RECENT JUDICIAL ANALYSIS ON TRANSFER PRICING

Relevance of Judicial Analysis:

- Organisational set-up
- FAR analysis
- Comparable analysis
- Rate analysis

Relevant for transfer pricing strategies and management.

Nvidia Graphics

In the ITAT (Bangalore) decision in the case of Nvidia Graphics Private Limited v DCIT (IT(TP) No.1223/Bang/2011), dated 9 February 2018, the ITAT held that the TPO erred in determining the role of Indian taxpayer more akin to commission agency instead of a purely marketing support service provider. The Indian taxpayer adopted TNMM as its MAM and its profit margin is 9.10% in respect of marketing support services. The ITAT agreed with the contention of the Indian taxpayer. The agreement on marketing support services provided the following:

"Functions performed

Marketing Strategy

NVIDIA Singapore formulates the overall marketing strategy for the NVIDIA India. NVIDIA Singapore lays down the guidelines, procedures and rules, lo be implemented by the NVIDIA India.

NVIDIA India is responsible for the tactical implementation of the marketing strategy drawn by NIVIDIA Singapore. NVIDIA India formulates the marketing strategy for India in consultation with NIVIDIA Singapore.

Developing marketing and sales collaterals

NVIDIA Singapore is primarily responsible for developing and providing marketing collaterals in line with the global policy. For the provision of marketing support services. NVIDIA Singapore provides promotional and marketing collaterals like brochures, catalogues, presentation and demonstration materials to be utilised by NIVIDIA India for the marketing support function.

NVIDIA India is not engaged in developing marketing and sales collaterals.

Advertisement and sales promotion

NVIDIA Singapore provides promotional and marketing material free of cost to NVIDIA India and formulates the overall advertising and sales promotion strategy.

NVIDIA India executes the India specific advertising strategy to facilitate the sale of, NVIDIA's products in India. The marketing activities of NVIDIA India are limited to raising market awareness of NIVIDIA's products in India.

Assistance in Identifying Customer India

NVIDIA India is responsible for liaising with potential and existing customers to identify potential clients for NVIDIA's products in India. NVIDIA India actively participates in trade shows and

exhibitions and performs product presentations. NVIDIA India is responsible for identifying potential customers for NVIDIA Singapore.

On identification of customers in India, NVIDIA Singapore would interact with customers directly to conclude the contract,

Pricing decision

Price negotiations are undertaken by NVIDIA Singapore directly with customers.

NVIDIA India quotes only those prices as specified in the price list provided by NVIDIA Singapore and is not involved in price negotiations with the customers.

Contract with customers

NVIDIA Singapore enters into contract, directly with customer in India for the sale of NVIDIA's products. NVIDIA India does not enter or conclude contracts or contractual terms directly with customers."

The ITAT observed from the above that the taxpayer is involved in making sale transaction, except for price negotiation and raising of invoice. This was not marketing support services but akin to commission agency business. The ITAT did not consider permanent establishment issues.

But in the case **Nokia**[1] and **Mastercard**[2], the Court emphasized on the importance of Functional, Asset and Risk (FAR) analysis that it shows the true substance of transaction in India and has relevance in determination of permanent establishment. Therefore, in these cases, the Court reviewed the FAR while deciding whether the Indian subsidiary constitutes PE of the Foreign Parent or not.

In Re, GoDaddy India

In Advance Ruling in reference to M/s GoDaddy India Web Services Pvt. Ltd. (Ruling No. AAR/ST/08/2016, dated 4 March 2016, the Authority for Advance Ruling was faced with the similar issue. The local entity was providing marketing support services to its non-resident parent company. The local entity was remunerated at operating cost plus 13%. The facts of the case, to the extent, it is relevant to the present case, is provided below:

GoDaddy India Web Services Private Limited (hereinafter also referred to as GoDaddy India) proposes to enter into a 'Services Agreement' with GoDaddy.com, LLC (hereinafter also referred to as 'GoDaddy US') located in Arizona, USA and incorporated in Delaware, USA. GoDaddy US is a domain name registrar and provides other web services to customers across the world. Go Daddy India proposes to provide a gamut of services to its client GoDaddy US. It shall provide support services in an integrated manner to assist GoDaddy US develop its brand in India, carry on its operations efficiently and serve customers in India, which are as under:

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[1] [ITA Nos. 1963 & 1964/Del/2001] / [2018] 94 taxmann.com 111 (Delhi - Trib.) (SB)

[2] [AAR No. 1573 of 2014] / [2018] 94 taxmann.com 195 (AAR - New Delhi)

1) Marketing and promotion services: GoDaddy India proposes to engage in promotion and marketing of GoDaddy US services in India. This would essentially include increasing the awareness of services provided by GoDaddy US and establishment of the brand GoDaddy in India. Towards this, the GoDaddy India proposes to provide the following services:

- Direct Marketing: GoDaddy India shall advise GoDaddy US regarding various aspects of the market situation prevailing in India from time to time. GoDaddy India would also advise GoDaddy US regarding upcoming events, festivals, holidays in India and accordingly the suitable timing for rolling our campaigns or advertisements in India (either in various social media or by way of dispatch of personal emails to GoDaddy US existing customers in India). The content of advertisement would be prepared by the marketing team of GoDaddy US itself. Also, such advertisement would be directly placed on social media by GoDaddy US. The necessary advice in this regard and said information would be provided from the GoDaddy India to GoDaddy US.

- Branding Activities: GoDaddy India shall assist GoDaddy US in developing its brand in India by arranging for advertisement activities of GoDaddy US. An independent (third party owned) advertisement agency in India would be appointed by GoDaddy US directly. Such agency would negotiate the price for purchase of time slots or space for display of advertisement in the electronic or print media and coordinate regarding timing for display of the advertisement with Indian advertisement companies. Towards this, the GoDaddy India would provide information, advice and support to the marketing team of GoDaddy US regarding various events taking place in India where advertisements can be broadcasted. Also, GoDaddy India would suggest to GoDaddy US regarding the locations / geographies in India where banners, billboards could be placed. The advertising agency appointed by GoDaddy US will be solely responsible to arrange required permissions or licenses from any local or State Government authority regarding display of the advertisement at any location or place. The advertisement agencies so employed by GoDaddy US in the entire set of activities aforesaid would be remunerated for all expenses and relevant service charges directly by GoDaddy US and the GoDaddy India will have no role to play with regard to appointment of the advertisement agency in India or payment of consideration to the advertisement agency by GoDaddy US.

- Offline Marketing: GoDaddy India shall undertake marketing and promotional activities in India for GoDaddy US. Towards this, the GoDaddy India shall take part in seminars, talk shows or any other events as speakers to spread awareness regarding the GoDaddy brand and services offered by GoDaddy US. Also, the GoDaddy India may conduct road shows, take up a stall in a fair or exhibition, hold webcasts for GoDaddy US channel

partners or resellers in India to update them on new developments and services provided by GoDaddy US as per the instructions of GoDaddy US. The GoDaddy India may also sponsor specific events or social gatherings in India to reach out to the public for creating awareness of GoDaddy US brand. For this purpose, the GoDaddy India shall hire an agency in India which will enable the GoDaddy India to undertake the said activities. The said agency will take the required permissions or licenses from the local or State Government authorities or any third party event organizers for conduct of such events. The GoDaddy India would remunerate such agency directly for the services rendered by the said agency.

2) Supervision of quality of third party customer care center services: GoDaddy US intends to provide its customers in India a superior experience and quality services. GoDaddy US also intends to provide the customers with an avenue where the customers have round the clock access to technical support and assistance in relation to the services of GoDaddy US. Towards this, GoDaddy US will directly appoint a third party call centre in India to provide such support and assistance to customers in India. Further, to ensure that the call centre provides the best customer support service and that the employees of the call centre understand the relevant technical aspects, GoDaddy US shall require the GoDaddy India to provide oversight of the quality of the services of the call centre. GoDaddy India will have no role to play in selection or appointment of the call centre in India by GoDaddy US. GoDaddy India shall provide oversight of the quality of services rendered by the call centre and prepare a report, if desired by GoDaddy US, regarding the nature of complaints received by the call centre from customers in India so that GoDaddy could better appreciate the technical issues and provide long term solutions to customers.

3) Payment processing services: GoDaddy US will provide its services and products to customers in India through its website. To ensure maximum reach to the customer base in India and enable customers to procure the service without any difficulty in making payments, GoDaddy US desires to provide an online payment facility to its customers in India. Customers who possess an international credit card may make payment directly to GoDaddy US in US Dollars. Customers will also be able to obtain the services by using their Indian credit cards or bank payment facilities and make payments in Indian Rupees ('INR'). To enable customers to pay for services in INR, GoDaddy US proposes the GoDaddy India to provide payment processing facilities in India, collect money from the customers of GoDaddy US in India and remit the same to GoDaddy US. GoDaddy India shall outsource the payment collection activity to a third party service provider in India which will provide the necessary payment collection gateway facility to the customers who may wish to effect payments in INR. GoDaddy India proposes to open a separate bank account in India into which the

payment collection gateway company will deposit the moneys collected from the customers of GoDaddy US. Further, the GoDaddy India may also allow customers to directly deposit money in its bank account using their net banking facility. All such collections from customers (in respect of services provided by GoDaddy US) will be transmitted by the GoDaddy India to GoDaddy US on actual basis i.e. without any mark-up.

