

Recent Transfer Pricing ruling

WIRC ICAI –

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Agenda – Recent TP ruling

- Marketing intangible
- Intercompany lending – benchmarking
- Location savings
- Share investment
- Turnover filter
- Sale of shares
- Payment of royalty / brand fee
- +/- 5% benefit

MARKETING INTANGIBLE

Delhi ITAT (SB) ruling in L.G. Electronics P. Ltd.
[TS-11-ITAT-2013(DEL)-TP]

Facts

(Korea)

Use of industrial
property Rights,
designs & technical
know-how

Royalty
at 1%

100%
Subsidiary

Use of brand
name
& trademarks

AMP
Expenses

(India)

- TPO held that assessee was promoting brand owned by AE on its behalf by incurring excessive AMP expenses
- Bright Line Test applied and TP adjustment was made

Conclusion

Delhi ITAT (SB) – L.G. Electronics (I) P. Ltd. [TS-11-ITAT-2013(DEL)-TP]

- Advertisement Marketing & Promotion (AMP) expenses incurred by the LG India towards brand legally owned by the foreign AE constituted an 'international transaction'
 - Non-payment of consideration does not make TP provisions inapplicable
- Active involvement of LG Korea in marketing strategy development & received benefit from brand promotion in India
- Transaction of brand building by the assessee for the foreign AE is in the nature of 'provision of service' u/s 92B
- Higher advertisement expenditure cannot justify AMP adjustment unless brand promotion for foreign AE exists
- IT Act recognises legal ownership of brand and not economic ownership

Conclusion

Delhi ITAT (SB) – L.G. Electronics (I) P. Ltd. [TS-11-ITAT-2013(DEL)-TP]

- Use of Bright Line Test for determining cost / value of such transactions upheld
- DRP as well as AO were right in applying the spirit of the ‘cost plus method’ (after determining cost / value of transaction using Bright Line Test).
- Combination of two or more methods cannot be applied to determine ALP - Only one method should be used
- Non-application of any of recognized methods in TPO/DRPs orders does not make the entire proceedings void
- Retrospective application of Section 92CA(2B) upheld
- Reference to TPO for at least one transaction necessary for him to determine ALP for other transactions

Conclusion

Delhi ITAT (SB) – L.G. Electronics (I) P. Ltd. [TS-11-ITAT-2013(DEL)-TP]

- Selling expenses which do not lead to brand promotion cannot be brought within the ambit of AMP for determining cost/value of international transaction
- Use of comparables owning foreign brand as suggested by the assessee, rejected. Use of comparable domestic cases not using any foreign brand more appropriate.
- Lays down over 13 different criteria for ascertaining marketing intangible creation

Developments

Chennai ITAT – Ford India P. Ltd. [TS-148-ITAT-2013(CHNY)-TP]

- Comparable domestic cases not using foreign brand alone can be considered
- Selling expenses to be excluded in making AMP adjustment

Chandigarh ITAT – Glaxo Smithkline Consumer Healthcare Ltd.

[TS-72-ITAT-2013(CHANDI)-TP]

- AMP expenditure incurred only on foreign brand of AE held as ‘international transaction’
- No adjustment required for advertisement expenses attributed to promotion of domestic brand owned by assessee

Delhi ITAT – India Co. [TS-160-ITAT-2013(DEL)-TP]

- TPO to re-compute AMP adjustment after excluding selling expenses and by applying proper comparables in view of directions in LG’s case

INTERCOMPANY LENDING – BENCHMARKING

Delhi ITAT- Cotton Naturals (I) P. Ltd.
[TS-33-ITAT-2013(DEL)-TP]

Facts

Interest
at 4%

Loan in foreign
currency

(Foreign AE)

(India)

- TPO held that LIBOR not proper rate while deciding interest rate on receivables
- TPO adopted domestic rate while determining ALP & made TP adjustment
- TPO held that independent entity would not lend in foreign currency, if lending rates were higher in Indian currency
- No security for loan and assessee did not give details of financial health of subsidiary

Conclucision

Delhi ITAT – Cotton Naturals (I) P. Ltd.[TS-33-ITAT-2013(DEL)-TP]

- Domestic prime lending rate (PLR) not applicable where loan advanced to foreign subsidiary in foreign currency
- Financial position & credit rating for subsidiaries broadly similar as holding company
- Use of LIBOR upheld relying on Siva Industries [TS-438-ITAT-2011(CHNY)]

