers to show debt (or other financial transaction) is bona-fide. In respect of inter-company loans, the Report endorses two-sided approach (i.e. lender as well as borrower's perspective) and emphasis on use of realistic alternatives on both side of the transaction while determining key economic factors impacting loan pricing. It also suggests that in circumstances under "accurate delineation" of a transaction, the economic and business rationale of a loan can also be challenged.

In relation to financial guarantee, the Report reiterates that they are compensable if provide measurable benefits. Implicit support should be considered when pricing a guarantee transaction, such as when applying a yield-differential approach. Further, the report also suggest that if a guarantee from a related party has at least the partial effect of increasing the beneficiary's borrowing capacity, an accurate delineation analysis may split the transaction into two parts: (1) a loan from the lender to the borrower, based on the latter's capacity without the guarantee; and (2) a loan from the lender to the guarantor, followed by a capital contribution to the borrower. The guarantee fee should be calculated only on (1).