In consideration for the above-mentioned support services, the GoDaddy India shall charge a fee equal to the operating costs incurred by the GoDaddy India plus a mark-up of 13% on such costs, which will be received by the GoDaddy India from GoDaddy US in US Dollars. It is contemplated that GoDaddy US would be the only customer of the GoDaddy India. GoDaddy India would not provide any services for or on behalf of GoDaddy US in India or outside India. GoDaddy India is not authorized to enter into any contract or arrangement on behalf of GoDaddy US or which would bind it in any manner whatsoever. GoDaddy US will directly contract and render services to customers in India. It will directly engage relevant third party service providers in India such as marketing agencies and call centers. Further, the GoDaddy India will not be engaged in arranging or facilitating provision of services by GoDaddy US to customers in India. Furthermore, the GoDaddy India will not secure orders from customers in India or arrange or facilitate the provision of any service by any third party service provider to GoDaddy US. The only service to be performed by the GoDaddy India is provided to GoDaddy US on a principal-to principal and arm's length basis.

Cost Allocation - OECD approved – international practice – CPA certified

Jabil Circuit India Pvt. Ltd. – Mumbai ITAT Outcome: In favour of Taxpayer Category: Intra-group services

Tax Court accepts taxpayer's adoption of cost allocation mechanism pertaining to intra-group services namely IT and non-IT services (corporate support, business development support, etc.) rendered and received by the taxpayer. Taxpayer backed the cost allocation with a CPA certificate using various key factors like assets, revenue, no. of employees, etc.. Tax Court notes that allocation of costs using such factors is a well-accepted practice in international taxation. Furthermore, after going through the taxpayer's documents and supporting evidences, it was held that the cost allocation mechanism is in line with the OECD guidelines. Tax Court affirms reliance on CPA certificate which is specific and duly authenticated.

In Deloitte Consulting [TS-224-ITAT-2012(Mum)], the ITAT rejected the notion that contractual obligations bind the assessee even in related party scenario and hence cost allocations need to be treated as justified payment based on such obligations, holding that ALP has to be determined irrespective of such contractual obligations.

Nil Loan

Laqshya Media Limited [earlier known as Lakqshya Media Pvt Ltd] [TS-1261-ITAT-2018(Mum)-TP]

Laqshya Media Limited – Mumbai ITAT Outcome: Against Taxpayer Category: Nil ALP on Loan Tax Court rejects use of Nil arm's length determination of loans granted by taxpayer to its AE for further lending to step-down subsidiaries. However, the AEs incurred huge losses due to which taxpayer made substantial provision in its books of accounts and did not accrue any interest against outstanding loan considering the loans as non-performing assets/stressed assets. Taxpayer relied on principles of commercial expediency and real income theory wherein hypothetical income never earned by taxpayer could not be taxed. Further, taxpayer argued that the same should not be considered as international transaction. Tax Court rejects taxpayer's views stating that taxpayer advanced loan under loan agreements/arrangements to its AE and was entitled to rate of interest. Additionally, as long as the loan transaction is an international transaction the test of commercial expediency or notional income or revenue neutrality would fail.

Similarly, in US Technology Resources Pvt. Ltd. – Cochin ITAT Outcome: In favour of Taxpayer Category: Management Charges Tax Court rejects transfer pricing officer's questioning of commercial expediency on management charges paid by taxpayer to its AE. Relying on order passed by Chennai Tribunal in Seimens Gamesa & Renewable Power Private Limited (2018), it was noted that benefit is not a precondition for justifying arm's length price & hence the reasonability of payment of management service fees cannot be questioned.

HC: Routing money through AE for distribution rights acquisition from third party, not 'international-transaction'

Jan 15,2019

KSS Limited (formerly known as K Sera Sera Productions Ltd) [TS-1379-HC-2018(BOM)-TP]

Conclusion

Bombay HC upholds ITAT order for AY 2009-10, holds that the transaction of routing money through AE by assessee (engaged in production and distribution of films) for specific purpose

of acquisition of distributorship from Citi Gate (third party) is not an international transaction and hence the machinery under

Chapter X of the Act cannot be invoked; Rejects Revenue's reliance on clause (c) of Explanation to Sec 92B which states that "capital financing including any type of long-term or short-term borrowings, lending...or any type of advance, payments...or any other debt arising in the course of business would be included within the expression "international transaction", notes that this was not a case of financing or lending or advancing of any moneys but routing money through AE (used as a conduit as Citi Gate would not deal with assessee directly) for purpose of acquisition of distribution rights; Noting that neither at the point of payment to Citi Gate nor at the point of refund of money (upon cancellation of the agreement), the AE retained the advance for any significant period of time, HC holds that "This transaction did not result into diversion of income of the assessee to its AE"; Also, upholds ITAT's observation that in order to attract the provisions of Chapter X, there must be a transaction or arrangement between two or more AEs which gives rise to the income or benefit in the hands of at least one of them, observes that in the present case the advance was not given to

the AE but to the third parties for the purpose of acquisition of rights of distributorship.

SC: Upholds HC-order confirming deletion of guarantee fee TP-adjustment for Glenmark Pharma

Dec 12,2018

GLENMARK PHARMACEUTICALS [TS-1268-SC-2018-TP]

Conclusion

SC upholds HC-order confirming ITAT's deletion of TP-adjustment on guarantee fee amounting to Rs.11.51 Cr for AY 2008-09; HC had accepted guarantee commission fee charged by assessee to its AEs at 0.53% and

1.47%, confirming ITAT's rejection of TPO's approach of taking bank guarantee rate of 3% as benchmark on the basis that bank guarantee was not on the same footing as corporate guarantee; SC holds that the issue *"has been rightly decided by the High Court in favour of the*

Assessee and against the Revenue. The same would, therefore, not require reopening in this appeal"

ITAT: Rejects re-characterization of Redeemable Preference Shares into loan; Stresses on 'real-income' principle

Nov 01,2018

Cairn India Ltd [TS-1151-ITAT-2018(DEL)-TP]

Conclusion

Delhi ITAT, in second round of proceedings, deletes notional interest adjustment on account of recharacterization of Redeemable Preference Shares (RPS) into loan & advances for AYs 2011-12 & 2012-13, rejects AO/TPO's conclusion that assessee had given loans/advances to its AE in the disguise of RPS; In the first round of proceedings, pursuant to ITAT's remand of the issue on the basis that they were handicapped to decide the issue unless appeal for preceding AY 2010-11 was decided by CIT(A), HC had opined that ITAT

need not have felt constrained by such pendency and accordingly directed ITAT to decide the issue on merits; Relying on Globe United Engineering and Foundry HC ruling (wherein it was held that preference shares are really part of the company's share capital and not loans) and Sahara India SC ruling (wherein it was held that Optionally Fully Convertible Debentures are 'securities' under the Companies Act and therefore neither 'loans' or 'deposits'), ITAT opines that *"RPS cannot be categorised as loans and advances and, therefore, conclusion of the TPO/Assessing Officer that the assessee has given loans/advances to its AE in the disguise of RPS does not hold water";* Also relies on Pune Electricity Supply Co SC ruling and Rampgreen Solutions HC ruling to stress on principle of 'real income' being subject to tax; Lastly, noting that the AE had redeemed the RPS in 2012-13 and Revenue had accepted the redemption, ITAT directs AO/TPO to delete the TP adjustment for both the years.

Unreliable CUP

JSL Limited (Now Jindal Stainless Ltd) – Delhi ITAT Outcome: Against Taxpayer Category: Comparability Analysis Tax Court rules on the benchmarking of international transaction

being export of graded stainless steel products to its Chinese Associated Enterprise (AE), also exported to third parties. Accordingly, rejects taxpayer's use of market quotations downloaded from internet without comparability analysis. Holds that the Comparable Uncontrolled Price (CUP) method can be used to compare prices of exports of same types of stainless steel to unrelated (non-AE) party in China, if market quotations are authentic and reliable, drawing reference to the term 'quoted price' defined in OECD Transfer Pricing Guidelines. Tax Court observed that taxpayer compared monthly average rates between AE & non-AE by aggregating monthly transactions and taking an average of sales to AEs and similarly with third party sales. Where no CUP data was available for a particular grade of steel, taxpayer used internet quotations (Chinese) and used it for testing arm's length price. Tax Court rejected the quotations taken without comparability.

