Judicial pronouncements on International Tax and Transfer Pricing

-CA Bhavya Bansal Goyal

Bentham “precedents are judge made laws”

Precedents establish a principle or a rule that is followed while taking similar decisions.

Key TP Litigation issues

Some areas of litigation in the context of TP:

- Whether Associated Enterprise relationship exists u/s 92A
- Whether a transaction is international transaction u/s 92B
- Selection of MAM
- Selection of Tested Party
- Selection of Filters
- Selection of Comparables …..

Advanced areas:

- Intangibles;
- Attribution of Profit to PE
- Recharacterization of transaction;
- Corporate guarantee commission & Interest in AR;
- Shareholders function/Interest free loan …….. ETC

Pr. CIT v. Softbrands India (P.) Ltd [TS-475-HC-2018(KAR)-TP]

Pr CIT vs.SOFTBRANDS INDIA PVT.LTD. {Kar HC}

Facts

- Revenue's appeal against the ITAT on
  - exclusion of certain comparables and
  - applying RPT filter of 15%.

Decision

- The Karnataka HC ruled that the Tribunal is the **final fact-finding authority** and the jurisdiction to consider the factual nature of issues is with the Tribunal
- As long as there is **no unreasonableness** in the order of the Tribunal in the findings of the fact, the same does not qualify to be a "substantial question of law."
- **Perversity of the findings of the Tribunal** should be established on the basis of cogent material, which was available before the Authorities below including the Tribunal.
- It is not allowed to either of the parties i.e. the Assessee or the Revenue to invoke the jurisdiction under **section 260A** merely because the Tribunal comes to reverse or modify the findings given by the lower Authority.
- The HC also held that issues pertaining to selection of comparable data and criteria for comparability while undertaking an economic analysis in a TP study do not give rise to a "substantial question of law."

SAP Labs India Pvt Ltd v ITO [TS-225-SC-2023-TP]

SAP Labs India Pvt Ltd v ITO

- Apex Court reversed Karnataka HC judgment on issue of comparables selection and whether it constitutes a 'substantial question of law'
- **SC noted**: *"there cannot be any absolute proposition of law that in all cases where the Tribunal has determined the arm's length price the same is final and cannot be the subject matter of scrutiny by the High Court in an appeal under Section 260A of the IT Act."*

SC Decision

- SC remits the cases back to the concerned High Courts
  - to decide and dispose of the respective appeals afresh
  - in light of the observations made and
  - to examine in each and every case whether the ITAT has followed the guidelines laid down under the Act and the Rules while determining the ALP

Takeaway

- Overturned a well settled position propounded by Softbrands;
- Will give unnecessary burden to the already burdened HCs;
- Wastage of judicial time

Infobip Ltd {ITA No. 820/Del/2022}

Facts

FACTS

- the assessee provided services to its Associated Enterprise (“AE”), namely bSmart Tech Pvt. Ltd. (“BTPL”) under the Business Cooperation Agreement;
- in the nature of Financial Support Services, Sales Support Services and Legal Support Services based out from London, UK;
- The consideration received for providing services to BTPL was not offered to tax by the assessee;
- the assessee was issued a show cause to explain why management support services fee should not be taxed

Submissions before ITAT

- Services in the nature of **managerial** and
  - "managerial" services is not covered under the FTS clause of Article 13(4) of India-UK DTAA;
- **Make Available clause** not satisfied:
  - Services are not of enduring nature;
  - BTPL is not in a position to apply and use the technical knowledge on their own without the support of the assessee
  - Services are continuously provided year after year on a regular basis and there is no change in the nature of services rendered by the assessee;
  - NO transfer of knowledge
- Email correspondence submitted to show nature of services provided

Article 13(4) India-UK DTAA

- Article 13(4) of the India-UK DTAA defines the term "Fees for Technical Services" to mean-

"payments of any kind to any person in consideration for the rendering of any technical or consultancy services (including the provisions of services of technical or other personnel) which:

(a) Are ancillary or subsidiary to enjoyment of right....

