TRANSFER PRICING

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Quashes Reassessment Order based on invalid TP order. Further, Order passed not in conformity with DRP's binding direction, bad in law. – Nomura Research Institute Financial Technologies India Private Limited vs. DCIT [TS-214-ITAT-2020(Kol)-TP]

The Assessee is engaged in providing software services to its Associated Enterprises ('AEs'). Assessee's Return of Income for AY 2014-15 was taken up for scrutiny through CASS on "non-TP" risk parameters. Reference to the Transfer Pricing Officer ('TPO') was made on 8 September 2015 based on Instruction no. 3/2003. Prior to the receipt of any order from the TPO, the Assessing Officer ('AO') passed final assessment order on 31 August 2016. Subsequently, the Assessee received a notice from the TPO initiating TP proceedings. Rejecting the Assessee's contentions of the TP proceedings being invalid, the TPO passed an order dated 27 October 2017 making upward TP adjustment. As the final order was passed before receipt of the TP order, the AO initiated re-assessment proceedings under Section 148 of the Act, by issuing notice dated 26 February 2018. The AO cited reason that the income has escaped assessment on account of non-consideration of the TP order. The AO then passed the draft assessment order incorporating TP adjustment made vide TP order dated 27 Oct 2017. The Assessee preferred objections before the Dispute Resolution Panel ('DRP'). The DRP held the re-opening of the assessment as bad in law. However, the AO passed the final reassessment order dated 16 May 2019 ignoring DRP's directions.

The Hon'ble Tribunal uploading DRP's directions, held as under:

- The TPO acted without jurisdiction as the original reference to the TPO became infructuous once the final assessment order was passed by the AO;
- The final assessment order dated 31 August 2016 explicitly stated that the same complied to Instruction no. 3/2016 dated 10 March 2016 in respect of Transfer Pricing and accordingly, the TPO order is not-est in law. Re-opening of assessment based on a report which is a nullity is bad in law.
- Even after re-opening the assessment, a fresh reference has not been made to the TPO. Hence, the adjustment made without a valid reference to the TPO cannot be sustained.

The Hon'ble Tribunal further observed "The directions of the DRP are binding of the AO u/s 144(13) of the Act. The final assessment order dated 16.05.2019 should have incorporated the finding of the DRP as directed in the order of the DRP. When the DRP has held that the re-opening of the assessment is bad in law, the AO, in our view, has no other alternative but to drop the assessment proceedings on the ground that re-opening of assessment has been held as bad in law. As the AO has not followed the binding directions of the DRP, we have to quash the final assessment order dated 16.05.2019 as bad in law."

Proceedings before the DRP are continuation of assessment proceedings, being a stage prior to the completion of assessment. Quashes TPO reference being contravention to Instruction 3/2016. - Sava Healthcare Limited vs. DCIT

Assessee's Return of Income was taken up for scrutiny through CASS on "non-TP" risk parameters. The AO made a reference to the TPO after according appropriate internal approval on the grounds that the transfer pricing addition made of more than INR 10 crore in earlier years was pending before DRP and accordingly, the case was covered under para 3.3(b) of the Instruction No.3/2016 dated 10-03-2016 issued by the CBDT. The TPO proposed an adjustment in line with earlier years. The DRP dismissed the objections and upheld the order of the TPO.

On appeal before the Hon'ble Tribunal, the Assessee contented that reference by the AO to the TPO should be declared invalid and consequential TP adjustment be deleted.

The Hon'ble Tribunal while adjudicating the said legal issue noted that the following:

- Para 3.3(b) of Instruction 3/2016 divulges that the reference can be made to the TPO when two conditions are cumulatively satisfied namely (a) there has been a transfer pricing adjustment of Rs.10 crores or more in an earlier assessment year; and (b) such adjustment has been upheld by the judicial authorities or is pending in appeal.
- The term "an earlier assessment year" does not refer to the immediately preceding assessment year. If, for any year prior to the immediately preceding assessment year also, a transfer pricing adjustment of INR 10 crores or more has been made, it will satisfy the first condition.
- In respect of second condition, whether the transfer pricing adjustment is upheld by the judicial authorities or is pending in appeal, it is a pre-requisite that the transfer pricing adjustment must have been made in the first instance by the AO in the final assessment order.
- Proceedings before the DRP are continuation of assessment and therefore the pendency of the matter before the DRP cannot be equalized with the pendency of an appeal so as to satisfy the second condition of para 3.3(b) of the 2016 Instruction. Hon'ble Tribunal referred to Hon'ble Bombay High Court decision in Vodafone India Services (P) Ltd. Vs. Union of India (2013) 39 taxmann.com 201 (Bom.) to draw a support in this regard.

In view of the factual matrix and above discussion, Hon'ble Tribunal held that the reference made by the AO to the TPO was in contravention with the Instruction No.3/2016. Since the Instruction was binding on the AO and such reference being declared as invalid, the consequential transfer pricing adjustment was directed to be deleted.