ITAT: Deletes Rs141Cr TP-adjustment; Sale to non-AEs incomparable due to volume, geographical differences

Nov 22,2018

Firmenich Aromatics Production (India) Pvt Ltd [TS-1214-ITAT-2018(Mum)-TP]: Holds that export to AEs cannot be compared with domestic sales to unrelated entities due to huge difference in volume, different geographical markets, market sensitivity, bargaining power, local competition, functions

performed and risks assumed; Holds that it is essential to adjust differences in order to create a level playing field to ensure like by like comparison, notes that TPO did not quantify these differences which were required

to be adjusted as per Rule 10B(3);

ITAT: Rejects TPO's CUP sans adjustment for different geographies, customer preference & market strategy

Jun 20, 2018

Emami Limited [TS-468-ITAT-2018(Kol)-TP]

Conclusion

Kolkata ITAT upholds CIT(A)'s acceptance of assessee's TNMM over TPO's CUP-method for benchmarking assessee's (manufacturer in FMCG Industry) sale of finished goods transaction

for AY 2012-13; Noting that prices at which assessee had sold its products to third party distributors in countries like Kenya, Congo, Sri Lanka etc. were compared by TPO with those sold to assessee's AEs in Bangladesh, Dubai and UK without any adjustments to difference in economies of these countries, ITAT opines that *"CUP cannot be applied*

without adjustments on account of differences in market and economic conditions of countries in which products have been sold to independent third parties"; Also observes that TPO had conveniently compared only selective products out of over 250 different products sold by assessee to AE and had failed to make adjustments on account of market preference, customer preference, market strategy etc.; Further, ITAT rejects TPO's calculation of FOB rate of goods of different sizes sold to AE and non-AE based on proportionate price per unit, explains that "*this methodology is devoid of any merit, as in FMCG sector the pricing of product, as per unit/quantity is never done proportionately"*; Considering assessee's TP-analysis as 'sound'

and noting that Revenue had not objected to application of TNMM in all earlier years, ITAT concludes that *"selective application of CUP Method by TPO is ad hoc, and without any cogent basis, hence the entire approach followed by the Ld. TPO in rejecting the TP study memorandum of assessee for application of TNMM method is unjustified"*; Separately, for AY 2011-12, ITAT deletes interest adjustment on loans given by assessee to AE, accepts assessee's 8% interest rate to be at ALP.

Most Appropriate Method

Kehin India Manufacturing Pvt Ltd – Delhi ITAT Outcome: In favour of Taxpayer Category: Most Appropriate Method Tax Court rejects use of Resale Price Method (RPM) by transfer pricing officer for testing arm's length price of purchase of traded goods from AE on the basis of purchase & sale by taxpayer with related parties. It was held that RPM cannot be applicable when both purchase and resale are with AE. Thus RPM is applicable only when resale is made to unrelated party. If the resale price is tested with AE, it would be impossible to compute arm's length in respect of purchase of property. Tax Court proceeded to accept taxpayer's views of Transactional Net Margin Method (TNMM) as the most appropriate method of benchmarking the transaction based on results from taxpayer's trading segment.

Economic Adjustment

IKA India Pvt Ltd – Bangalore ITAT Outcome: In favour of Taxpayer Category: Economic Adjustments Bangalore Tax Court upholds many controversial stands taken by the Tax Office - Grants Capacity Utilisation adjustment, Grants working capital adjustments, treats foreign exchange as operating in nature, upholds adjustment only on international transaction.

Capacity adjustment

The assessee had highlighted in its TP documentation and before TPO that there were significant the differences in capacity utilization between assessee and comparables. Assessee submitted the installed capacity was under-utilized to a significant extent as it was just the third year of commercial operation.

ITAT noted that Rule 10B provided that that the most appropriate method for ALP computation would be one which *inter alia* provides the most reliable measure of ALP enabling reliable and accurate adjustments. Tribunal further observed that the Indian TP regulations, OECD Guidelines and the US transfer

pricing regulations call for an adjustment to be made in case of material differences in the transactions or the enterprises being compared so as to arrive at a more reliable arm's length price/ margin. ITAT explained that "*While the Indian transfer pricing regulations refer to the adjustments on uncontrolled transactions, however the same has to be read with Rule10B(3) of the Rules which clearly emphasizes the necessity and compulsion of undertaking adjustments. Hence in case appropriate adjustments cannot be made to the*

uncontrolled transaction, due to lack of data, then in order to read the provisions of transfer pricing regulations in harmony, the adjustments should be made on the tested party." In this regard, ITAT relied on various rulings including Mando India Steering Systems, Panasonic AVC Networks India, Biesse Manufacturing Company etc.

SDT

HC: Explains 'substantial interest' u/s 40A(2)(b) for SDT constitution; Relies upon ICAI Guidance Note

Dec 21,2018 HDFC Bank Ltd [TS-1299-HC-2018(BOM)-TP]

related party transactions [purchase of loans from HDFC ltd, payment for rendering services to HBL Global and interest payment to HDB Welfare Trust] were Specified Domestic Transactions (SDTs) u/s 92BA; Holds that loans purchased by assessee/ petitioner from its promoter (HDFC Ltd) does not fall within the meaning of SDT u/s 92BA(i) as HDFC Ltd does not have 'substantial interest' in assessee & is therefore not a 'person' as contemplated in Sec 40A(2)(b)(iv); Explains that 2 conditions have to be fulfilled for a person to

have 'substantial interest' as contemplated in Explanation to Sec 40A(2)(b) – the person has to be the beneficial owner of the shares and those very shares have to carry not less than 20% of the voting power; Rejects Revenue's clubbing of HDFC Ltd's direct shareholding of 16.39% with indirect shareholding of 6.25% in assessee (through its wholly owned subsidiary HDFC Investments Ltd) to establish 'substantial interest'; Holds that *"….This would be contrary to all canons of Company Law….It is well settled that a shareholder of a company can never be construed either the legal or beneficial owner of the properties and assets of the company*", relies on SC rulings in Bacha F. Guzdar and Vodafone International Holdings BV; Further, noting that the transaction was a purchase of 'asset' reflected in the Balance Sheet and not in the

P&L account, HC opines that *"Acquisition of an asset…cannot be said to be in the nature of an expenditure so as to come within the ambit of section 92BA (i)*"; HC also holds that assessee's interest payment to HDB Welfare would not fall within Sec 40A(2)(b) read with Explanation (b) as the Trust was exclusively set

up for the welfare of its employees and there was no question of assessee being entitled to 20% of the profits of such Trust.

Advertisement Marketing Promotional expenses

AMP expenses are linked to brand building (i.e. capital expenses/ non-routine expenses) or linked to revenue building (i.e. revenue expenses/ routine expenses). Delhi HC – Sony Ericson.

Observing the nature of transaction, Tax Court notes that the Irish AE acts as a legal title holder of trademark and has not charged royalty to taxpayer and since taxpayer operating in India reaps all the profits from India there would be no reason to compensate its AE for marketing activities. (PepsiCo India Holdings Pvt. Ltd. – Delhi ITAT)

ITAT: Deletes L'Oreal's AMP-adjustment absent agreement to share/reimburse AMP-expenses with AE - Feb 04,2019 L'Oreal India Pvt Ltd [TS-34-ITAT-2019(Mum)-TP]

PE attribution:

HC: Upholds PE-constitution for 24 GE Group entities, affirms 26% profitattribution for 'marketing' activity Jan 09,2019 GE Energy Parts Inc [TS-1328-HC-2018(DEL)-TP]

ITAT had observed that the AO carried the exercise of attribution in two parts, viz., calculation of total profit from the sales made by GE overseas entities in India, which was worked out at 10% applying Rule 10(iii) and second, attribution of such profit to marketing activities, which was taken at 35% of 10% relying on Delhi ITAT ruling in Rolls Royce. However, ITAT had upheld AO's stage 1 attribution of 10%, but with respect to stage 2 attribution, ITAT had directed to apply 26% of total profit in India as attributable to the PE holding that extent of activities by GE Overseas in making sales in India is roughly one fourth of the total marketing effort. HC found no infirmity in the approach of ITAT and upheld the same citing case of Galileo International Inc. as well as in Hukum Chand.

