TRANSFER PRICING

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Samsung India Electronics Pvt Ltd [Delhi ITAT] Date of Ruling January 7, 2020

In the case of Samsung India Electronics Pvt Ltd ("the assessee"), Delhi ITAT deleted TP adjustment on account of advertising, marketing and promotion expenses (AMP), interest on outstanding AE receivables and markup of 1-5% on the sale of fixed assets for AY 2012-13.

With regard to the AMP adjustment the coordinate bench ruling in assessee's own case for AYs 2005-06 to 2011-12 wherein similar adjustment was deleted was followed. It was held that the scope and value of international transaction cannot be expanded beyond the reimbursement received under Marketing Development Fund (MDF) Agreement to cover the entire gamut of AMP expenditure incurred by assessee during the year.

Regarding the issue of TP adjustment in respect of interest accrued on outstanding receivables, it was held that the interest cannot be recomputed treating a transaction as international transaction in case of sale and purchases based on each invoice. The ITAT noted that "What is required to be done is to examine, by going through entire transaction between the AE and the non AE parties regarding the payment pattern and to arrive at a decision as to whether there is any overt or covert scheme to transfer the profits by the way of delaying the payments to the assessee by the AE and thus getting benefited". It stated that "This pattern unless established by the revenue, no adjustment on outstanding receivables can be made", the ITAT hence deleted the addition observing that no such pattern was established by Revenue.

On the third issue of TP adjustment on account of disallowance of mark-up of 1% to 5% charged by the AE on the sale of fixed assets, ITAT opined that mark-up of 1% to 5% has to be allowed as it cannot be said that AE would be in a position to extend services to the

assessee at free of cost. It was noted that "The observation that only one division of AE charging mark-up while others do not charge cannot be a reason to make any adjustments in the mark-up and consequently to the depreciation". ITAT concluded that "deduction of the ALP of the transaction on purchase of fixed assets by the assessee is directed to be deleted"

Case Law Update

Date of serving of order if Assessee opts out of e-proceeding is date of Manual Service - FCI OEN Connectors Limited vs. DCIT [Kerala High Court - WP(C).No.11952 OF 2019(T)]

Dispute Resolution Panel ('DRP') in the instance case rejected objections to the draft assessment order on the ground that the objections were filed post 30 days from the date of electronic receipt of the draft Assessment order. In the instant case, the Assessee had not opted for the e-proceeding facility and had chosen to have its assessment proceedings continued in the manual mode.

Setting aside DRP's rejection of objections and adjudicating the date of service of the draft Assessment order in case of taxpayers opting out of e-proceedings, Hon'ble Kerala High Court observed as under:

- Except in the seven metro cities specified, the use e-proceeding facility was made optional and if the taxpayers chose not to opt for the electronic facility, the proceedings had to be conducted manually;
- Since the Assessee has opted for manual mode of proceedings, it is the date of the receipt of the draft assessment order through the manual mode, that determines the starting point of limitation for the period of 30 days under Section 144(C)(2) of the Act and not the date when the same was electronically served;
- On account of fairness in tax administration, the Assessee should not be prejudiced on account of service of an order through a mode that he did not opt for. Further, the choice of the Assessee have to be respected.

Final Assessment Order liable to be quashed in case of deliberate non-compliance by the AO of some of the directions of the DRP - M/s. Global One India Pvt. Ltd. vs. Dy. Director of Income Tax [ITA NO. 1980/Del/2014]

The Assessee filed its objections before the DRP against the transfer pricing and other corporate tax adjustment proposed by the TPO and AO, respectively. The DRP in its direction granted relief to the Assessee in respect of Transfer Pricing adjustment pursuant to which entire TP adjustment would be deleted. The AO vide order dated 30.01.2014 passed final assessment order and assessed the income without following the directions given by the DRP on TP adjustment. Subsequently, pursuant to the TPO's order giving effect to DRP directions, the AO passed a rectification order under Section 154 of the Act dated 15.07.2014 and deleted the TP adjustment.

Adjudicating the Assessee's appeal, the ITAT quashed the final assessment order as the AO has not complied with certain directions issued by the DRP (with respect to the TP issues), as per section 144C(10) of the Act. The ITAT also added that subsequent rectification order passed by the AO under Section 154 of the Act (deleting the TP adjustment) does not hold the test of legal sanctity as per the provisions of Section 144C(10) of the Act. Key observations of the ITAT in this regard are as under:

- Sub-Section (10) of Section 144C is not procedural but a mandatory requirement. The AO was very well aware that the DRP has given certain directions in respect of TP adjustment and it is binding on the AO to follow every direction issued by the DRP as per Section 144C(10) of the Act.
- When the Assessing Officer has deliberately chosen not to follow a binding provisions under Section 144C of the Act while passing the final assessment order, the Assessment Order, itself becomes null and void.
- As regards rectification, there is no mistake committed on part of AO, in fact AO was very well aware that the DRP has given certain directions in respect of TP issue and so it could not be termed that there is a mistake apparent on record.