Developments

Mumbai ITAT – UnionPro Solutions Ltd. [TS-75-ITAT-2013(Mum)-TP]

- Tested party to be always the taxpayer & not AE, as effect of transaction on income of “assessee” relevant
- Interest on Bank FD for similar term the safest comparable
- But upholds LIBOR for consistency purpose

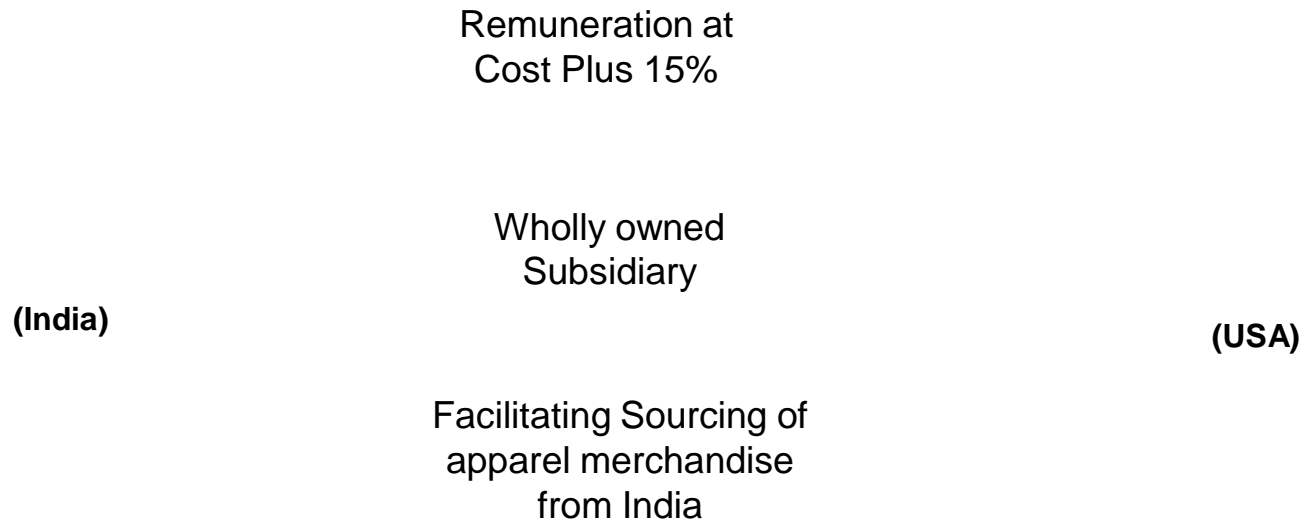
Mumbai ITAT – Hinduja Global Solutions Ltd. [TS-147-ITAT-2013(Mum)-TP]

- Upheld LIBOR (without mark-up) for lending to subsidiary in USD

LOCATION SAVINGS

Delhi ITAT – GAP International Sourcing (I) P. Ltd.
[TS-667-ITAT-2012(DEL)-TP]

Facts



TPO's conclusions

- “Cost plus” remuneration model rejected
- Assessee held to be risk bearing entity, which created substantial intangibles
- Location savings due to operation in low cost economy not factored into remuneration model
- ALP determined based on 5% commission on ‘FOB’ value of goods sourced by AE through Indian vendors

Conclucion

Delhi ITAT – GAP International Sourcing (I) P. Ltd. [TS-667-ITAT-2012(DEL)-TP]

- Assessee wrongly categorised as risk bearing agent for AE
- Nothing on record to show that assessee developed substantial human resources intangibles
- No decision-making or entrepreneurial role embedded in work profile of assessee's employees
- Merely following guiding instruction provided by AE does not create 'supply chain'
- No addition on account of location savings as assessee not 'sole beneficiary'
- Assessee's PLI of net profit/cost appropriate and not percentage of FOB value of goods sourced
- Cost plus 32% markup acceptable

SHARE INVESTMENT

Hyderabad ITAT – Vijai Electricals Ltd.
[TS-142-ITAT-2013(HYD)-TP]

Facts

Investment at
Rs. 21 Crores

**Vijai
Electricals
(India)**

Subsidiaries

**Foreign
Entities**

- CIT held that the transaction of investing in foreign subsidiaries was an 'international transaction'
- CIT observed that no reference to TPO was made, therefore, assessment order erroneous & prejudicial to interest of Revenue
- Assessment order set aside under revision proceedings u/s 263

