

TRANSFER PRICING

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ICAI released the Ninth Edition of the Revised Guidance Note on Report under Section 92E

The revised guidance note incorporates amendments made by the Finance Act, 2022 by covering important update relating to associated enterprises, international transactions, guidance related to selection of most appropriate methods, computation of ALP, adjustment thereof and documentation etc. ICAI vide this Guidance Note intends to assist in understanding respective responsibilities of the taxpayer enterprise and the accountant, provide guidance on verification procedures to be adopted by the accountant for giving report and the prescribed particulars in the annexure thereto. The guidance note also highlights that by virtue of Finance Bill, 2022, the last date for issuing directions for faceless ALP determination u/s.92CA, faceless DRP u/s.144C, Faceless appeal/ proceedings before the Appellate Tribunal u/s.253/section 255 of the IT Act have now been extended from March 31, 2022 to March 31, 2024. Further a new Sec.158AB has been inserted after Sec.158AA by the Finance Act, 2022 in order to prevent filing of repetitive appeals. ICAI points out that CBDT vide Notification dated May 20, 2020 has extended provisions of safe harbour rules to AYs 2020-21 and 2021-22 [Substituted for "assessment years 2020-21 and 2021-22" by the Income-tax (Eighteenth Amendment) Rules, 2022) as well].

The guidance note further explains that the 'most appropriate method' will have to be selected after a meticulous appraisal of facts and circumstances of the international transaction or specified domestic transaction. The methods for ALP computation have been discussed in the guidance note, ICAI further highlights that OECD Transfer Pricing Guidelines 2022 have incorporated the application of quoted prices under the CUP method while establishing arm's length nature of commodities' transfer between AEs. ICAI highlights that under the Cost Plus Method (CPM), direct and indirect costs of production are to be determined, however the said terms 'direct' or 'indirect' costs are not defined and that a reference may therefore be made to the industry practice as well as the pronouncements of the ICAI.

Google India Private Limited vs. The Deputy Commissioner of Income-tax [ITAT Bangalore IT(IT)A Nos.1511 & 1512/Bang/2013]

Google India Private Limited (GIPL), the assessee is engaged in the business of providing Information Technology (IT) and Information Technology Enabled Services (ITES) to its group companies and also acts as a distributor for the Adwords Programme in India.

Google AdWords Program Distribution Agreement dated December 12, 2005, was with Google Ireland Limited (GIL). As per the agreement, the assessee was appointed as a non-exclusive distributor of the AdWords programme to advertisers in India. The department issued a show-cause notice to Google proposing to treat the payments made by Google India to Google Ireland as royalty payments where the assessee stated that the payments were not like 'royalty' under the Income Tax Act and India-Ireland Double Taxation Avoidance Agreement (DTAA), but like advertisement fees. The assessing officer rejected the contention and held that the activities performed by the assessee under the distribution agreement are complemented by those performed under the service agreement. It was held by the AO that the transfer of distribution rights is itself IP rights covered by 'similar property' as per the definition of 'royalty' under Explanation 2 to Section 9(l)(vi) of the IT Act. The Bangalore ITAT observed that merely because the marketing, distribution and ITES activities are carried out in India and revenues are generated from India or Indian advertisers don't define under the royalty.

"Use of Google Brand Features, etc are de hors any consideration payable to Google Ireland and further they are incidental and ancillary for achieving the main purpose of marketing and distributing the Google Adwords Program. Hence, the lower authorities were not right in treating the payments as royalty," ruled the Tribunal. It was observed that various ITAT decisions have held that income from the sale of advertisement space on a website is not taxable in India if there is no PE of the foreign enterprise in India. Online advertisement is now covered under equalisation levy('EL'). If the online advertisement was already covered under the definition of royalty, then bringing it as part of the EL scheme would not arise.

While allowing the appeal, the Tribunal held that the impugned payment cannot be characterized as royalty under the India-Ireland DTAA.

- Admits Department's SLP against Madras High Court decision ruling on interpretation of the time period available to the Transfer Pricing Officer to pass a Transfer Pricing order - Pfizer Healthcare India Private Limited (SPECIAL LEAVE PETITION (CIVIL) Diary No(s). 21872/2022)

Hon'ble Supreme Court of India admits Department's Special Leave Petition against the Madras High Court ruling in case of Pfizer Healthcare India Private Limited (WA No. 1148/2021) and has issued the notices (refer attached order).

Madras High Court in the said case had dealt with on legal ground over interpretation of the time period available to the Transfer Pricing Officer to pass a Transfer Pricing order. In the said order, the High Court had held that the Transfer Pricing order dated 1 November 2019 for AY 2016-17 was barred by limitation.

