

TRANSFER PRICING

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Lotus Footwear Enterprises Ltd [TS-21-ITAT-2023(CHNY)-TP]

The assessee Lotus Footwear Enterprises was in the business of manufacture of footwear. The assessee retained 90% of invoice value while selling goods to its Associated Enterprise ("AE") which sold the goods to final customer Nike. The AE in turn retained only 1.15% of the balance 10 % and distributed the rest (8.85%) to other AEs as remuneration for Design, Models and Technical, Know-how. The matter related to AYS 2009-10, 2010-11 and 2011-12.

The Transfer Pricing Officer ("TPO") discarded assessee's claim of being a risk bearing manufacturer since assessee bore same risk as borne by any other contract manufacturers. Further the TPO also denied the economic adjustments assessee sought owing to initial years of business operations during start-up phase. Consequently the TPO made an adjustment Rs.60.50 Crores for all the three years which far exceeded the 100% of revenue ultimately realized by the assessee group from Nike.

Chennai ITAT however directed TPO to restrict TP adjustment considering 100% of sale consideration receivable from Nike, and denied economic adjustments in second round of proceedings to assessee. The ITAT noted that the matter had been remitted by the same bench vide order dated 21.09.2016 observing that assessee entered into an Advance Pricing Agreement (APA) and nature of assessee's business would have considerable bearing on Arm's Length Pricing Study. The assessee also submitted that APA covered AYS 2015-16 to 2019- 20 with a roll back period of three years covering AYS 2012-13 to 2014-15.

The ITAT states, "...it could be seen that Ld.TPO has proposed overall adjustment of Rs.60.50 Crores for all the three years which far exceeds the 100% of revenue ultimately realized by the assessee group from Nike. The same could not be held to be justified from any angle particularly considering the fact that in APA for subsequent years, it has been agreed that ALP, in no case, would exceed 100% of sale consideration receivable from ultimate customer". ITAT accepts assessee's plea and directs TPO to restrict TP adjustment, for all the three years, by considering 100% of sale consideration receivable from Nike. It also directs TPO to verify the figure as worked out by assessee and restrict adjustment to that extent, thereby denying any economic adjustment to assessee.

- **Accepts Assessee's valuation following method prescribed under Rule 11UA over TPO's Discounted Cash Flow - Aaradhana Realities Limited (earlier known as Essar Investment Limited) v. DCIT (ITA No 2195/MUM/2014)**

Facts:

- The Assessee undertook International Transaction of sale of equity share Essar Capital Limited (ECL) to its AE at the rate of INR 10 per share. The aforesaid value of INR 10 per share was more than the value determined in the valuation report obtained by the Assessee from an independent valuer.
- ECL, being an investment company, had inconsistent stream of revenue. The independent valuer determined value of the share by using Profit Earning Capacity Value (PECV) Method, however, since same was coming as "Nil", it was ignored.
- Then the valuer adopted Net Asset Value (NAV) Method and determined the value of one share of ECL at INR 4.97.
- The Assessee selected Comparable Uncontrolled Price ('CUP') method for benchmarking
- The TPO rejected CUP method and adopted Discounted Cash Flow ('DCF') adopting actual figures for computing per value of the shares. The TPO accordingly made a TP adjustment of INR 38 crs.
- The Assessee vehemently contended that the TPO does not have the right to change the method adopted by the Assessee unless the TPO satisfied that the data or the information used are not reliable or incorrect.
- The TPO also made a secondary adjustment by treating difference between ALP determined by Assessee and ALP determined by TPO as terms of loan/credit facility provided to the AE and charging interest thereon.

Hon'ble Tribunal

Hon'ble Tribunal noted as under:

- For the purpose of arriving at the valuation using DCF method actual figures cannot be substituted for future projections.

- Notes DCF Method cannot be applied in the facts and circumstances of the present case given the uncertainty regarding income/future cash flow projections. Draws support from Indian Valuation Standard 2018 issued by the Institute of Chartered Accountant of India (ICAI)
- Accepts Assessee's without prejudice submission, of adopting value determined on the date of sale of shares by following method under Rule 11UA of the Rules. Notes that Rule 11UA of the Rules is also based on Net Asset.
- With regard to interest imputation on TP adjustment by treating the difference amount treated as outstanding receivables, holds that the same is clearly in the nature of secondary adjustment and cannot be sustained in the absence of specific provisions. Observes that for the relevant AY, there were no provisions for making secondary TP adjustment by treating debt as equity.
- **Deletes TP-adjustment qua purchase of commercial right from AE - WNS Global Services Pvt Ltd [TS-1273-ITAT-2020 (Mum)-TP]**

Facts:

- WNS Capital Investment Private Limited (WCIL), a WNS group entity entered into a Masters Services Agreement (MSA) with Aviva Global Services (Management service Private Limited (Aviva Singapore) on 11.07.2008 to provide BPO services as mentioned in the MSA to Aviva Singapore and Aviva Group entities. As per the MSA, WCIL was required to provide services to Aviva entities across the world for a period of eight years and four months. However, in Mar 2011, with five years and eight months of MSA remaining, the Assessee purchased all rights and obligations in respect of the said MSA from WCIL for a consideration of USD 110 million.
- The Assessee determined said consideration based on the valuation report obtained from third party valuation expert, who undertook the valuation based on expected earnings from the MSA for the balance unexpired period of the MSA and the expected growth in the revenues from Aviva Singapore over a period of time.
- Prior to entering into agreement with the Assessee with regard to the purchase of business and commercial rights, WCIL had outsourced the work under the MSA to various legal entities within the group across India and Sri Lanka on a non-exclusive basis under a revenue sharing arrangement in the ratio of 15:85 in favour of the legal entities in India and Sri Lanka.
- The TPO determined the ALP based on incremental benefit approach. He determined the ALP by considering only incremental value earned by WNS India by replacing actual billings. Accordingly, the TPO made an adjustment of INR 171 crs on account of purchase of business rights.
- DRP upheld the approach of the TPO.