(b) Are ancillary or subsidiary to enjoyment of property...

(c) **make available technical knowledge**, experience, skill, know-how or processes, or consists of the development and transfer of a technical plan or technical design."

For (a) & (b)-there has to be payment of royalty and the services have to be ancillary and subsidiary to the services for which royalty is being paid-Not satisfied in this case

ITAT decision

Nature of services

- administrative services, accounting services, legal services and other support services that are ancillary in nature

Managerial services

- services are thus essentially in the nature of managerial services which are in our considered view outside the scope of the meaning of FTS under Article 13(4) of the India-UK DTAA;

No "MAKE AVAIABLE"

- services provided by the assessee to BTPL does not make available any technical knowledge/experience, skill, know-how or processes or consist of the development and transfer of technical plan or technical design enabling BTPL to apply technology contained therein
- **Tax Adjustment was deleted**

Decisions relied on

- i) De Beers India Minerals (P) Ltd. vs CIT 208 Taxmann.406
- ii) Raymond Ltd. vs CIT 80 TTJ 120 [Mum ITAT]
- iii) DIT v. Guy Carpenter & Co. Ltd.[2012] 20 taxmann.com
- 807/207 Taxman 121/346 ITR 504 (Delhi)
- iv) ADIT Vs. Rolls Royce Industrial Power India Ltd. ITA No.
- 1599(Del) 2011
- v) Aircom International Ltd. (AAR No. 883 of 2012]
- vi) Intertek Testing Services India (P.) Ltd. In re [2008] 175 Taxman
- 375/307 ITR 418(AAR)
- vii) Dy. DIT (International Taxation) v. Scientific Atlanta Inc. [2009]
- 33 SOT 220 (Mum.)

TAKEAWAY: Maintenance of adequate supporting

Crayon Group AS [TS-417-ITAT-2023(Mum)-TP]

Facts

- Crayon Group AS a foreign assessee. 2 additions made on account of TP:
  - Crayon AS issued compulsorily convertible debentures at an interest rate of 6.5% to its Indian AE. The TPO/DRP made TP adjustment using the SBI PLR @ 11%; and
  - Crayon AS did not charge any CG fee. The TPO/DRP has made addition on account of CG fee in the hands of the foreign assessee @ 1% using average of bank rates
- The transactions had been considered at arm's length in the Indian AEs hand u/s 92(3)

Key submissions before ITAT

- Assessee has chosen Indian AE as a tested party;
- Base erosion principles;
- Mirror report has been held to be at an arm's length;
- For Corporate guarantee; Bank rate can not be used for CG rate comparison;

ITAT ruling & Key takeaways

- Mirror report in case of section 92(3) can not be used to justify ALP of foreign AE
- **CCD Interest:**
  - Tested party' concept doesn't apply to the Comparable Uncontrolled Price (CUP) Method.
  - Interest rates on CCDs cannot be compared with bank lending rates.
- **CG:**
  - Relying solely on judicial precedents for ALP determination is not scientific.
  - Bank and corporate guarantee rates aren't directly comparable.

MATTER REMITTED TO TPO TO RECOMPUTE ALP

Kimberly Clark Lever Private Limited [TS-364-HC-2023(BOM)-TP]

Facts

Invalid Transfer Pricing Order cannot be a basis for reopening of the Assessment us 147 / 148

FACTS:

- The AO made a reference to the TPO on 26 October 2009.
- No notice u/s 143(2) (Scrutiny asstt) was issued before making the said reference to the TPO
- The TPO passed an order under Section 92CA(3) on 29 October 2010.
- The AO initiated reassessment proceedings u/s 147/ 148 on the reason that the income had escaped assessment based on the TP Order.
- The reassessment proceedings were quashed by the ITAT on the TP order being invalid.
- Department preferred an appeal to High Court

HC decision

- HC observed- AO's belief that income has escaped assessment must be based on some **material on record**. However, the only material relied upon is the order of the TPO here;
- An imp fact is that an **AO can make reference to the TPO u/s 92CA** only after selecting the case for scrutiny assessment;
- **No notice u/s 143(2) was issued** before making the said reference to the TPO.
- **The TPO order was a nullity in law and void ab initio;**

Takeaway- The AO could not have relied upon an order of the TPO which is a nullity to form a belief that certain income chargeable to tax has escaped the assessment for the relevant AY.