Recharacterisation:

ITAT: Deletes TP-adjustment towards leased assets depreciation; Rejects reallocation of expenses between segments Oct 26,2018

Lufthansa Technik Services India Pvt Ltd [TS-1133-ITAT-2018(DEL)-TP]

Conclusion

Delhi ITAT deletes TP-adjustment towards depreciation on assets purchased from AE for leasing to independent parties in assessee's 'home base' segment for AY 2008-09; Notes that TPO had reallocated expenses between 'home base' segment and 'domestic' segment using turnover as allocation key and recomputed assessee's PLI, further arriving at shortfall after considering comparables' margin, TPO adjusted the shortfall in purchase price of leased assets and disallowed depreciation; ITAT rejects TPO's reallocation of expenses holding that since accounts were regularly maintained in the course of business, duly audited and free from any qualification by the auditors, "they should be taken as correct unless there are strong and sufficient reasons to indicate that they are unreliable"; Observes that TPO had proceeded on false premise that assessee failed to allocate any expenses to the homebase

segment even though details as to assessee's allocation of routine expenses were available on record, further noting that lease price to third parties was same as purchase price paid to AE, ITAT deletes TP-adjustment; Also rejects Revenue's request for restoring the issue to AO/TPO for fresh consideration, holds that "no second innings should be given to the Revenue if sufficient material is on record and the revenue authorities have ignored to consider such material", relies upon Gujarat HC ruling in Rajesh Babubhai Damania; Separately, rules upon comparable selection for Market Support Services segment, excludes 4 comparables, viz, APITCO Limited, Choksi Laboratories, RITES Limited & WAPCOS Limited on grounds of functional dissimilarity, not meeting filters and remits comparability of Best Mulyankan Consultants Ltd to verify 25% RPT filter.

Others

92A – Associated Enterprise

Section 92A(1) defines AE for the purpose of transfer pricing provisions as an enterprise which –

a. directly or indirectly participates "in the management or control or capital of the other enterprise"; or

b. If the same persons participate in the management, control or capital of both the enterprises.

Section 92A(2) states that for the purposes of Section 92A(1), two enterprises shall be deemed to be AEs if, inter alia – "(i) the goods or articles manufactured or processed by one enterprise, are sold to the other enterprise or to persons specified by the other enterprise, and the prices and other conditions relating thereto are influenced by such other enterprise"

ITAT in the case of ***Orchid Pharma Ltd. v. Deputy Commissioner of Income Tax*** clarified the scope of the concept of associated enterprises under the Income Tax Act, 1961 ("**ITA**") and held that mere influence over price by one enterprise is not sufficient to constitute participation in 'control' of that enterprise over the other as mandated under Section 92A(1). The ITAT discussed the interplay between the basic definition of AE under Section 92A(1) and situations listed in Section 92A(2), holding that the two should be read conjointly to determine whether two enterprises qualify as AEs.

The High Court of Gujarat (High Court) has upheld the decision of the Income-tax Appellate Tribunal, Ahmedabad (the Tribunal) in the case of Veer Gems (the taxpayer). The Tribunal earlier ruled in favour of the taxpayer and had held that the mere fact of participation by one enterprise in the management or control or capital of the other enterprise, or the participation of one or more persons in the management or control or capital of both the enterprises shall not make them Associated Enterprises (AEs) under sub-section (1) to Section 92A of the Income tax Act, 1961 (the Act) unless any of the criteria specified in sub-section (2) to Section 92A is fulfilled.

ITAT: Accepts ALP-determination based on PLI for 6 months period before restructuring

Oct 11,2018

ERICSSON Telephone Corporation India AB [India Branch] [TS-1106-ITAT-2018(DEL)-TP]

Conclusion

Delhi ITAT upholds CIT(A)'s deletion of Rs.1.27cr TP-adjustment in case of Ericsson Telephone's India Branch for AY 2002-03; Notes that in the middle of the subject year, assessee restructured its business, closed down its installation/assembly business [constituting to 98% of its turnover], transferred it to Indian Group Company and included profit from sale of fixed assets in the receipt side; ITAT upholds CIT(A)'s approach of considering at ALP, assessee's PLI for international transaction carried out for 6 months excluding profit from sale of fixed assets, as PLI (14%) was higher than comparables mean margin at 8%; Observing that assessee was incurring unutilized capacity in the form of fixed costs which were no longer recoverable through normal business activity, ITAT opines that *"there was no level playing field with the…comparables, in as much as, the comparables were not on the same platform with that of the assessee"*; Thus, holds that "*the first appellate authority has given a very reasonable and justifiable finding in coming to the conclusion that the appellant has earned OP/TC of 14%"* and since it was based on actual data, concludes that CIT(A)'s order can't be treated *"as not being based on sound reasoning"* or being *"ill founded"*

HC: Market Research Users Council incomparable to commercial organization, working pattern & model dissimilar

Oct 09,2018

Belkin India Private Ltd [TS-1098-HC-2018(DEL)-TP]

Conclusion

Delhi HC confirms ITAT's decision to hold Media Research Users Council (MRUC) as not comparable to assessee's marketing support services for AY 2011-12; Notes that Tribunal had excluded MRUC from comparables list on grounds of functional dissimilarity, failure to meet turnover filter, and difference in risk profile, etc.; Observes that MRUC was outsourcing most of its activities to a third party research agency unlike the assessee; Finds that the element of quid pro quo or payment of consideration commensurate with the service given was absent in MRUC's case as major source of its income was in form of membership fees and subscription fee for Indian Readership Survey (IRS) and Indian Outdoor Survey (IOS) reports which were prepared for its members; Thus, holds that *"The working pattern and model adopted by MRUC was unlike a commercial organization and completely different. The dissimilarities are too striking and apparent to be ignored"*

ITAT: Rejects foreign-AE as tested-party, assessee's marketing/ distribution function least complex

Oct 03,2018

Jaso India Private Limited [TS-1065-ITAT-2018(Kol)-TP]

Conclusion

Kolkata ITAT rules on MAM and selection of foreign AE as tested party for benchmarking international transactions of assessee (engaged in supplying cranes and mechanical equipment) for AY 2012-13; Notes that assessee had been shifting its stand in so far as in its TP-study, it had specifically stated that RPM is not appropriate as MAM and that assessee should be selected as the tested party since its functions were the least complex; However, during proceedings before DRP, assessee stated that RPM should be selected as MAM since assessee's functions were that of a mere dealer of goods but also stated that foreign AE (though it was a manufacturing entity) should be selected as the tested party on the ground that the AE had least complex functions; Observing that assessee performed function of market research, customer mining, order program from customers, requirement analysis,

quality checks, apart from bearing marketing, price, credit, bad debt, warranty, forex, inventory and manpower risk, ITAT opines that "*With such a complicated profile,*

we are unable to accept the contentions of the assessee that RPM is the MAM"; Further, noting that AE was a leading manufacturer and supplier of wide range of lifting and transport systems and had a notable presence and leadership in international markets, ITAT holds that *"These functions, when compared with distribution and marketing function of the assessee, leads us to a conclusion that Jaso India is the party which has the least complex functions. Hence the contentions of the assessee that its AE, which should be selected as the tested party is hereby rejected"*

ITAT: Microsoft's 113 patentable inventions through software development in India clinches characterization as contract R&D

Sep 20,2018

Microsoft India (R&D) Pvt. Ltd [TS-1015-ITAT-2018(DEL)-TP]

Conclusion

Delhi ITAT rejects Microsoft India R&D's classification of its software segment as 'routine software developer' engaged only in testing & coding at lower level for its ultimate parent (Microsoft US), characterizes it as 'contract R&D service provider' for AY 2011-12; Notes that though assessee maintained all relevant primary records, it did not produce the same before the authorities and was *"simply trying to marginalize its role to a bare minimum by a lip service contrary to what has been stated in the TP study"*;

Thereafter, on perusal of agreement between assessee & Microsoft US, observes that assessee agreed to undertake R&D work, the output of which was agreed to be owned by Microsoft US & R&D was of such a work which was requested and approved in writing by Microsoft US; States that even though integration of all the software developed in several countries is done in the USA, it did not mean that the research work done by assessee ceased to be a research work in itself, further opines that *"The fact that 113 patentable inventions were done by the assessee in India by its software development work, which were registered in the USA, leaves no room for doubt that it is undoubtedly engaged in research activities and is significantly different from a routine software developer"*; ITAT opines that assessee also satisfied most ingredients in Circular No 3.2013 dated March 26, 2013 (providing guidelines

for identifying if a Development center in India is a contract R&D service provider with insignificant risk); Thereafter, ITAT also rules on comparables selection and other issues which resulted in Rs.225cr TP adjustment in software development & ITeS segments.

