TRANSFER PRICING

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Case Law Update

- Instruction No.3/2003 issued by the CBDT is binding on the Assessing Officer. Ruling in favour of Revenue upholds order under Section 263 passed by CIT and set-aside Tribunal order as unsustainable in law - Obulapuram Mining Company Pvt Ltd [TS-1262-HC-2019(KAR)-TP]

Facts:

The Assessment was completed by the AO under Section 143(3) read with Section 153A of the Act. The AO in his order though recorded that the Assessee has sold iron ore to its AE at a much lower price when compared with the export of iron, in other overseas transactions, the AO did not make a reference to the TPO for determination of ALP.

The CIT passed his order under Section 263 of the Act as Instruction No.3/2003 issued by the CBDT mandates reference to the TPO wherever the aggregate value of international transaction exceeds INR 5 crores (amended to INR 15 crs).

The Hon'ble Tribunal quashing revision order under Section 263 of the Act observed that Instruction No.3 is not binding on the AO and the AO himself making his own assessment without referring the matter to the TPO is one of the possible views under the Act. The Revenue Department preferred an appeal to Hon'ble High Court against the Tribunal order.

High Court's Ruling:

Hon'ble High Court held that Instruction No.3/2003 issued by the CBDT is mandatory / binding on the AO as observed by Supreme Court in case of M/s. S. G. Asia Holdings (India) Pvt. Ltd. [Supreme Court in Civil Appeal No. 6144 of 2019 @ SLP(C)No.12126 of 2019].

Hon'ble High Court ruling in favour of Revenue and restoring order under Section 263 passed by CIT observed as under:

"In view of the above discussion, the impugned order passed by the ITAT is clearly unsustainable in law as it runs counter to S.G.ASIA. Hence, we have considered the first question raised by the Revenue as a substantial question of law and answer the same in favour of the Revenue. Resultantly, this appeal merits consideration,"

- Tribunal upholds that recovery of expenses entail intra-group services in the given facts. Remits determination of mark-up - Tata Coffee Limited [TS-138-ITAT-2021(Bang)-TP]

Facts:

- The Assessee had spent INR 9.44 crs in connection with acquisition of an entity in Russia. Subsequently, on account of change in strategy by Group, the said entity was acquired by another AE.
- Accordingly, the Assessee raised a debit note of INR 9.44 crores on the AE as recovery of expenses incurred by the Assessee on due diligence (pre-acquisition) exercises.
- The TPO as well as DRP alleged that the said transaction entail service element and should be recovered with a mark-up (10 percent imputed in this case).
- Before Hon'ble Tribunal the Assessee claimed it is a mere case of recovery of expenses.

Tribunal's Ruling:

- Hon'ble Tribunal noted the fact that the Assessee had initially intended to acquire the entity in Russia and therefore it cannot be held that the expenses of INR 9.44 crs were incurred by the Assessee on behalf of the AE.
- Rejecting the contention of the Assessee, Hon'ble Tribunal observed that "in an uncontrolled transaction when the Assessee is transferring the benefit of ground work done by it on acquisition project to an uncontrolled party, it would have charged a mark-up in the normal course since its resources, infrastructure, skills, time, etc. were invested in the said activities."
- Regarding the mark-up, Hon'ble Tribunal remarked that the same needs to be determined based on any one of the Method prescribed under the Act and accordingly, the issue is remanded to the TPO for limited purpose of benchmarking.
- Hon'ble Tribunal upholds selection of foreign AE as tested party - Sun Pharmaceutical Industries Ltd [TS-171-ITAT-2021(Ahd)-TP]

Relying on the coordinate bench decision in the Assessee's own case held that AEs are accepted as tested party being the least complex for comparability analysis of international transaction of the Assessee. Coordinate Bench while pronouncing its decision in favour of the Assessee had made the following key observations:

- In order to understand the concept of tested party, one need to refer to the transfer pricing legislations of developed countries where the principles of transfer pricing have been in use for a long time and act as a guiding force for all the developing economies.
- There is no bar against the selection of Tested party either Local party or Foreign party. Neither Income- tax Act and nor any guidelines on Transfer pricing provides so.
- The driving force in selection of tested party should be the least complex FAR of the party than the volume of comparable data. OECD TP guidelines as well as UN TP Manual supports that the tested party normally should be the least complex party to the controlled transactions.
- In the APA agreement signed by the Assessee with the CBDT, it is also emphatically mentioned that foreign AEs are the tested parties.
- While the year under consideration is not a covered period under APA, however, principals laid down for comparability analysis in that does have a greater persuasive value. Draw support from Rule 10 MA of the Rules in applying the methodology as accepted in APA for the impugned year in appeal.
- The observation of the TPO that no comparables are available runs contrary to the finding of the CBDT in APA.
- Relies on various judicial precedence wherein in substance it was held that a foreign entity (a foreign AE) could also be taken as a tested party for comparison.

