

<p>TRANSFER PRICING CA. Bhavya Bansal, CA. Bhavesh Dedhia, CA. Shazia Khatri</p>	
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Case Law Update

- Applies purpose test for evaluating Government subsidy; Subsidy in the nature of Capital receipt cannot form part of operating revenue for margin-computation - Hyundai Construction Equipment India Pvt Ltd [TS-611-ITAT-2021(PUN)-TP]

Facts:

- The Assessee is mainly engaged in manufacturing and trading of excavators.
- For AY 2014-15, the Assessee computed its Profit Level Indicator (PLI) under the Transactional Net Marginal Method (TNMM) from manufacturing segment, inter alia, treating the government subsidy received under package scheme of incentives, 2007 as part of operating revenue, which was also offered to tax.
- The TPO opined that the subsidy was in the nature of extraordinary item of income which required exclusion from the operating revenue.
- The Assessee on without prejudice before the AO contented the government subsidy should be considered capital receipt not subject to tax.
- The DRP treated the subsidy as a revenue receipt and also upheld its exclusion from the operating revenue for the purpose of the PLI determination.

Tribunal's Ruling

Hon'ble Tribunal observed that:

- The decisive factor for considering the nature of subsidy as a capital or revenue receipt is the 'purpose' for which the subsidy has been granted and not the manner of its disbursal.
- In the instance case, the purpose of subsidy is industrial growth; it is linked with the setting up of industrial units; and the amount of subsidy is linked with the amount of investment made in the eligible unit. Simply because the subsidy has been disbursed in the form of refund of VAT and CST, it will not alter the purpose of granting the subsidy.
- In view of the above, Hon'ble Tribunal noted that the subsidy received is a capital receipt and should not be chargeable to tax.
- As the subsidy has been held to be a capital receipt, it cannot form part of operating revenue of the Manufacturing segment of the Assessee for PLI computation.
- Regarding the amendment made by the Finance Act, 2015 by inserting clause (xviii) to section 2(24) w.e.f. 01-04-2016 (i.e. AY 2016-17 onwards), providing that assistance in the form of subsidy or grant of cash incentives etc. (other than the subsidy which has been taken into consideration in determining the actual cost of the asset in terms of Explanation 10 to section 43(1)), shall be considered as an item of income chargeable to tax; Hon'ble Tribunal noted that the issue is sub judice before the Tribunal as the year under consideration is AY 2014-15.
- Revenue should get the valuation of the transaction done through its own expert, if the valuation report of the Assessee is not acceptable to the revenue, restores the issue - Star India Pvt Ltd [TS-593-ITAT-2021(Mum)-TP]

Facts:

- The Assessee has acquired the bundle of sports rights from its AE. The said transaction was benchmarked by applying CUP method. Though the AE had obtained the bundle of rights from third party at USD 1338 million, however, the Assessee has bought the bundle of right from the AE at USD 1255 million with a discount of 9.5 percent.
- The Assessee has furnished valuation reports of independent valuers and expert opinion to demonstrate arm's length nature.
- The TPO did not approve the value determined by the independent valuer. The major arena of dispute between the TPO and the valuation report of the independent valuer was with regard to the determination of terminal value for the bundle of sports rights and comparison of actual profit & loss / revenue with the projected value.
- The TPO selectively used certain observations of one independent valuer to demonstrate contradictions between the observations of the other independent valuer and the expert's opinion. He also referred to certain observations made in International Valuation Standards and book authored by Prof. Aswath Damodaran. The TPO has also referred to certain material available on a website and determined a substantially lower value, thereby proposing a TP adjustment.
- The DRP largely upheld the order of the TPO.

Tribunal's Ruling

Hon'ble Tribunal restoring the issue remarked as under

"It is a fact on record that the valuation report of the independent valuer as well as expert opinions furnished by the assessee were available before the departmental authorities. However, no effort was made by the departmental authorities to find out the deficiencies/flaws, if any, in assessee's valuation with a counter valuation being made by another expert

The case of the revenue is, when the rights are for finite period and would be expiring after certain time limit, how can the valuer determine the terminal value for infinite period. More so, when there is no certainty that the sports rights would be renewed in favour of the assessee. There can be some truth in the aforesaid objection raised by the revenue. Further, it is a fact that for terminating the contract for Champions Trophy T20 league the assessee has paid compensation of USD 366 million. In the valuation report of the independent valuer, this cost has been distributed over the life of the event. This is also a grey area which requires examination. At this stage, we are not in a position to either accept or reject the objections of the revenue.