ITAT: Shilpa Shetty's free brand ambassadorship services to Rajasthan Royals outside TP-ambit, deletes adjustment

Aug 28,2018

Shilpa Shetty [TS-885-ITAT-2018(Mum)-TP]

Conclusion

Mumbai ITAT deletes Rs.3.42cr TP-adjustment for Shilpa Shetty (assessee) for AY 2010-11 towards brand ambassadorship services rendered free of cost, rejects applicability of TP-provisions; Notes that assessee was party to a Share Purchase Agreement (SPA) [though she was neither buyer / seller of shares] for transfer of a portion of shareholding in Mauritus based company (EMSHL) to Kuki Investments (Bahamas based company represented by assessee's husband, Raj Kundra) and she undertook to provide brand ambassadorship services to Indian company, JCIPL (100% subsidiary of EMSHL) in relation to promotional activities of IPL team - 'Rajasthan Royals';

Regarding CIT(A)'s view that assessee & Kuki Investments were AE's u/s 92A(2)(J), ITAT opines that *"AE relationship between the Assessee and Kuki is based on only one limb of sec. 92A(2)(J), i.e. an individual controlled one enterprise (RK controlled Kuki)"*; Absent Revenue showing how that individual (Raj Kundra or his relative) controlled the other 'enterprise' (assessee), ITAT holds that *"Without satisfying the second limb, i.e. that individual or his relative controlled the other enterprise, provisions of sec. 92A(2)(j) cannot be applied"*; Further, rejecting CIT(A)'s conclusion that there was a deemed international transaction between assessee & JICPL u/s 92B(2), ITAT holds that *"Section 92B(2) of the Act cannot be applied to hold that transaction between assessee and JICPL was an "International transaction" as neither any of the parties to the SPA were an AE of the assessee nor JICPL entered into a prior agreement with the AE of the Assessee (JICPL was not a party to the SPA); and as such the pre-requisite of a prior agreement between a non-AE with the AE of an assessee is not fulfilled"*

ITAT: Deletes Rs. 436 cr capital-gains addition on slump-sale, rejects FMV substitution invoking Sec 50D/92BA

Aug 16,2018

Gujarat Fluorochemicals Ltd [TS-822-ITAT-2018(Ahd)-TP]

Conclusion

Ahmedabad ITAT deletes Rs.436.80 cr. capital gains addition on transfer of wind energy business of Gujara Fluorochemicals Ltd. ('assessee') on slump sale basis, rejects Revenue's substitution of fair market value (FMV) for the sale consideration of assets; Vide agreement dated March 30, 2012, assessee sold its entire wind energy business to its subsidiary ('IRL') on slump-sale basis for Rs. 1 cr., however, AO invoked Sec. 50D observing that immediately after the transaction, IRL revalued the assets at FMV of Rs.437.80 cr. as on April 1, 2012; Firstly, with regard to the year of taxability, ITAT accepts assessee's stand that the AO had endeavored to shift the transaction from AY 2012-13 to 2013-14 only to explore applicability of Sec. 50D; Notes that the AO did not doubt the genuineness of the agreement dated March 30, 2012, further on analysis of all the objections taken by AO/DRP in light of explanations given by assessee, ITAT holds that sale had taken place in AY 2012-13 (i.e. on March 30, 2012) and not in AY 2013-14; Holds that " *When the rights have been transferred by way of slump sales, possession on papers given, cheques for consideration handed over and it was deposited in the bank, the rights have been settled on this date",* states that the circumstances narrated by the AO/DRP relates to peripheral procedural compliances; Moreover, on applicability and scope of Sec. 50D, ITAT refers to Bombay HC ruling in Morarjee Textiles wherein it was held that Sec. 50D would be applicable only after the AO comes to a finding that consideration received is not ascertainable or cannot be determined, observes that in present case, *"nowhere such aspect is discernible";* ITAT remarks that "*even if it is to be construed for the sake of arguments that transaction has taken place in AY 2013-14, then also the AO cannot replace the sale consideration disclosed by the assessee as per section 50D with fair market value.";* Lastly, *w*ith respect to applicability of Sec. 92BA (dealing with specified domestic transaction), ITAT notes that assessee had not claimed Sec 80IA deduction in AY 2013-14, remarks that *"Had the AO demonstrated that arrangement*

between the assessee and IRL showed unusual profit to the assessee, which would grant higher deduction u/s. 80IA, he could re-compute that, but no such circumstances are

available"; Stating that profit or loss on sale of fixed assets of eligible undertaking are not entitled to deduction u/s 80IA, ITAT concludes that Sec 92BA will not be applicable

ITAT: Rejects NAV based ALP-determination for non-resident's sale of Indian company shares

Aug 30,2018

Topcon Singapore Positioning Pte Ltd [TS-897-ITAT-2018(DEL)-TP]

Conclusion

Delhi ITAT rejects TPO/DRP's Net Asset Value (NAV) based ALP for benchmarking consideration for sale of shares in an Indian company by assessee (Singapore company) to another non-resident entity (AE) for AY 2012-13; Notes that under a stock purchase agreement, assessee was to sell shares in the Indian company based on its NAV, which at that point of time was estimated to be USD 3.4million but the sale finally took place at USD 3.5million, which was more than fair market value of Rs.187 per share as ascertained by an

independent valuer on Discounted Cash Flow (DCF) Method; However, TPO/DRP held that based on NAV, the shares ought to have been sold to USD 3.79million and therefore proposed TP-adjustment of Rs.1.39million; ITAT reiterates that the role of TPO is to determine ALP and *"It is not open to the TPO to go beyond this role of determining the ALP and intrude in the exclusive domain of the Assessing Officer to determine the income*

taxable in the hands of the assessee", relies on jurisdictional HC ruling in Cushman & Wakefield; Rejecting TPO/DRP's NAV based method for determining ALP, ITAT states that *"On a technical note, a price decided, even if that be so, between the associated enterprises- as the assessee and the buyer of shares are, can never be a valid CUP input for the simple reason that it is only the transaction value for transactions between the independent enterprises that the transaction value can be considered as a comparable uncontrolled price...Nothing, therefore, turns on the original agreement terms and it has no relevance in determination of*

arm's length price."; Noting that in the present case, the company in which shares were transferred was not in the winding up nor was there any reasonable prospect of its going into liquidation, ITAT clarifies that *"In these circumstances, the adoption of Net Asset Value or*

book value was not really warranted… Given the fact that it was treating as a going concern, the valuation on the basis of future earnings was quite justified"; However, observing that TPO had not examined that aspect of the matter and simply proceeded on the basis of NAV, ITAT remits matter back to TPO for fresh determination.

HC: Upholds ICRA-Online inclusion; Rejects assessee's water tight classification for KPO-BPO

Aug 03, 2018

Swiss Re global Business Solutions India Pvt Ltd [formerly known as Swiss Re Shared services (India) Pvt Ltd] [TS-766-HC-2018(KAR)-TP]

Conclusion

Karnataka HC dismisses assessee's appeal challenging ITAT-order on 2 comparables (Jeevan Scientific Technologies Ltd and ICRA Online Ltd) for assessee rendering ITeS to AE for AY 2011-12, follows Softbrands India ruling; Regarding Jeevan Scientific Technologies, stating that ITAT had only remanded the case back to the file of AO/TPO for fresh consideration and therefore its selection as a comparable had not yet become final at the hands of AO/TPO, HC opines that "... we do not find any substantial question of law to be arising with regard to the said company M/s Jeevan Scientific Technologies Ltd(seg)"; Further, rejecting assessee's contention to exclude ICRA Online as it was a KPO, HC refers to KPO-definition as per Rule 10TA(g) to opine that "From the…definition of KPO, it appears to be a specie of genus BPO and both being ITES services provided by the Software industry to their clients, the area of KPO may fall in the indicated areas of operation and the exclusion as specified in Rule 10TA(g) is only for Research and Development Services whether or not in the nature of contract Research and development services, but we do not find any water tight compartment or any specified classification of KPO and other types of BPOs in Rule 10TA"; Further, explains that "If the concerned KPO which falls within the definition of genus category of BPO as per the segmental information available in public domain, the Assessee could very well persuade the Authorities below to compare only segmental information so available in public domain, but we cannot accept the broad submission…that since the declared comparable- M/s ICRA Online Ltd., was a KPO, therefore, the same should not be comparedwith the case of the Assessee"; Upholding ITAT-order, HC states that "Tribunal, in our opinion, has rightly observed… that once the level of knowledge that is being used for Outsourcing is at a

reasonably comparable pedestal, the type of service industry to which the comparable company and the Assessee-Company cater may not matter much"

ITAT: Deletes TP-adjustment on royalty/ intra-group services; TPO cannot determine ALP on estimated basis

Jul 31,2018

Firmenich Aromatics India P Ltd [TS-758-ITAT-2018(Mum)-TP]

Conclusion

Mumbai ITAT deletes TP-adjustment in respect of assessee's payment towards royalty and information system services for AY 2012-13; In respect of royalty payment, notes that AO/TPO disallowed the royalty u/s 37 alleging absence of evidence to suggest transfer of technical knowhow during the year but made TP adjustment by estimating that assessee had to pay 10% of the royalty amount to AE; Stating that TPO determined ALP of royalty by making an ad-hoc adjustment purely on estimate basis without following any approved method prescribed under the statutory provisions, ITAT holds that " *there is no provision under the Act empowering the Transfer Pricing Officer to determine the arm's length price on estimation basis, that too, by entertaining doubts with regard to the business expediency of the payment and in the process stepping into the shoes of the Assessing Officer for making disallowance under section 37(1) of the Act"*; In respect of receipt of information system services, notes TPO's contradictory finding, on one hand, observing that assessee failed all the tests including actual rendition of services but on the other hand accepting that AE had provided the software; Thus, ITAT opines that "*when the Transfer Pricing Officer himself agrees that the AE has provided software and certain services, there is no reason for not accepting the payment made to the AE to be at arm's length in the absence of any contrary evidence brought on record and by simply applying the benefit test…. Without complying to the statutory provisions, the Transfer Pricing Officer certainly cannot determine the arm's length price on ad–hoc / estimation basis"*