Other Update

- Amendments in Master File and CbCR Rules [Notification no. 31/2021 dated 5 April 2021]
- The amendment in Rule 10DA of the Rules reinforces that the requirement of Master file is applicable to "every person" being a constituent entity and it is not restricted with respect to residency.
- Earlier where one or more resident constituent entities of the MNE group existed, only one of the constituent entities resident in India were permitted to be designated for filing MF (in Form no. 3CEAA) on behalf of other resident constituent entities. However, now any constituent entity (not necessarily a resident in India) of the MNE Group may be designated for filing of Form no. 3CEAA on behalf of other constituent entities (resident as well as non-resident). This also support and ease compliance from practical standpoint and ensures no duplicative filing happen through different constituent entities forming part of the same group.
- Monetary threshold for applicability of CbCR has been increased to consolidated group revenue of INR 6,400 crs (from INR 5,500 crs) or more. This amendment is prompted to realign the threshold with OECD prescribed threshold of Euro 750mn, in view of foreign exchange fluctuation.

  In addition to above, there are few other amendments for administrative purpose which includes the change in designated income-tax authority to whom the filing should be addressed to.

Tax Guide by IRAS (Singapore) - Transfer Pricing Guidelines on Centralized Activities in MNEs

The Singaporean Inland Revenue Authority on 19 March 2021 issued a guide on analyzing the importance of the centralized activities in Singapore and providing guidance on how to analyze these activities from TP perspective.

Some key takeaways as under:

- The functional profile of the headquarters (global or regional) (herein after referred as "HQ") is dependent on the nature of its activities and the risks assumed. Where the HQ assumes a risk for transfer pricing purposes, it must both control the risk and have the financial capacity to assume the risk.
- Therefore, it would be critical to analyze the Group's profit drivers as well as the overall value chain of the MNC Group vis-à-vis the HQ's contribution to such profit drivers and its position within the value chain. This would aid in the determination of whether the HQ would operate as an entrepreneur or a service provider.

- Where the HQ acts as a principal, the transactions would be in practice tested using one sided method with the related party being the tested party, since the HQ usually would have the more complex functional profile.
- Where the HQ conducts activities relating to core business processes or provides centralized administrative services, these transactions would be tested depending on the nature of the activities - If the service provider shares in the risks and rewards, a profit split between the service provider and the other related parties may be appropriate. This would be possible where the services relate to core business processes and typically are part of the supply chain of the MNE group. In other instances, a TNMM approach may be appropriate where the value of the services provided is driven by the costs.

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MTU India Private Limited ITA 157/Pun/2018- Pune ITAT

The assessee, MTU India Private Limited, is a subsidiary of Tognum Asia Pte Ltd., Singapore (formerly known as MTU Asia Pte Ltd) and is engaged in the business of marketing and distribution of MTU, Detroit Diesel and Mercedes Benz (Off highway) diesel engines and spare parts including associated equipment.

The TPO observed from the assessee's final accounts that Commission revenue on indent sales included prior period income of Rs.5.65 crores and held that such prior period income was not liable to be included in the operating revenue of the assessee for benchmarking purposes. Accordingly, the TPO computed assessee's PLI at (-) 2.95% which led to TP-adjustment of Rs.4.80 crores. Assessee challenged the working done by the TPO before DRP. Certain directions were given by the DRP, however, no relief was allowed on the question of exclusion of prior period commission income of Rs.5.65 crore. While giving effect to the directions, the TPO, worked out the amount of TP-adjustment at Rs.4.28 crore. Aggrieved, assessee filed appeal before the ITAT urging, inter alia, that prior period commission income ought to have been included in the operating revenues of the assessee.

ITAT Ruling

Pune ITAT held that commission income should be included in the operating revenue base as 'Prior period income' for determining ALP of marketing support services for the assessee.

ITAT explained that any item of operating revenue, which is not in relation to the international transaction, goes out of the ambit in the ALP determination. It was noted that one can determine whether or not a particular item of operating revenue is in relation to the concerned international transaction by identifying the scope of the international transaction. ITAT clarified that "when the international transaction gets concluded in year two, then the costs/revenue of the international transaction from year one also qualify for consideration in determining the ALP even though characterized as `Prior period costs/revenue'". The said commission income was earned by assessee on transactions of rendering marketing services for which the credit notes were issued by the AEs during the given AY, but invoices were raised in earlier year(s), ITAT stated that to determine its inclusion/exclusion, "we need to examine if it is in relation to the international transaction under consideration".