Though, detailed submissions have been made from both sides in favour and against the value determined by the independent valuer, however, it has to be stated that valuation of an asset is a highly technical job, which requires expertise in technical knowledge and skill on the subject.... Instead of entrusting the job of finding out the correctness in assessee's valuation as per the independent valuer's report, the departmental authorities have taken up the task themselves in pointing out various deficiencies in the valuation report. In the process, the TPO has referred to certain materials available in the some valuation book and had used them selectively to reject the valuation of the assessee. In our view, this is a thoroughly incorrect approach. Since, the subject of valuation is highly technical, and can only be done by a person having expertise over the subject, a person having no technical knowledge/expertise cannot be in a position to decide whether the value determined by the independent valuer and the expert's opinion in support, are incorrect. Thus, if the valuation report of the assessee is not acceptable to the revenue, the better course would have been to get the valuation of the transaction done through an expert. Therefore, in our considered opinion, the revenue must ascertain the correctness in assessee's valuation reports by getting the valuation done through its own expert.

We must observe, in course of hearing learned Counsel for the assessee had opposed restoration of the issue for valuation purpose. However, we are unable to accept the objections of the assessee. As we have discussed earlier, valuation is a highly technical subject and can be done by a person having expertise on the subject. If we

undertake the exercise of either accepting or rejecting the valuation report of the assessee, we would be committing the same error as was committed by the departmental authorities by assuming the role of a valuer.

[emphasis added]

- Accepts inter-unit transactions at cost for Section 80IC deduction being in accordance with arm's length principle - Hero MotoCorp Ltd. [TS-624-ITAT-2021(DEL)-TP]

Facts:

- For the manufacturing activity, various components for assembly of two-wheelers, like gear box, fuel tank, etc. were purchased by non-eligible units of the Assessee from 3rd parties, due to proximity of location, business relationship, etc. and were thereafter transferred without any value addition at the same material purchase price to the eligible unit of the Assessee.
- The Assessee benchmarked the said inter-unit transaction using comparable uncontrolled price method bring price charged by 3rd parties and corroborated the same with Transactional Net Margin Method approach.
- The TPO alleged that the Assessee shifted profits from non-eligible unit to eligible unit in order to claim higher deduction under Section 80IC of the Act.
- The TPO accordingly, proposed a TP adjustment by imputing a mark-up on the cost charged by non-eligible unit to eligible unit.

Tribunal's Ruling

Hon'ble Tribunal relied on coordinate bench ruling in Assessee's own case for preceding year wherein identical disallowance made by the assessing officer was deleted. Hon'ble Tribunal held as under:

- No value addition was carried out by the non-eligible units.
- The non-eligible units in the aforesaid transaction merely incurred the cost of purchase on behalf of the eligible unit, which was subsequently debited to such unit. Accordingly, the aforesaid transaction was not in the nature of inter-unit purchase and sale of goods, covered within the provisions of Section 80IA(8) read with Section 80IC(7) of the Act.
- Accordingly, in the absence of any enhancement in the market price of the goods, no substitution of actual material cost was warranted by applying provision of section 80IA(8) read with section 80IC(7) of the Act for the purpose of computing deduction.
- The transaction was a genuine business transaction borne out of commercial expediency.
- Mere appointment of engineers not sufficient cause to reclassify business profile of the Assessee - Parametric Technology (India) Pvt Ltd [TS-608-ITAT-2021(Bang)-TP]

Hon'ble Tribunal vacated the recharacterization of Assessee's business profile from a marketing support service provider to a technical service provider. Hon'ble Tribunal held that the mere appointment of engineers by the Assessee cannot be the reason to reclassify functional profile.

Relevant portions of the ruling is reproduced as under:

"the TPO in the impugned assessment order observed that the services provided by the taxpayer to the AE are in the nature of marketing support services. However, while making the TP adjustment, he changed the business profile of the assessee recorded in page 21 of the TP order. Contrary to this, he reclassified the assessee's business profile from contract marketing service provider to a full-fledged technical/business support service provider only on the reason that the assessee has not furnished proper bifurcation of employees involved in the two activities. In our opinion, this cannot be a reason to reclassify the business profile of the assessee. The engineers could have been appointed to carry out some work in the field of marketing services. There is no prohibition on this count. The assessee is not disentitled to appoint engineers for carrying out the marketing

services with regard to international transactions to its AE. Since judicial discipline requires consistency in its proceedings from year to year, the business profile of the assessee cannot be changed from year to year wherein the all the international transactions of the assessee are based on the same agreement dated 8.8.1994 with its AE. Being so, in our opinion, it is appropriate to vacate the findings of the revenue authorities on this count and allow the grounds taken by the assessee."

[emphasis added]