Hon'ble Tribunal

Deleting the adjustment, Hon'ble Tribunal observed as under:

- The TPO has determined arm's length price on incremental benefit approach and none of the transfer pricing methods as prescribed under Section 92C has been followed. Whereas, the Assessee has followed in its transfer pricing study as the CUP method as the most appropriate method by determining the value of the MSA on the basis of valuation report given by the independent valuer.
- The TPO has not followed any of those methods, which is not a curable defect and goes to the root of the matter. Under these circumstances, we are of the considered view that the addition made by the TPO cannot be sustained.
- Even on the issue of determining arm's length price on the basis of valuation report from the independent valuer, we find that the TPO/DRP has not found any fault in the report in which the projected revenue and projected operating from the unexpired period of the MSA was considered to determine the price payable by WNS India to WCIL and, therefore, the TPO/DRP cannot resort to their own estimate in determining the arm's length price.
- Valuation of an intangible requires expertise and knowledge in the domain of valuation principles, markets and business. Even if the TPO/DRP were not in agreement with the variables assumed/valuation undertaken by the independent valuer, they ought to have desisted from their own exercise of adhoc valuation without having appointed a valuation expert to determine the value of the MSA.
- On the specific valuation date, the valuation has to be done on the basis of certain parameters or forecasts made as at the point of time of valuation. Thus, any future happening/occurrence based to the date of valuation cannot be foreseen.
- In case the actual working of the contract/hindsight is to be treated as genuine for valuation then transfer of customer relationship by WCIL to the Assessee and renewal/extension of contract apart from the MSA incentive payment for the unamortized period must be taken into account for determining the ALP.

- Interest on loan paid to unrelated third parties can be taken for benchmarking interest on NCDs. Lays comparability guidance - Dans Energy Private Limited [TS-906-ITAT-2022(Bang)-TP]

Remitting the issue of benchmarking interest on Non-Convertible Debentures (NCDs), Hon'ble Tribunal observes as under:

- The ALP of interest depend on various factors like the nature and purpose. of the loan, currency in which the loan is provided and in which interest is to be paid, security or guarantees offered by the borrower, the amount & duration of the loan and credit rating of the borrower.
- First internal comparables should be evaluated for ALP computation. If for any reasons, internal comparables fail the comparability test, then the external comparables can be adopted for ALP computation.
- Interest paid on third party loans can be taken as internal comparables for interest payment on NCDs.
- Taking internal comparable in form of loan from third parties would take care of the credit rating of borrowers and nature and purpose of the loan.
- If the NCD issued to associated enterprise is denominated in Indian rupees and the loan taken from third parties is also denominated in Indian rupees and the interest on such loans is also paid in Indian rupees, the question of geographical difference does not arise. If currency is different, it should be analysed whether any adjustment can be made for such difference as mandated by Rule 10B(3) of the Rules.
- The NCD issued to associated enterprise is unsecured and loans taken from third parties are secured loans, then, adjustment for this difference should be made.
- Only if the internal comparison fails, then external comparables can be adopted. However, the borrowers in external comparables should have similar credit rating like that of the Assessee.
- Further, NCD and convertible debenture cannot be adopted for comparison.

- Deletes TP-adjustments for reimbursement of expenses as substantial evidence already submitted by the TPO - Infinity Retail Limited [TS-904-ITAT-2022(Mum)-TP]

Facts:

- The Assessee made reimbursement of out of pocket expenses incurred by the AEs on behalf of the Assessee amounting to 1,32,81,256. The Assessee submitted third-party invoices for INR 1,04,13,664/
- The TPO, after granting benefit in respect of the same, proposed transfer pricing adjustment of INR 28,67,592 (difference).
- Hon'ble DRP upheld the approach of the TPO.

Hon'ble Tribunal

Relying on coordinate bench decision of earlier year, Hon'ble Tribunal deleted the adjustment and noted as under:

"There is no change in the facts and circumstances in the present assessment year. The Appellant had not furnished third-party invoices or other supporting documents for 22% out of pocket expenses reimbursed. The TPO/Assessing Officer has not pointed out any defect/discrepancy in the bills/supporting documents furnished .by the Appellant as the same have been examined and accepted. Accordingly, adopting the reasoning given by the Tribunal in the order of the Tribunal for the Assessment Year 2008-09 [ITA No. 7718/Mum/2012 on 13.10.2022] reproduced hereinabove and following the decision of the Tribunal for the Assessment Year 2010-11 [ITA No.2297/Mum/2015], we delete the transfer pricing addition of INR 28,67,592/- made in relation to reimbursement of out of pocket expenses to AE."