

## TRANSFER PRICING

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### **BMW India Financial Services Pvt Ltd [ITA No. 478 & 562 /Del/2022]**

The assessee, BMW India Financial Services Pvt. Ltd, obtained IT support services from its AE (BMW AG) for AY 2017-18 and 2018-19, at cost plus 5% mark-up. Assessee also procured certain external licenses from the AE at cost (without any mark-up).

AO/TPO/DRP held that assessee merely performs coordination services and adds no value to the functions that the third party performs. Hence, the same doesn't require any mark-up from Indian entity. AO/TPO/DRP further held that the third-party cost, which is invariably allocated to the Indian entity, already includes a mark-up, and thus, a double-mark up could not be justified under these circumstances, more so, when around 88% of the total IT cost is third party cost.

Before ITAT, assessee argued that 5% mark-up on IT Software services and 7% mark-up on administrative expenses is in consonance with the international trade practices.

ITAT noted that it is critical for the assessee to avail IT support services from specialized teams in BMW AG, and that the performance/co-ordination of functions/services being rendered through a centralized office/Group companies helps the participating Group companies in achieving global standardization of processes, realization of economies of scale, realizing operating and financial efficiencies. ITAT observes that the services received from BMW Group are provided by experienced personnel who focus on their respective domains. ITAT thus holds that *"it cannot be said that the software/IT support services cannot be charged at par. A markup of 5% policy for the IT services rendered is an acceptable markup by international guidelines and as per EU Joint Transfer Pricing Forum. It cannot be expected that the parent organization supply support services without charging anything for such services rendered. Hence, we hold that the markup of 5% is sufficient to recoup the expenditure involved by the AE in exploration, inspection, testing and finalization of the suitable software. Accordingly, we direct that no other expenses other than 5% markup be allowed on the support services rendered by the AE.*

Accordingly, ITAT held that a mark-up on IT support services rendered by the AE is justified and that 5% mark-up on such services is an accepted international practice.

### **Adani Power Ltd [ITA Nos. 3563/Ahd/2015 & 2216/Ahd/2016]**

Ahmedabad ITAT confirms CIT(A)'s characterization of advances by Adani Power Ltd to AEs as 'loans', for AYs 2010-11 and 2011-12. Assessee argued that sums advanced to AEs (Adani Power Pte Ltd - incorporated with the object of investing in coal mines and carry on the business of an investment holding company, and Adani Shipping Pte Ltd - incorporated with the object of carrying on business of chartering and owning of ships) were in the nature of quasi-equity. TPO/AO however held that the advances were in the nature of debt, and held that assessee should have charged interest @ 5.38% which was the PLR prevailing in Singapore. CIT(A) revised benchmarking of interest @ 2.48% p.a. for Adani Shipping Pte Ltd and 2.62% for Adani Power Pte Ltd, on the basis that interest rate should be benchmarked to the currency concerned in which the loan has to be repaid (USD in this case). CIT(A) also restricted the period of interest to the specific period for which loan was advanced to the AEs, and not for the entire year. Adjudicating appeals filed by both assessee and revenue against CIT(A)'s order, ITAT notes that CIT(A) correctly observed that only when the assessee was confronted to benchmark interest on the advances, it came up with the alternate contention that the amount could be treated as quasi capital; ITAT upholds CIT(A)'s finding that there is nothing on record to support that the advances were in the nature of quasi-capital; Refers to coordinate bench decisions in Kalpataru Power Transmission Ltd and Soma Textile & Industries Ltd; ITAT also holds that CIT(A) did not err in holding that *"ALP of the interest rate for the loan advanced to a foreign subsidiary should be computed based on the market determined rate applicable to the currency in which the loan has to be repaid i.e. USD"*, follows Delhi HC ruling in Cotton Naturals (I) (P.) Ltd and Delhi ITAT ruling in Assotech Moonshine Urban Developers (P.) Ltd. ITAT upholds CIT(A)'s restriction of computation of interest to the period for which the loans advanced to AEs.

- **Dismisses Revenue's appeal; Confirms ITAT-order quashing passing final assessment-order not passed in conformity with DRP directions - Flextronics Technologies India Pvt Ltd [TS-63-HC-2023(KAR)-TP]**

Hon'ble High Court had admitted Revenue's appeal to consider inter-alia following questions of law –

*“(i) Whether ITAT is right in holding that entire assessment order as barred by time when draft order and final assessment order were passed within time limit;*

*(ii) Whether ITAT is right in holding final assessment order as bad on the ground that AO has not passed order as per DRP's directions;*

*(iv) Whether ITAT is right in holding that assessment order passed u/s. 143(3) r.w.s. 144C(13) is bad in law even though the said order is passed according to parameters set out in said provision.”*

Answering above questions in favour of the Assessee and against the Revenue, Hon'ble High Court noted as under:

- Under Section 144C of the IT Act, the Assessing Officer is bound by the directions issued by the DRP and required to pass the assessment order in conformity with the directions issued within one month from the end of month in which such directions are issued.
- The Assessing Officer has rightly passed the order within time. But it is relevant to note that the said order is not in conformity with Section 144C of the IT Act. Hence, no exception can be taken to the impugned order passed by the Tribunal. Hon'ble Tribunal in its order has quashed the final assessment order being not in conformity with the DRP's direction.
- **Delhi High Court admits question of law dealing with revision under Section 263 in view of non-reference to the TPO for SDT - M/S ETT LIMITED (FORMERLY KNOWN AS INDIAN EXPRESS MULTIMEDIA LTD.) [ITA 45/2020]**