TPO within its jurisdiction to determine value of intra-group services as "NIL" if Assessee fails to demonstrate (a) receipt of services; and (b) that services were not duplicative in nature - Knorr Bremse Systems for Commercial Vehicles India Private Limited vs. DCIT [TS-1122-ITAT-2019(PUN)-TP]

Pune ITAT upheld "NIL" arm's length price determination for shared services citing absence of receipt of services and duplicative nature. Key observations of the ITAT in this regard are as under:

- The Assessee has not placed on record copies of such correspondence or fax or emails or evidence of the visits by personnel of AE to demonstrate that any such services were actually provided by the AE.

- The services for which the Assessee claimed to have been paid to its AE, were, in fact, performed by self, as emanates from the functional description in its own TP study report;
- A mere signing of an agreement for receipt of services, and that too with its AE, is not sufficient. The factum of receipt of services needs to be necessarily established before claiming any deduction.

With regard to Assessee's argument on aggregated benchmarking approach under Transactional Net Margin Method, ITAT observed as under:

- In the TP study, the Assessee itself did not combine the transaction of payment of shared service charges with other transactions concerned with the manufacturing activity;
- Barring that, the mere fact that the Assessee claimed to have availed certain services and utilized the same in the overall business would not make them as 'closely linked transactions', so as to come up for consideration in an aggregate manner.
- The transactions of payment of shared services and normal Manufacturing activities cannot be clubbed because these are neither under a package deal nor they are structured in such a manner that the Assessee has no option to accept one and reject the other nor they are so inextricably linked that one cannot survive without other.
- Once the addition is sustained on the ground that the Assessee failed to prove the receipt of services at the very outset, there can be no question of any aggregation.

Operating Profit to Value Added Expenses ('OP/VAE') as known as "Berry Ratio" appropriate PLI for logistics and freight forwarding service provider - DHL Logistics Private Limited vs. DCIT [ITA No.1030/Mum/2015]

The Assessee is a logistics service provider offering a comprehensive portfolio of international, domestic and specialized freight handling services. The Assessee had benchmarked its international transactions as per the Transactional Net Margin Method (TNMM) at entity level using OP/VAE as Profit Level Indicator ('PLI'). The TPO was of the view that OP/VAE could not be considered appropriate PLI on account of (a) the handling charges in its case varied from customer to customer and were dependent upon the mark-up which the Assessee obtained from its customers based on negotiations. Accordingly, even the so-called freight element had a component of profit (or value added); and (b) OP/VAE could not be calculated reliably from the financials of the comparable companies and lots of assumptions were to be made in order to derive the same. The TPO observed OP/VAE could have been adopted if the freight and other costs were only a pass-through expense, which however was not so in the present case as the freight was also the contributor to the operating profit of the Assessee. Accordingly, the TPO adopted operating profit to the operating costs ratio (OP/OC) as an appropriate PLI for benchmarking the international transactions of the Assessee. The TPO also proposed some variation in the comparable companies selected and proposed a TP adjustment. DRP largely upheld the approach of the TPO in this regard.

The ITAT after deliberating at length concluded that (a) the 'Freight Expenses' paid to third parties by the Assessee are pass-through in nature; and (b) Operating Profit / Value Added Expenses ('OP/ VAE') is an appropriate PLI for benchmarking the logistics services and Freight forwarding business provided by the Assessee. The ITAT's conclusion were based on the following reasoning:

- The Assessee does not carry out function of "freight transportation" itself, nor does it assume risks or employ assets in relation to freight services;
- The Assessee merely acted as an agent of third-party airlines / ocean carrier which can be evident from the agreements and invoices.
- The net margin realized by the Assessee pursuant to its international transactions with its AEs are to be determined only with reference to the cost incurred directly by the Assessee itself and its profit margin cannot be imputed on the basis of the cost incurred by the third party or unrelated parties.
- Acknowledging that not all comparable companies disclose VAE expenses separately, the ITAT has remanded the matter to the file of the AO / TPO for conducting a fresh benchmarking analysis and directing to select only those companies which had provided their VAE separately.