Springer India Pvt Ltd [TS-403-HC-2023(DEL)-TP]

Facts

- Issue was related to MAM selection;
- This case relates to **AY 2012-13**
- Assessee entered into an APA which covered period **AY 2013-14 to AY 2021-22**
- **APA guidelines introduced in India in Finance Act 2012 wef from AY 2013-14**
- ITAT remitted matter to AO, to consider subsequent year APA;
- Revenue filed an appeal to High Court

Findings of HC

- HC noted that the APA covered 18 transactions out of which it was agreed that
  - 16 transactions will be benchmarked by using the 'other method'; and
  - 2 transactions will be benchmarked by using TNMM and RPM

- Revenue's contention - ITAT erred in directing APA to form the basis for benchmarking:
  - whereas APA was brought in the statute only in AY 2013-14; and
  - this case related to AY 2012-13

HC decision

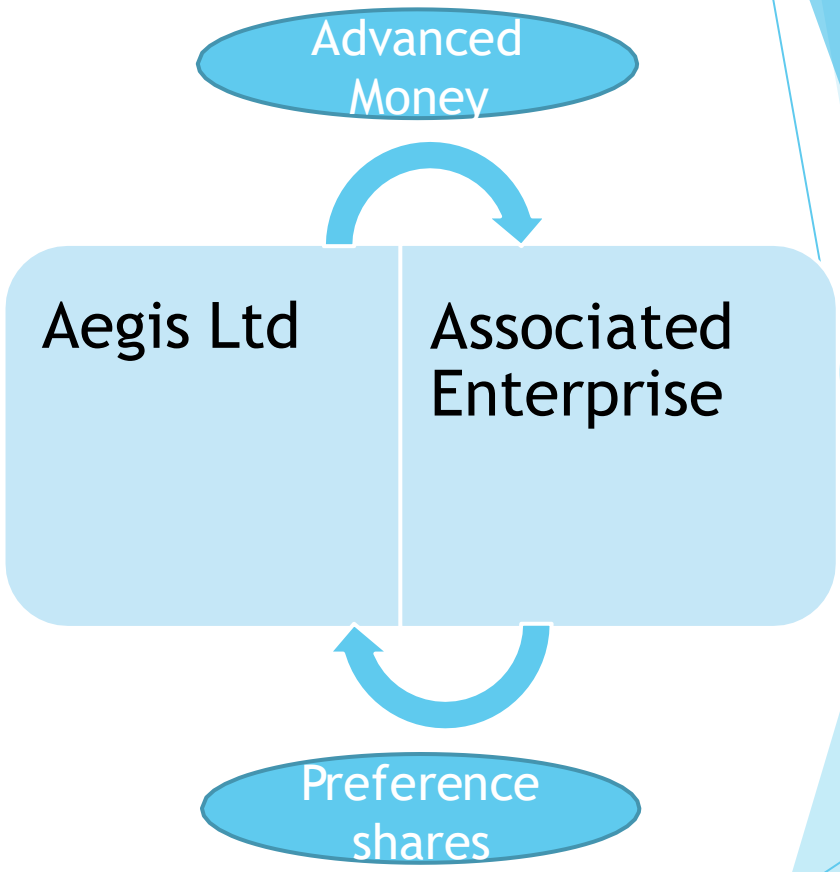
- ITAT adopted a **wholesome approach**;
- HC held "*having regard to this limiting factor and given the **complexity of the transaction** which the respondent/assessee is involved in, the Tribunal thought it fit that the APA could be used to benchmark the transactions even for the AY in issue*";
- Takes into account "*the **TPO will have to determine as to whether the FAR in the given AY is the same as those which are covered in the APA***";
- HC HELD - no error been committed by the ITAT, either in the application of law or on facts

TAKEAWAY: FAR supreme importance; & Guidance can be taken from subsequent year APA

Aegis Limited [TS-463-ITAT-2023(Mum)-TP]

Facts

- Aegis is into providing ITeS/BPO services for AY 2018-19;
- AE issued Preference shares to Aegis;
- TPO recharacterized preference shares to an interest free loan advanced by Aegis Ltd to the AE;
  - interest was charged on notional basis.