SC: Dismisses McKinsey India's SLP; HC upheld its research & information service characterization as KPO

Feb 07,2019

McKinsey Knowledge Centre India Pvt Ltd [TS-49-SC-2019-TP]

Conclusion

SC dismisses McKinsey India's SLP against HC-order for AYs 2011-12 & 2012-13, states that *"We are not inclined to entertain these Special Leave Petitions under Article 136 of the Constitution of India"*; HC had upheld ITAT's characterization of research and information services rendered by McKinsey India to its AE as high-end knowledge-based research services (KPO); Noting that the services rendered by assessee were *"specialized and require specific skill based analysis and research that is beyond the more rudimentary nature of services rendered by a BPO"*, HC had concluded that *"it would be incorrect to slot the services provided by the Assessee into that of a BPO, when it is more akin to a KPO"*; Further, HC had upheld ITAT's TP-adjustment on outstanding AE-receivables rejecting assessee's contention that early or late realization of sale/ service proceeds is incidental to the transaction of sale/ service and that there can be no question to benchmark the interest separately.

The Research and Information (R&I) Services Division could be further divided into through 3 sub-groups- (a) Knowledge On Call Group – provides journalistic research information support. The services included financial analysis. (b) Practice Research Group - focusing on domain specific research support. The services included sector data and analysis, capital market insights, perspectives and industry trends and (c) Analytics Group - focusing primarily on time intensive analysis requiring expertise and analytical tools and techniques. The services included data analysis, model/tool development, proprietary database management, practice specialized analytics.

For AYs 2011-12 & 2012-13, ITAT had characterized the research and information services rendered by assessee to its AE as high-end knowledge-based research services (KPO) as it involved huge expertise and skills. Noting that assessee had to carry out research from internet based databases or other sources to compile data, which was then customized / processed in accordance with requirements before transmitting it outside India after organizing into templates in Excel, Power Point etc., ITAT had held that *"it is evident that the assessee is making value addition to the information accessed by it from databases etc."* Further, observing that deduction u/s 10A was granted for AY 2006-07 on the basis of assessee's contention that it was making a great value addition to the data before exporting it, ITAT had held that was not simply collecting data from databases. Aggrieved, assessee filed

an appeal before Delhi HC on the ground that ITAT erred in concluding that nature of services provided by it under the Research & Information Services segment was in the nature of KPO services.

On perusal of the Master Service Agreement (Agreement) between assessee & McKinsey and Co. Inc., USA (AE), HC stated that its functions included Knowledge management systems and infrastructure issues which would encompass infrastructure support, application support, application operations group and survey development center. HC also noted that ITAT, based on examination of the Agreement, sample copies of service requests, as well as the McKinsey India website concluded that the assessee was providing knowledge-based research and information services after observing that there was clearly a form of knowledge intensive analysis rendered by the assessee which was a more nuanced and involved service

than that which is provided by a BPO. Further, HC relied on Maersk Global Centres (India) ruling wherein it was held that services rendered by it were specialized and required specific skill-based analysis and research that was beyond the more rudimentary nature of services rendered by a BPO. Thus, HC held that *"it would be incorrect to slot the services provided by the Assessee into that of a BPO, when it is more akin to a KPO."*

ITAT: Rejects CPM considering huge differences in FAR of assessee's domestic & export division

Jul 16,2018

The Himalaya Drug Company [TS-614-ITAT-2018(Bang)-TP]

Conclusion

ITAT deletes TP-adjustment, upholds TNMM over TPO's CPM as MAM for benchmarking export transaction for Himalaya Drug Company (assessee - partnership firm engaged in the business of manufacture and sale of herbal pharmaceutical products) for AY 2011-12; Rejects TPO's approach in applying gross profit margin of the domestic consumer product division to the cost of goods sold in exports to AE as *'factually erroneous and contrary to the mandate of Rule 10B(1)(c)'*, notes that though the products sold in the domestic consumer product division were comparable to the products sold to AEs, the functions performed, assets employed and risks undertaken in both the segments were not the same; Further, observing that the number of differences and adjustments to be carried out for comparison purposes were large in number, ITAT remarks that *"to give a mathematical number to all these*

differences would mean indulging in the exercise within a realm of subjectivity which is to be avoided", thus holds that CPM cannot be considered as MAM in the peculiar facts and circumstances; ITAT also rejects TPO's view that assessee acted as a contract manufacturer in respect of products exported to AEs (since the products were sold to AEs at cost plus 15% and the assessee did not undertake any other functions), opines *that "TPO's understanding of a contract manufacturer will make every manufacturer of goods in India who would not only make domestic sales but also effect sales to an overseas distributor as a contract manufacturer"*; ITAT also deletes AMP-adjustment absent any material evidence to substantiate the existence of any agreement or arrangement (either express or implied)

between assessee and AE for promotion of its brand, further noting that net margin from AE-exports at 15.80% was more than net margin earned in personal care product division in the domestic segment at 11.30%, ITAT concludes that *"the ALP of the assessee's international transactions with its AEs were at Arm's Length and therefore no separate adjustment for AMP expenditure is called for"*

HC: Dismisses Revenue's appeal; Upholds gross profit/sales as PLI for autocomponents import

Jul 09,2018

Kirloskar Toyota Textile Machinery Private Ltd (formerly known as Kirloskar Toyota Textile Machinery Private Ltd) [TS-502-HC-2018(KAR)-TP]

Conclusion

Karnataka HC dismisses Revenue's appeal against Tribunal's allowance of assessee's [Kirloskar Toyota Textile Machinery Private Ltd] claim that gross profit over sales (PLI) can eliminate difference in depreciation claim due to machinery age, rate / method difference; ITAT had directed AO/TPO to adopt comparison of profitability ratios using gross profit over sales to benchmark international transaction of purchase of auto components from AE for AY 2010-11;

HC: Lays-down principles on 'substantial question of law' for TP-appeals on comparables-selection

Jun 26,2018

Softbrands India P Ltd [TS-475-HC-2018(KAR)-TP]

Conclusion

Karnataka HC dismisses Revenue's appeal challenging ITAT's comparables selection for software developer assessee for AY 2006-07, lays down law on interpretation of 'substantial question of law' in respect of appeals against comparables selection in TP cases; Highlighting that the existence of a substantial question of law is *sine qua non* for maintaining an appeal before HC u/s 260A (pari materia with Sec 100 r.w.s. 103 of Civil Procedure Code), reiterates that findings of fact cannot be disturbed while dealing with appeals u/s 260A unless such findings are ex-facie perverse, unsustainable and exhibit a total non-application of mind by

the Tribunal to the relevant facts and evidence, relies on various precedents; Specifically clarifies that Sec 260A(6) does not give any extended power to HC [beyond the parameters of the substantial question of law] to disturb the findings of fact given by the Tribunal, holds that the argument that HC can touch upon the issue of facts also in appeal u/s 260A(6) bereft of substantial question of law is 'misconceived'; Lamenting that process of making huge TP-adjustments results in multi-layer litigation at multiple For a causing serious damage to the demand of expeditious judicial dispensation on which international trade and transactions depend on, HC reiterates that Revenue authorities cannot be allowed to make it their 'prestige issue' to agitate Tribunal orders merely because they are dissatisfied with Tribunal's finding of facts, also clarifies that *"same yardsticks and parameters will have to be applied, even if such appeals are filed by the Assessees*"; HC also rejects Revenue's contention that due to different views taken by different benches of Tribunal, the present appeals u/s 260A deserve to be entertained/admitted for laying down certain guidelines about the Filters/Most Appropriate Method to be adopted for ALP determination, expounds that *"if the High Court takes the path of making such a comparative analysis...., it will drag the High Courts into a whirlpool of such Data analysis defeating the very purpose and purport of the provisions of Section 260-A";* Further, stating that *"entire exercise of making Transfer Pricing Adjustments on the basis of the comparables is nothing but a matter of estimate of a broad and fair guess-work of the Authorities based on relevant material brought before the Authorities"*, HC holds that *"Tribunal being the final fact finding body remains so for this Special Chapter X also… the exercise of fact finding or 'Arm's Length Price' determination or 'Transfer Pricing Adjustments' should be allowed to become final with a quietus at the hands of…the Tribunal"*; In the present case, noting that ITAT had given cogent reasons & detailed findings on application of

filters & selection of comparables, HC concludes that *"we find ourselves unable to call such findings of the Tribunal perverse in any manner so as to require our interference under Section 260-A"*