Conclucision

Hyderabad ITAT – Vijai Electricals Ltd. [TS-142-ITAT-2013(HYD)-TP]

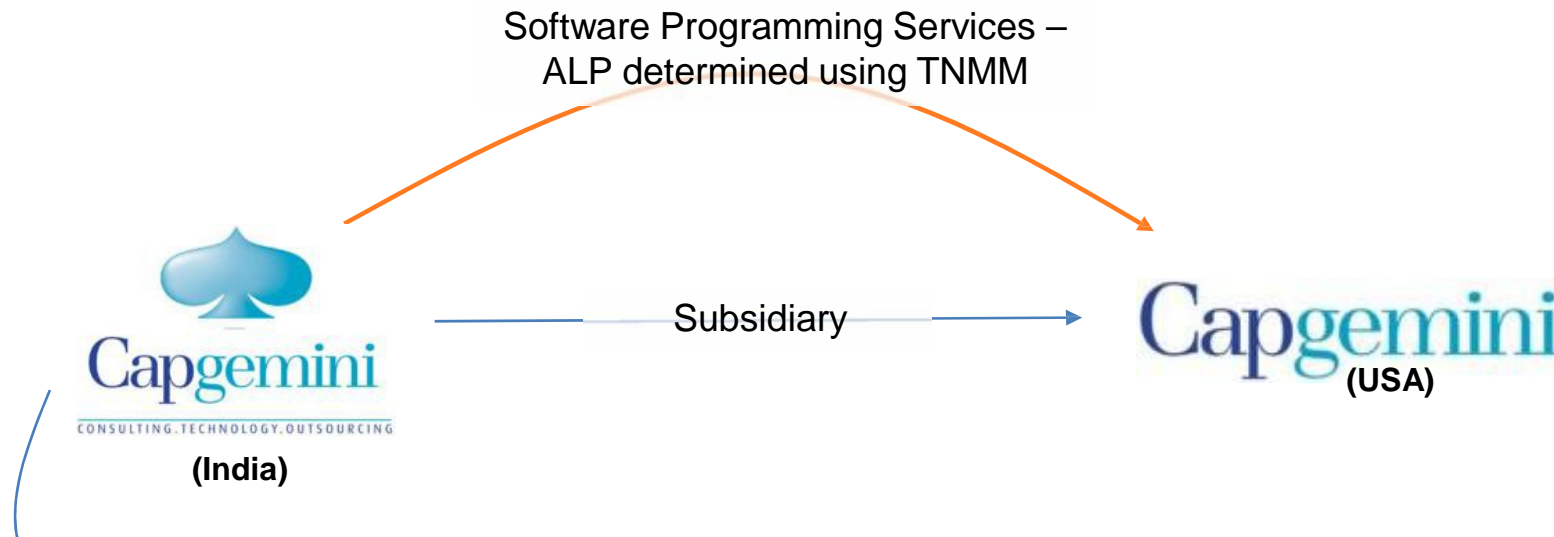
- Investment made in subsidiaries abroad not an international transaction u/s 92B
- TP provisions not applicable as there is no income
- CIT's order revising assessment order set aside

**Impact on Inbound
Investments -
Shell type cases?**

TURNOVER FILTER

Mumbai ITAT – Capgemini India P. Ltd.
[TS-45-ITAT-2013(Mum)-TP]

Facts



- TPO included companies like Wipro and Infosys as comparable for computing arm's length margin
- TPO used standalone financials as against consolidated financials used by assessee
- Assessee sought for exclusion of Infosys and Wipro since they had very high turnover

Conclucusion

Mumbai ITAT – Capgemini India P. Ltd. [TS-45-ITAT-2013(Mum)-TP]

- Rejected upper turnover filter filter,
 - Fixes Rs. 100 Cr as lower limit
- Concept of economy of scale relevant for manufacturing, not for service oriented IT companies
- No linear relationship observed between margin and turnover of comparables
- Only standalone financials to be considered as consolidated financials include profits from overseas jurisdiction with different geographical / marketing conditions
- Extraordinary ESOP cost incurred by Capgemini on Kanbay's acquisition to be excluded from operating cost base in TNMM working

Controversy

Bangalore ITAT – Trilogy E-Business Software India P. Ltd.