Aegis Ltd

- ITAT observed:
  - *The **TPO cannot disregard** the transaction and substitute **without any material of exceptional circumstances** pointing out that the assessee had tried to conceal the real transaction or that the transaction in question was sham;*
  - *The TPO cannot question the **commercial expediency** of the assessee entered into such transaction.*
- ITAT relied on AY 2009-10 decision which was subsequently upheld by HC
- Same view was also followed for AYs 2010-11, 2011-12, 2013-14, 2014-15 and 2017-18, thus adjustment was deleted.

TAKEAWAYS

- TPOs can recharacterize when substance differs from form;
- EKL Appliances-Delhi HC-Business rationality
- Section 92 and 92CA-Reference for determining ALP, not rationality of transaction

Star India Private Limited v. ACIT – [2023] 151 taxmann.com 77 (Mumbai-Trib.) (SB)

Facts

- Assessee was a company engaged in **broadcasting and distributing various satellite channels** primarily in India. It entered into a Master Rights Agreement (MRA) with ESPN Star Sports Ltd. (ESS), US based entity, to ***purchase a bundle of sports event broadcasting rights***.
- Assessee used 'Other method' as the MAM first ; however, later adopted CUP and used a valuation report for comparability analysis
- TPO made TP adjustments on the deficiencies found in the valuation report submitted by the assessee.
- The controversy revolved around **selecting the most appropriate method between the CUP and Other methods**. Due to the different view adopted by the predecessor Bench in the assessee's own case, the Hon'ble President constituted Special Bench on reference made by the Division Bench.

Issues before SB

1. Can Assessee resile from the most appropriate method adopted in its Transfer pricing study report?
2. Which is the most appropriate method in the transaction under consideration?
3. Whether the ALP determined by the Assessee is correct?

SB ITAT Ruling

- The Members of the Special Bench of Tribunal had diversified views:

Vice President:

- In favour of the assessee- the ALP of 'Purchase of Bundle of Sport Broadcasting Rights' determined by the assessee under the CUP method was correct.

Accountant Member:

- Since, the Bundle of sports broadcasting rights was transferred, which is a **unique intangible asset**. Hence, the '**Other Method**' would be MAM to value those rights at different points in time based on changes in economic conditions and market situations.
- The sale of a bundle of sports broadcasting rights is also a **unique transaction** where other traditional methods fail. Thus, the 'other method' is the most appropriate method in this case.

Judicial Member:

- Agreed with the Accountant Member that, the 'Other Method' and not the 'CUP Method' was the MAM.

SB ITAT Ruling

- The tax payer **can resile** from the MAM earlier adopted-
  - Precedents- Delhi HC- Pr. CIT Vs Matrix Cellular International Services Pvt. Ltd. (2017) 100 CCH 0191
  - use of one method in a transfer pricing report does not estop the assessee from later claiming that another method is the most appropriate one.
- the MAM to be adopted for the "bundle of rights" is the **"Other Method"** by 2:1 majority;
- Issue of ALP determination **placed before division bench again.**

Takeaway

- Huge implications;
- Impact on TP adjustments made over five years, aggregating to nearly Rs 10,000 Crores
- The Division Bench proceedings are critical for both sides

Lintas India Pvt Ltd vs. ACIT 148 Taxmann.com 482 {Mumbai ITAT}

Facts

- Lintas India Pvt Ltd ("the assessee") an Indian entity, engaged in advertising business, paid GIS service charges to its overseas AE and benchmarked the same using CUP method.
- TPO rejected the benchmarking:
  - assessee failed to satisfy the **'need test' of services** availed and
  - hence determined cost as Nil.