ITAT: Rejects WDV based benchmarking of purchase transaction; Accepts customs / DCF / chartered engineer's valuation

Apr 28,2018

Sarens Heavy Lift (I) P Ltd [TS-294-ITAT-2018(DEL)-TP]

Conclusion

Delhi ITAT upholds DRP-order rejecting TPO's benchmarking of assessee's purchase of used cranes on the basis written down value of the cranes for AY 2010-11; Notes that TPO rejected assessee's TNMM and adopted written down value of cranes as recorded in the books of AE as ALP under CUP-method; However, observes that DRP, relying on Tecumseh ruling, accepted assessee's justification of ALP under TNMM based on valuation done by the chartered engineer, value accepted by the custom authorities and value derived by DCF method; Upholding DRP's order, ITAT opines that " *The reasoning given by the DRP to reach the conclusion that the additions cannot be sustained is impeccable and we find it difficult to take a different view in view of the said legal position"*; Separately, regarding assessee's submission that Revenue's appeal should be quashed since Sec 253(2A) [providing that AO may also file an appeal before the ITAT against an order passed in pursuance of directions of the DRP] stood omitted by IT-Act vide Finance Act 2016 without any saving clause, ITAT opines that *"saving right to initiate proceedings for liabilities incurred during currency of Act would not apply to omission of a provision in an Act but only to repeal, omission being different from repeal"*, refers to General Finance Company ruling

ITAT: Rejects 50% profit-attribution to Indian branch on HO's sales absent economic nexus

Jun 05,2018

Corning SAS- India Branch Office (Formerly known as Corning SA-India Branch Office) [TS-421-ITAT-2018(DEL)-TP]

Conclusion

Delhi ITAT rejects AO's attribution of 50% profits made by Corning SAS in France (AE), from direct sales made in India, to its India Branch office (BO) for AY 2005-06; Notes that BO earned commission income @ 3% on direct sales made by it to customers in India and in all other AYs (preceding as well as succeeding), AO himself had accepted the 3% commission without attributing additional profits to BO in respect of direct sales made by Corning SAS France in India; Rejects AO's assignment of a relative weightage of 60% to the assets utilized by the BO [without providing any rational basis], observes that BO only provided sales representation services in India and the same prima facie did not involve utilization of assets; Noting that sales made by Corning SAS France to the Indian customers are wholly channeled through the BO for which it is remunerated with 3% commission and since no substantial functions are performed, risks undertaken or assets employed by BO in India in relation to the direct sales made by Corning SAS France in India, ITAT holds *"no additional profit in addition to the 3% commission income earned, is required to be attributed"*; Further, stating that *"the Economic Nexus is an important feature for Attribution of Profits (profits attributable to the PE) in Corporate World"*, ITAT concludes that ratio of Morgan Stanley SC ruling is applicable to the present case as there was no direct economic nexus between the assessee and the Corning SAS, France in respect of the transaction in dispute.

ITAT: Market survey benefited assessee, cannot be equated with shareholders' activity; Deletes TP-adjustment

May 31,2018

BMW India Pvt Ltd [TS-401-ITAT-2018(DEL)-TP]

Conclusion

Delhi ITAT deletes TP-adjustment made in respect of BMW India's payments on account of market survey and technical support services to its AE, BMW AG, for AY 2007-08; In respect of adjustment on account of market survey report, notes that BMW AG arranged for market survey report [conducted by third party] for BMW India and charged the costs incurred to BMW India without any margin/markup, however TPO proposed an adjustment holding that the said report was for the benefit of BMW group and not for the benefit of the assessee; Referring to OECD Guidelines, various debit notes and written confirmations from BMW AG, ITAT notes that the market survey report was a country specific report and was different

from shareholders' activity; Rejecting Revenue's contentions that the expenses incurred by BMW AG were for its own benefit to approach the customers/market in India, ITAT holds that the said report is *"for the benefit of BMW India only"* and thus deletes TP-adjustment; Regarding assessee's payment for technical support services to BMWAG, ITAT rejects TPO's approach of discarding 2 comparables selected by assessee [after a comprehensive search on Royalty Stat database] on the basis that they were not from Germany; Holds that difference in geographical location of market is not sufficient reason to reject a comparable until it can be substantiated that the same resulted in different market conditions, follows Bharati Airtel ITAT-ruling and accordingly deletes TP-adjustment

HC: Upholds Rule 10B invocation for allowing capacity under-utilization adjustment to manufacturer assessee

May 07,2018

Petro Araldite Pvt Ltd [TS-317-HC-2018(BOM)-TP]

Conclusion

Bombay HC dismisses Revenue's appeal, upholds ITAT's invocation of Rule 10B(1)(e)(iii) for allowing capacity utilization adjustment to the assessee (engaged in the business of manufacturing and dealing in basic liquid and solid resins as well as formulations) for AY 2005-06; Notes that ITAT had upheld assessee's capacity utilization claim after illustrating how higher capacity utilization would lead to higher profitability as fixed costs would be spread over a larger number of units manufactured; Considering that capacity utilization materially affects the profit margin, HC holds that *"the invocation of Rule 10B (1) (e)(iii) of the Rules, cannot be found fault with"*; Also stating that it was a self-evident position that all aspects/differences between the international transactions and the comparable uncontrolled transactions materially affecting the net profit margin have to be taken into account so as to have the fair comparison while determining the ALP of the tested party's transaction, HC concludes that *"this question does not give rise to any substantial question of law as Rule 10B (1)(e)(iii) of the Rule is self evident*"; HC also upholds ITAT's TP-adjustment restriction only to assessee's international transaction, relies on various precedents including co-ordinate bench ruling in assessee's own case for AY 2008-09

ITAT: Directs aggregation of Google India's Adwords & ITeS transactions; Adopts PSM as MAM

May 11,2018

Google India Private Limited [TS-335-ITAT-2018(Bang)-TP]

Conclusion

Bangalore ITAT remits Google India's functional characterization for TP purpose for AYs 2009-10, 2010-11 & 2011-12, directs TPO to aggregate functions (like ITeS) which have a direct nexus with core business activity [Adwords distribution programme]; Clarifies that *"characterisation of functions cannot be based on .. merely terms of contract or description of the services given by the assessee-company. It has to be determined having regard to the actual conduct of the parties"*, guides AO/TPO to consider CBDT Circular 6/2013 in deciding assessee's functional profile; Holds that *"In respect of transactions aggregated with AdWords business transaction, the TPO shall bench-mark the transaction by adopting Profit Split Method as most appropriate method, as the transaction of business of AdWords programme requires deployment of assets and functions of different entities located in different geographical locations in order to ultimately deliver services as the combined effort generate revenues"*, relies on Orange Business Services India Networks and Global One India rulings; Also directs TPO to examine whether assessee's functions resulted in creation of intangibles i.e. marketing intangibles or technological intangibles, whether such intangibles are owned/transferred by assessee and if transferred, whether assessee was adequately compensated for it

TP issues – functional characterization of Google India

Upholds TPO's rejection of assessee's TP-study on the basis that no separate FAR-analysis was done for each function performed with AEs. ITAT opines that " *TP analysis should be ideally made on a transaction by transaction basis except in cases where transactions are so closely inter-related or continuous that application of arm's length principle on a transaction by transaction basis would be unreliable or cumbersome. Only in those cases the transactions are aggregated."*

ITAT directs TPO to aggregate functions which have a direct nexus with core business activity [AdWords distribution programme] and also examine whether assessee's functions resulted in creation of intangibles i.e. marketing intangibles or technological intangibles, whether such intangibles are owned/transferred by assessee and if transferred, whether assessee was adequately compensated for it Clarifying that "*characterisation of functions cannot be based on not merely terms of contract or description of the services given by the assessee-company. It has to be determined having regard to the actual conduct of the parties"*, ITAT guides AO/TPO to consider CBDT Circular 6/2013 in deciding assessee's functional profile.

In respect of transactions independent of AdWords distribution programme, ITAT states that

characterisation of the functions performed shall be based on the actual conduct of the parties and actual activities performed. The comparability of all these independent transactions shall be judged with reference to uncontrolled similar transaction by adopting MAM and comparability factors.

Further, ITAT states that " *In respect of transactions aggregated with AdWords business transaction, the TPO shall bench-mark the transaction by adopting Profit Split Method as most appropriate method, as the transaction of business of AdWords programme requires deployment of assets and functions of different entities located in different geographical locations in order to ultimately deliver services as the combined effort generate revenues."* Relies on Orange Business Services India Networks, Global One India rulings in support of the proposition that PSM can be adopted as MAM in cases involving multiple interrelated international transactions which cannot be evaluated separately.