[TS-748-ITAT-2012(Bang)-TP]

- Upholds turnover filter of Rs. 1 Cr- Rs. 200 Cr; Ruling in Genysis Integrated Systems followed
- 8 Comparables selected by TPO excluded applying turnover filter

Mumbai ITAT – Willis Processing Services India P. Ltd.

[TS-49-ITAT-2013(Mum)-TP]

- Rejects turnover filter slabs submitted by assessee and held that turnover not a criteria u/r 10B for selection of comparables
- Considers charts/graphs submitted by Revenue to demonstrate absence of correlation between turnover and profit margin

Controversy

Delhi ITAT – Cincom Systems India P. Ltd. [TS-150-ITAT-2013(DEL)-TP]

- Excludes Wipro, Infosys, KALS Information System from comparables list due to very low turnover of the assessee
- Noted divergent judicial views and held that view more favourable to the assessee will be preferred

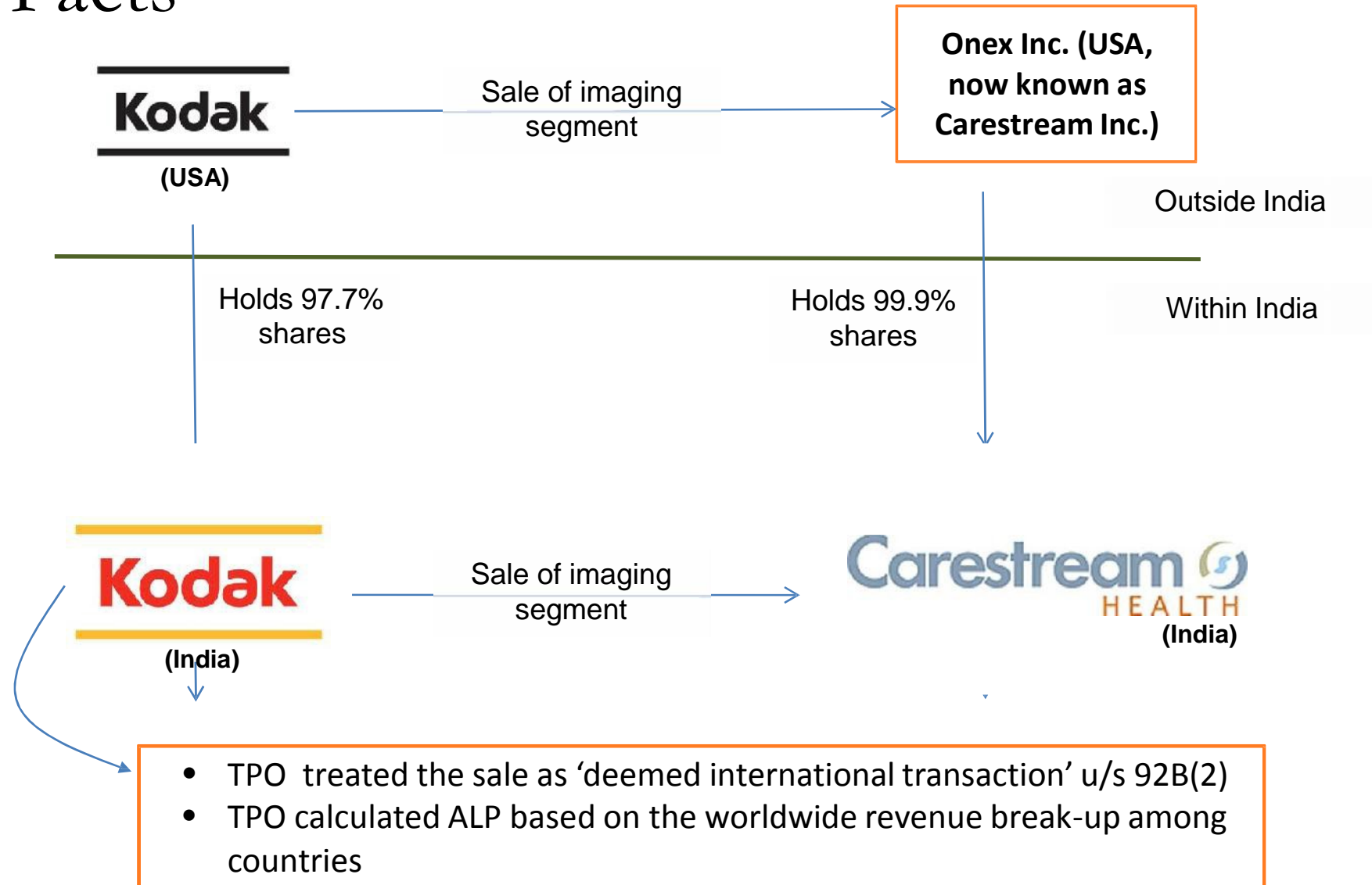
ITAT Special Bench

- Constituted to rule on application of ‘turnover filter’