ITAT Ruling

- The ITAT rejected TPO view, relied on the robust documentation submitted and held :
  - services are required for business of Indian entity and thus was requested to overseas AE;
  - Indian entity has been benefitted on availing the services;
  - adopted reasonable allocation keys;
  - proper agreement between Indian entity & its AE
- ITAT instructed to do proper benchmarking by examining the documents placed by Indian entity.
- ITAT held that cost of intra-group services cannot be considered "Nil" if documentation is robust.

TAKEAWAY: IMPORTANCE OF ROBUST DOCUMENTATION

Director of Income Tax vs. Travelport Inc. (Civil Appeal No. 6511-6518 of 2010) Supreme Court

Facts

- Travelport Inc provided **electronic global distribution services** to airlines through a Computerized Reservation System (CRS).
- CRS services were marketed in India through **Indian distribution agents**. Travelport Inc earned USD/EUR 3.00 per booking made in India and paid USD/EUR 1.00–1.80 as commission to Indian agents.
- ITAT held that the taxpayer had a permanent establishment (PE) in India as **fixed place PE and dependent agent PE (DAPE)**.
- Since only a miniscule portion of the taxpayer's activity was performed in India, ITAT held that only 15% of total revenue (0.45 cents) was attributable to India. ITAT relied on *DIT vs. Galileo International Inc., (2009) 180 Taxman 357 (Delhi)*
- ITAT held as payment to agents far exceeded such income, no income should be taxed in India.
- Revenue appealed before the Supreme Court for taxation of the entire income of the taxpayer in India.

SC Ruling

SC observed and held:

- The ITAT arrived at the quantum of revenue accruing to the taxpayer which can be attributed to activities carried out in India, on the basis of **FAR analysis;**
- The commission paid to the distribution agents was more than twice the **amount of income attribution and this was already taxed**. The ITAT rightly concluded that the same extinguished the tax assessment;
- The question as to what portion of the income can be reasonably attributed to the operations carried out in India is a **question of fact**; and
- On the question of fact ITAT has already determined what can be reasonably attributed to India.
- SC dismissed revenues appeal an in effect ITAT order upheld

Schott Glass India Pvt Ltd [TS-462-HC-2023(BOM)-TP]

Facts

- The assessee is engaged in the business of trading and manufacturing of glass;
- Assessee incurred **“Solar test Trial”** costs and excluded them from computation of operating margins as being extraordinary;
- ITAT order upheld exclusion of assessee’s Solar Test activity costs from computation of PLI

Bom HC Ruling

- Bombay HC dismissed Revenue's appeal against ITAT order;
- HC noted that the solar test trials, carried out by assessee were an exception to its regular business of producing tubes for pharmaceutical packaging, hence extraordinary in nature

TAKEAWAY: Extraordinary expenses have to be excluded while computing operating margins

Cummins India Limited [TS-489-HC-2023(BOM)-TP]

Facts

- Assessee is engaged in the business of manufacture and sale of internal combustion engines, spares, etc;
- Assessee **paid royalty** to its AE for providing technical know-how and technical knowledge for manufacturing of engine;
- Benchmarked it under the **combined transaction approach** under manufacturing segment using TNMM as MAM;
- TPO separated royalty from the manufacturing segment and sought to benchmark it using CUP;
- Another fact is that in **earlier years ITAT has upheld combined transaction** approach.
- Current Year ITAT passed an unfavourable order

HC Observation

- HC noted ITAT has failed to recognize that royalty agreement for the years under consideration was the **same royalty agreement** and that TPO had accepted assessee's benchmark of the royalty under the aggregation approach along with transactions of the manufacturing segment for **AYs 2011-12 to 2014-15**;
- HC noted that **facts are same as earlier orders**, refers to Apex Court's ***Radhasoami Satsang*** case that held that Department was bound by the previous decision in absence of any change in material facts;

HC decision

- HC held that
  - ITAT should have followed the order of the coordinate bench rendered under **identical facts and same agreement**;
  - HC upheld the combined transaction approach of benchmarking royalty along with the manufacturing segment.