- **FCCDs are debt instrument, benchmarking interest rate as applicable to lending of money may be applied to determine ALP of these transactions - Howden Solyvent (India) Pvt Ltd (TS-773-ITAT-2022(CHNY)-TP)**

Facts:

- The Assessee has issued fully & compulsorily convertible debentures (FCCD) to its AE wherein it was required to pay interest of 12 percent to its AE.
- The TPO observed that FCCD carries an inherent option to convert which is not the case in a typical loan transaction. Taking data as available in public domain for unsecured CCD, computed average ALP at 3.4 percent.
- The DRP observed that the FCCD was to be considered either as equity or advance for share capital which is akin to share application money. As the funds have been received from AE as FDI and not ECB, the DRP determined the interest rate as NIL.

Hon'ble Tribunal's Ruling:

Deleting the TP adjustment in the hands of the Assessee, Hon'ble Tribunal observed as under:

- The term debentures, in its ordinary sense, denote one of the modes for borrowing money by any company in exercise of its borrowing powers.
- The instrument imports an obligation or a covenant to pay. It is a repayment of the loans of the money borrowed by issue of debentures. Thus, the debentures are essential borrowing of money against interest with a certain other rights.
- Hon'ble Tribunal relied upon Hon'ble Supreme Court in the case of *R.D. Goyal v. Reliance Industries Ltd. (2003; 113 Comp. Cas. 1)* has held that a debenture is an instrument of debt executed by the company managing its receipt to repay the same at a specific rate and also carrying interest.
- Thus noted that the benchmarking interest rate as applicable to lending of money may be applied to determine ALP of these transactions.
- On computation of interest rate, Hon'ble Tribunal observed that *"since the debentures are denominated in Indian Rupees, the same, in our considered opinion, could be benchmarked at SBI Prime Lending Rate with mark-up of 2% considering the fact that the assessee has credit rating of BB+ (S & P)."*

- **Dismisses Revenue's SLP against Bombay High Court ruling wherein High Court had dismissed Revenue's appeal challenging ITAT's comparable companies - 3i India Private Limited [TS-624-SC-2022-TP]**

Hon'ble Supreme Court dismisses Department's Special Leave Petition against the Bombay High Court ruling in case of 3i India Private Limited [TS-580-HC-2021(BOM)-TP], noting as under:

"We do not find any good ground and reason to interfere with the impugned judgment and hence, the special leave petition is dismissed."

In that said decision, Hon'ble High Court while dealing with department's proposed question of law on inclusion of certain comparables and characterization of services had opined that entire exercise of making transfer price adjustment on the basis of comparables is nothing but a matter of estimate of a broad and fair guesswork of the authorities based on factual relevant material brought before the authorities, i.e., TPO, DRP and the Tribunal which are the fact finding authorities. Hon'ble High Court had observed that Hon'ble Tribunal has not committed any perversity or applied incorrect principles to the given facts and when the facts and circumstances are properly analyzed and correct test is applied to decide the issue at hand, then, we do not think that questions as pressed raises any substantial questions of law.

- **Hon'ble Tribunal analyses the term "control" under Section 92A(2)(j) of the Act - ITA Nos. 125 and 126/Mum/2021**

Facts:

The Assessee's case was re-opened for the following reason – *“It was noticed that Reliance had given guarantee for the benefit of Biomatrix. Sandeep Tandon - A director in Reliance (mentioned a KMP in the Annual Report) was also a 91% shareholder in Biomatrix at the time of this deal. Thus Sandeep Tandon had control over both Reliance and Biomatrix making these two companies AEs u/s 92A(2)(j)”*

Hon'ble Tribunal's Ruling:

Dealing with the question - Whether just because someone is described as a key managerial person (KMP) in the annual accounts and is a director of the company, can it be said that the “enterprise is controlled by such an individual” as is the necessary precondition for invoking Section 92A(2)(j) of the Act? Hon'ble Tribunal noted as under:

- The expression 'control' in Section 92A(2)(j) of the Act cannot be viewed in isolation of connotations of expression 'control' in other clauses of Section 92A(2) of the Act.
- Merely because a person is described as a key managerial person in annual accounts of a company or is a director in a company, he cannot be said to be controlling the said company.
- The connotations of 'control' in the scheme of Section 92A(2) of the Act are far more cogent than visualized by a simplistic notion of 'key managerial person'. When a person appointing less than half of the board of directors cannot be said to be in control of a company, it is futile to even suggest that a person can be said to be in control of a company merely because he is a director of the company, or he is described as a KMP of the said company in its own choice of words in the annual accounts.
- The reasons for re-opening have to be examined on a standalone basis i.e. as recorded. They cannot be supplemented in any form.
- Since nothing recorded in the reasons for re-opening suggests that this person had any control over the Assessee, the reasons for re-opening are unsustainable.