SALE OF SHARES

Mumbai ITAT – Kodak India P. Ltd.
[TS-93-ITAT-2013(Mum)-TP]

Facts



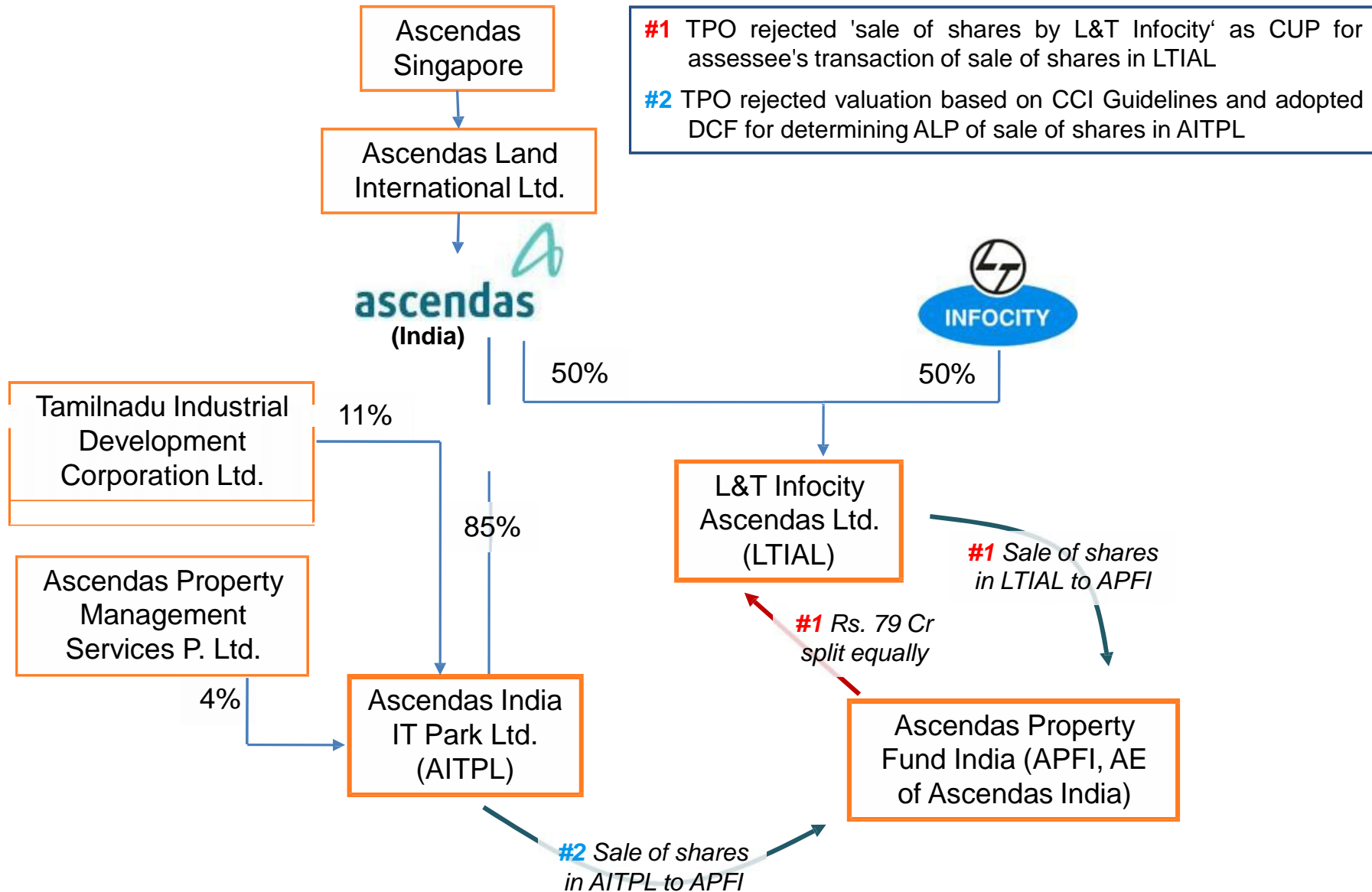
Conlcusion

Mumbai ITAT – Kodak India P. Ltd. [TS-93-ITAT-2013(Mum)-TP]