Hon'ble High Court admits Revenue's appeal and frame following questions of law:

*“A. Whether the ITAT has erred in law and in facts in setting aside the order passed by Ld. PCIT (Central)-2 u/s 263 of the IT Act?*

*E. Whether the ITAT erred in holding that the case was not required to be referred to the Transfer Pricing Officer (“TPO”) without appreciating the fact that the case was clearly picked up on Transfer Pricing Risk Parameter of large value domestic transaction with associated enterprise and mandatorily required to be referred to the TPO for examination of specified domestic transaction?*

*F. Whether the IT AT erred in law in interpreting the provisions of section 80IA by holding that the enterprises/undertakings are entitled for claiming deduction u/s 80IA on sale of the Industrial Undertaking?*

*G. Whether the impugned orders passed by the ITAT are perverse in light of the actual inaccuracies in the said orders?”*

- **ITAT rejects capacity utilization adjustment, cites lack of industry trend details - Dell International Services India Private Limited [TS-43-ITAT-2023(Bang)-TP]**

#### **Facts:**

- One of the adjustment proposed by the TPO was on manufacturing segment wherein the TPO reworked the margin on cost earned by the Assessee and rejected the adjustment towards under-utilized of capacity.
- The TPO in his order noted as under:
  - o Adjustments can be made to the operating cost of the comparable companies.
  - o Under-utilization of capacity is due to general trend in the industry, which is also affecting the comparables.
  - o The Assessee was incorporated in the year 2003 and it is not the initial stage of operations.
  - o The Assessee has assumed 100% capacity utilization of the comparables.
  - o While calculating the adjustment of under-utilization of capacity, the Assessee has considered all costs and there is no analysis of fixed cost, variable cost and semi variable cost.
- DRP upheld the approach of the TPO.

#### **Hon'ble Tribunal**

Rejecting the plea of the Assessee, Hon'ble Tribunal remarked as under:

- The Assessee has given details of under-utilization of capacity from assessment year 2011- 2012 onwards and all the years have under-utilization of capacity. No details are available on the record as to whether the utilization level improved in the subsequent years.
- No reason are given as to why there is under-utilization of capacity for 3 years.
- No details are given as to what is the general industry utilization level.

- Assessee has not even explained the industry scene prevalent during the year and what are circumstances applicable in its case resulting in underutilization of capacity. No efforts are made even to bring the details of industry utilization level or general industry trend on the record.
- All the costs cannot be removed for capacity underutilization adjustment. It is beyond understanding how can costs like freight, commission, sub-contracting charges, rates & taxes etc. can be considered for capacity under-utilization adjustment.
- Accordingly, Hon'ble Tribunal noted, "We agree with the above observations that if the Assessee has under-utilization capacity during the subject assessment year and it will be factually and legally eligible for an adjustment for the same. However, in the instant case, same is not demonstrated except stating the installed capacity and utilization level. For the aforesaid reasoning, we reject the plea of the Assessee as regards the adjustment of under-utilization capacity. It is ordered accordingly."
- **5% mark-up on availing IT Support Services justified as acceptable under international guidelines - BMW India Financial Services Pvt Ltd [TS-68-ITAT-2023(DEL)-TP]**

**Facts:**

- The Assessee obtained IT support services from the AE. The same was examined by the TPO and the factum of obtaining of services has not been disputed by the revenue. The TPO held that the services were necessary for the operational performance of the Assessee.
- However, the TPO held that no concrete explanation has been given by the Assessee as to why a markup is warranted on a third party cost. The TPO held that the Assessee merely performs coordination services and adds no value to the functions that the third party performs. Hence, the same doesn't require any mark-up from Indian entity.
- The AO held that third party cost in anyway has been allocated to the Indian entity which includes a mark-up, therefore a double mark-up is not justified.
- DRP upheld the order of the TPO and AO.

**Hon'ble Tribunal**

Hon'ble Tribunal noted as under:

- For the recovery of costs by BMW Group, a full cost approach is followed which means all directly and indirectly attributable costs, which are needed to provide the service are considered.
- Further, the entire log of usage by the Assessee for respective IT support services is maintained in SAP, which gets auto populated against respective material code of the IT support service, at the time of rising of an invoice by BMW AG.
- It is critical for the Assessee to avail IT support services from the specialized teams in BMW AG. Performance/co-ordination of functions/services being rendered through a centralized office/Group companies, helps the participating Group companies in achieving global standardization of processes, realization of economies of scale, realizing operating and financial efficiencies, the services received from the BMW Group are provided by experienced personnel who focus on their respective domains, other direct benefits derived by the Company from such IT Support services include leveraging on the specialized support services of BMW Group who have the required expertise and knowledge.
- It cannot be expected that the parent organization supply support services without charging anything for such services rendered.
- A markup of 5 percent policy for the IT services rendered is an acceptable markup by international guidelines and as per EU Joint Transfer Pricing Forum.
- Accordingly, Hon'ble Tribunal held that the markup of 5% is sufficient to recoup the expenditure involved by the AE in exploration, inspection, testing and finalization of the suitable software. No other expenses other than 5% markup be allowed on the support services rendered by the AE.