Profits attributable to Google Ireland

Regarding DRP's deletion of adjustment made by AO for AY 2009-10 and 2010-11 on account of attribution of profits to Google Ireland on the basis that Google India was an agent of Google Ireland, ITAT holds that "*It is undisputed fact that the transaction of AdWords programme between the assessee-company and Google Ireland is subjected to bench marking"* Relying on E-Funds IT Solution and Morgan Stanley rulings, ITAT states that there will be a need to attribute profit to PE if TP-analysis does not adequately reflect the functions performed and risks assumed by the enterprise. ITAT opines that *"In such a situation there would be a need to attribute profit to PE for those functions and risks that have not been*

considered." Remits issue for de-novo assessment in light of **E-Funds IT Solution and Morgan Stanley** rulings.

ITAT: Upholds CUP citing AE-customer transaction at same price, without value addition

May 14,2018

AT & S India (P) Ltd [TS-336-ITAT-2018(Kol)-TP]

Conclusion

Kolkata ITAT deletes TP-adjustment of Rs. 100.29 crores in respect of export of printed circuit boards (PCBs) by assessee to its AE in Austria [for further sale in Europe as distributor] and payments made to AE for receiving purchase and order handling services and sales services under a Cost Contribution Agreement (CCA) for AY 2012-13; In respect of export transaction, rejects TPO's adoption of entity level TNMM absent cogent evidence or material from Revenue to prove that CUP method was not suitable for the assessee; Noting that AE did not do any value addition in the goods manufactured by assessee and prices at which PCBs were sold by the assessee to AE were equal to the prices at which PCBs were sold by AE to independent customers in Europe, ITAT adopts CUP-method as MAM and deletes TP-adjustment, relies on co-ordinate bench ruling in assessee's own case for YA 2011-12; In respect of payment for services under CCA, rejects TPO/DRP's Nil-ALP observing that for previous AYs 2009-10 to 2011-12, TPO had consistently accepted assessee's TP documentation without making any adjustments; Relying on Radhasoami Satsang SC ruling, ITAT opines that " *Revenue has to have some consistency in its views and it cannot blow hot and cold at its sweet-will"*; ITAT also rejects DRP's view that assessee had not satisfied the benefit test, clarifies that *"the authority of the TPO would be to conduct a transfer pricing analysis to determine the arm's length price ('ALP') and not to determine whether there is a service or not from which the assessee benefits"*

ITAT: Daikin's Indian subsidiary constitutes DAPE; Attributes profits, TP-analysis not adequately reflecting FAR

May 30,2018

Daikin Industries Ltd [TS-395-ITAT-2018(DEL)-TP]

Conclusion

Delhi ITAT rules that the wholly owned Indian subsidiary of Daikin Industries Ltd. (assessee, a Japanese company), constitutes assessee's dependent agent PE for AY 2006-07; Holds that the entire activities of identifying customers, negotiating and finalizing prices with customers in India etc. were done by DAIPL (Indian subsidiary) not only for the products sold as distributor, but also for which assessee claimed to have made direct sales in India; Acknowledging the tremendous efforts required for effecting sale in highly competitive industry of air-conditioning and refrigeration equipments, ITAT remarks that *"We fail to comprehend as to how the assessee came in contact with customers in India and made sales to them directly, when DAIPL, situated in India, had to spend a huge amount of selling and distribution expenses (of Rs. 14.38 cr.) for selling similar products in India.";* Thus, rejects assessee's stand that DAIPL was acting only as a communication channel for its direct sales, considering assessee's failure to demonstrate its direct involvement from Japan in making sales to Indian customers and e-mails exchanged between assessee and DAIPL demonstrating that DAIPL was negotiating and finalizing deals with Indian customers; ITAT then rejects assessee's argument that since TPO had considered the international transaction of commission paid by assessee to DAIPL for market support services to be at ALP in case of DAIPL, no further income could have been attributed to assessee's operations in India; Notes that assessee had neither reported any international transaction in Form 3CEB nor conducted any benchmarking exercise, further, the benchmarking of commission for DAIPL was done only with respect to 2 functions [forwarding customers' request to assessee and forwarding assessee's quotations to the customers] and thus, other functions performed (negotiating and finalizing contracts on behalf of assessee) remained excluded from the process of ALP-determination; Also lays down that ratio decidendi of Morgan Stanley ruling would not apply and assessee's case would fall within the exception laid down by SC [i.e. if TP-analysis does not adequately reflect FAR of the enterprise, there would be a need to attribute profits to the PE for those functions/risks not considered]; On attribution of profits to PE, ITAT upholds 10% net profit rate as reasonable and then determine net profit attributable to the marketing activities in India at 30% of the net profit so determined at 10% of sales in India

ITAT: Rejects re-characterization of distribution activity as service absent

difference between form & substance

Apr 13,2018

Comm Vault Systems (India) Private Limited [TS-245-ITAT-2018(HYD)-TP]

Conclusion

Hyderabad ITAT rejects TPO's re-characterization of assessee's distribution transaction as a service transaction requiring markup for AY 2011-12; Perusing the agreement between assessee and its AE [for distribution of AE's product in India], ITAT states that *"the intention of the parties is clear that the assessee shall be a distributor of AE's products in India"* and is not required to make the payments to the AE till the assessee makes profit from the transactions; Follows Sony Ericsson Mobile Communications HC ruling [wherein it was held that normally, tax authorities cannot disregard the actual transaction or substitute the same for another transaction as per their perception except where the economic substance of the transaction differed from its form] to state that in assessee's case *"there was no difference between the form and substance of the transaction of distribution to recharacterise the transaction as a service agreement"*; Further, accepting assessee's submission that since it had no revenue left after reducing the operating cost/expenses the AE was not paid any percentage [as per the terms of the agreement], holds that TPO's computation of mark up on assessee's operating cost was unjustified; Regarding applicability of Sec. 92(3) provisions considers assessee's submission that if the transaction is taken as distribution as agreed to between the parties, then the TP analysis would increase the loss, remits issue to AO/TPO to conduct fresh TP analysis by treating the assessee's transaction as a distribution agreement, clarifies that if loss declared by the assessee was increased by such TP study, then no TP adjustment can be made as provided in Sec 92(3)

HC: Appropriateness of method per se cannot give rise to 'question of law'

Apr 13,2018

Bombardier Transportation India Pvt Ltd [TS-244-HC-2018(DEL)-TP]

Conclusion

Delhi HC holds that appropriateness of the 'most appropriate method' per se does not raise a question of law since it involves analysis of facts done first by the Revenue authorities and

settled by the ITAT; HC holds that *"Unless the facts show glaring distortion in the adoption of one or the other method, a question of law cannot be said to arise*"; Accordingly, HC rejects admission of question of law raised by assessee involving rejection of CUP method by Revenue as the most appropriate method for the transaction of dealings in railway wagons based on the sale price made to the ultimate third-party buyer; HC notes that Revenue rejected CUP method having regard to the fact that it unduly restricted the choices of the Revenue and TNMM was considered to be a more appropriate method where greater choice was available; HC thereafter admits 3 legal questions raised by the assessee in respect of Tribunal's order on the issues of cherry-picking of comparables, deletion of comparables selected by the assessee, and intra-group services related to management support

ITAT: Upholds different 'tested parties' for different business models, rejects TPO's aggregated benchmarking

Jun 26,2018

WNS Global Services Pvt Ltd [TS-474-ITAT-2018(Mum)-TP]

Conclusion

Mumbai ITAT upholds CIT(A)'s order accepting separate benchmarking of assessee's transactions under Business model 1 - receipt of marketing & support services from AE (choosing foreign AE as tested party) and Business model 2 - assessee's rendering of ITeS to AE (choosing assessee as tested party) for AY 2004-05; Notes CIT(A)'s observation that under Business model 1, risks and rewards were with the assessee and AEs [which were remunerated on cost plus basis] were insulated from the risks borne by assessee as an entrepreneur, therefore upholds CIT(A)'s view that AE was rightly chosen as the tested party being the least complex entity; ITAT further upholds CIT(A)'s observation that under Business model 2, major risks were borne by WNS UK, which functioned as an entrepreneur and therefore, assessee (which was only a captive service provider bearing limited risks) was rightly chosen as the tested party; Further, observing that the transactions undertaken by assessee were not interlinked as various transactions formed part of different business models adopted by assessee, ITAT opines that *"TPO's approach of aggregating these international transactions and benchmarking the assessee at an entity level is not appropriate*

since the far profile of WNS India is different in both the transactions and hence, aggregating these international transactions and considering WNS India as the tested party is wholly misplaced and contrary to the TP regulations", relies on Knorr Bremse HC-ruling; Thus, ITAT concludes that *"the aforesaid transactions do not form a single composite transaction and the terms of each transaction have been agreed separately by the assessee with its AEs*", thus holds that CIT(A)'s separate benchmarking of the transactions was justified