Page Industries Ltd [TS-718-SC-2021-TP]

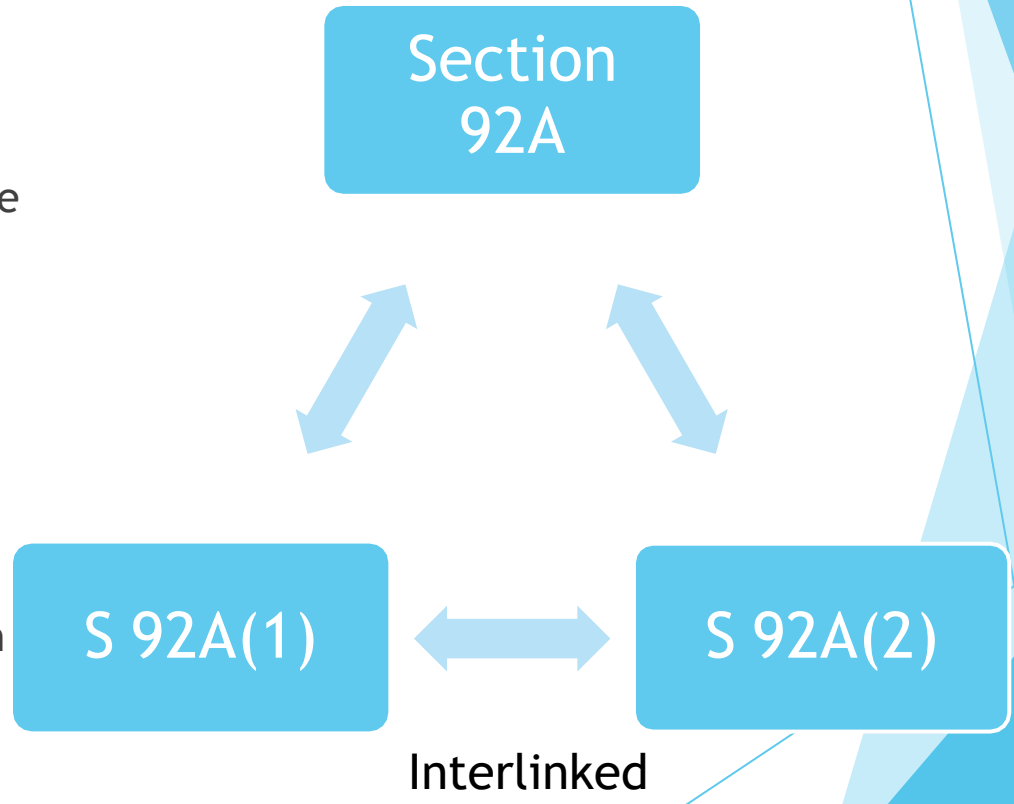
Background

- Section 92A(1) gives the meaning of associated enterprises from the **view of ownership, management or control.**
- Section 92A(2) lays down **certain criteria fulfilment** of which will make two enterprises as associated enterprises.
- Section 92A(2) of the Act creates **a deeming fiction**, enlisting thirteen scenarios in which two parties are deemed to be AEs
- 92A(1) lays down the broad definition of the term AE , 92A (2) lists down specific instances when two enterprises are deemed to be AEs.

Facts

HC ruling

- HC held that Section 92A (1) and (2) are interlinked and are to be read together;
- Memorandum of Finance Bill, 2002 states that 92A(2) was amended wef 01.04.2002 to clarify that 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, unless the criteria specified in sub-Section (2) are fulfilled.
- Two enterprises cannot be treated as an AE unless both the parameters laid down in Section 92A of the Act are fulfilled.



SC Ruling

- SC dismisses Revenue's SLP against the above Hon'ble High Court order stating that "We are not inclined to interfere with the impugned order".

- TAKEAWAY: Section 92A sub section (1) & (2) have to be read in conjuction with each other and they are interlinked.

THANK YOU!!

YOUR

QUESTIONS

PLEASE !!!

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