Under Transactional Net Margin Method- aggregation principle – reference to case of composite contract involving multiple international transactions. - M/s Lenovo India Private Limited vs. The Income Tax Officer [2020-TII-103-ITAT-BANG-TP]

The Assessee is engaged in the business of trading, manufacture and sale of desktops, laptops, servers and smartphones. The Assessee had inter-alia entered into transactions of (a) provision of sales facilitation services; and (b) administrative & business support services to its AEs. The Assessee had carried out separate analysis for both these transactions citing difference in Functions, Assets and Risks profile. The TPO however, aggregated both the segments / transactions and performed a common benchmarking analysis citing composite contract for services. The DRP in its direction did not deal with the objection on whether international transactions can be aggregated in the given facts and circumstances.

Remanding the issue to the file of the TPO, the Hon'ble Tribunal observed the following:

"As per the Indian Income-Tax Act, ideally, the transfer pricing is to be made on a transaction by transaction basis. However, Rule 10A(d) provides that the term 'transaction' includes a number of closely linked transactions. Thus, in cases where separate transactions are so closely linked or are closely inter-related or continuous and where application of the arm's length principle on a transaction by transaction basis becomes cumbersome for all involved and would not lead to an accurate result, recourse is often had to evaluate transactions following an 'aggregation' principle. Due to increasing presence of composite contracts and 'package deals' in an MNE group, the aggregation of transactions become necessary as a composite contract may contain a number of elements including royalties, leases, sale and licenses all packaged into one deal. One would usually want to consider the deal in its totality to understand how various elements relate to each other, but the components of the composite package deal may or may not, depending on the facts and circumstances of each case, need to be evaluated separately to arrive at the appropriate transfer price. Aggregation issue may also arise when looking at uncontrolled comparables. This is because third party information is not often available at the transaction level. In such circumstances, entity level information is the only recourse available. Therefore, whether ALP-principle is to be applied on a transaction by transaction basis or on an aggregation basis depends on the facts of each case and is not universally or generally applied in all composite contracts involving multiple transactions."

Accordingly, Hon'ble Tribunal observed as under in relation to aggregation of transactions:

- In case of composite contract arrangements, the third party information is not often available at the transaction level, thus if there is an intrinsically linkage between transactions then aggregation of transaction could be adopted / considered for the purpose of benchmarking.

Hon'ble Tribunal has also made following other key observations:

- Method adopted for benchmarking in previous years cannot be ignored when there is no change in the facts and law.
- Incurring of Advertisement, Marketing and Promotion expenses cannot be treated as international transaction and consequently determination of arm's length price would not arise if the principles laid down by the Hon'ble Delhi High Court in Sony Ericsson Mobile Communications India P. Ltd. [374 ITR 118 (Del)] are applied and the margins are accepted as at arm's length.

The fact that the TPO changes the method of computation of ALP does not mean it is a fit case for imposition of penalty if there is no dishonesty found in the conduct of the Assessee - Income Tax Officer vs. M/s Tianjin Tianshi India Private Limited

The Assessee, Indian Company, is engaged in trading/distribution of food supplements and health care equipment. The Assessee had entered into purchase transactions with an overseas Group Company's Branch Office ('PE') situated in India. The Assessee was of the view that the transaction between the Assessee and PE of the foreign AE situated in India would not attract the transfer pricing provisions. However, it had maintained TP documentation on conservative basis. The TPO during the TP Assessment proceedings proposed an upward adjustment to this transaction. In the merit appeal, CIT(A) deleted the said adjustment observing that there was no cross border transaction and accordingly, outside the purview of TP provisions. Hon'ble Tribunal reversed the said decision of CIT(A). Hon'ble Tribunal held that the said transaction between the Assessee and the PE of the foreign AE situated in India attracted the Transfer Pricing provisions. Pursuant to the said direction, Transfer Pricing adjustment was made.

Subsequently, the penalty under Section 271(1)(c) of the Act has been levied by the AO on the said adjustment. The Assessee filed an appeal before CIT(A) against the said penalty order. While deleting the penalty, CIT(A) held that provisions of Section 271(1)(c) of the Act would not get attracted as the Assessee was under belief that the purchase from the PE of the foreign AE situated in India would not attract the transfer pricing provisions. The Revenue Department filed an appeal before Hon'ble Tribunal.

Hon'ble Tribunal upholding CIT(A)'s order deleting the penalty under Section 271(1)(c) of the Act observed as under:

- In earlier years, it was not even clear whether the transactions are indeed international transactions or not.
- The adjustment primarily arose due to exclusion of some comparables, use of current year data by the TPO instead of multiple year data by the Assessee and also taking Net Profit Margin instead of Net Cost Plus margin as Profit Level Indicator. In view of the same, it cannot be said that the Assessee failed to exercise their transactions with all the due diligence or adopted any surreptitious mechanism.

Other Updates:

Recently, Hon'ble Gujarat High Court in case of FAG Bearings India Ltd. (R/TAX APPEAL NO. 862 of 2019 With R/TAX APPEAL NO. 864 of 2019) has admitted Revenue Department's substantial questions of law challenging Hon'ble Tribunal adoption of Transactional Net Margin Method as most appropriate method over Comparable Uncontrolled Price method for benchmarking the royalty transaction. Department has also challenged benchmarking of arm's length price at entity level instead if transaction level analysis as mandated by Section 92 of the Act.