- Though sale was consequent to global arrangement, terms of sale not influenced by such agreement.
- Transaction not ‘deemed international transaction’ u/s 92B(2), but purely a domestic transaction.
- Sec. 92B(2) covers transaction, which are not strictly international transactions, but have colour of them
- Provisions of Sec. 92B(2) can’t be read independent of Sec. 92B(1)
- Refused to disregard separate legal character of related entities
- TPO bound to follow one of the methods specified u/s 92C
- When mandatory provision is superseded or ignored, it affects jurisdiction

Chennai ITAT – Ascendas India P. Ltd.
[TS-1-ITAT-2013(CHNY)-TP]

Facts



Conclucusion

**Chennai ITAT –
TP]**

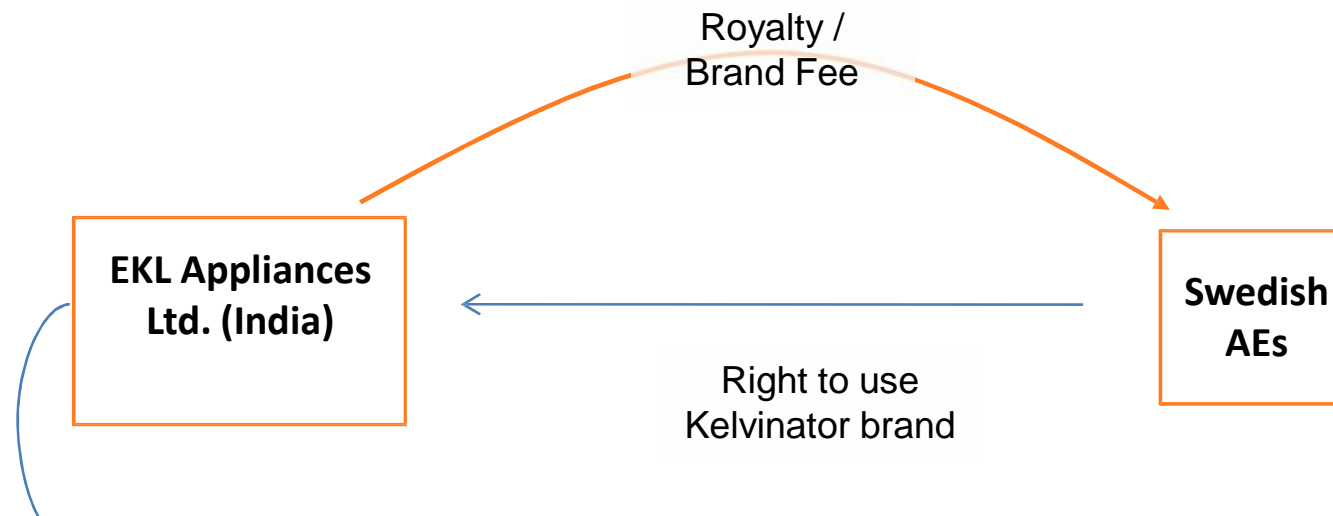
India P. Ltd. [TS-1-ITAT-2013(CHNY)-

- Share transfer by assessee and L&T Infocity in joint venture IT park to Ascendas group entity 'at same price' is not ALP applying CUP and attracts TP provisions
- Sale of shares in JV was one 'joint effort' and cannot be regarded as comparable
- Rejected use of CCI valuation to justify share transfer price
- Purpose of CCI guidelines is different and it cannot be transported into TP benchmarking
- Use of Discounted Cash Flow held to be more appropriate
- Rejects additional 'discount for illiquidity' of shares as 'weighted average cost of capital' (WACC) factors all risks

PAYMENT OF ROYALTY / BRAND FEE

Delhi HC – EKL Appliances Ltd.
[TS-206-HC-2012(DEL)-TP]

Facts



- TPO held that the royalty payment had not benefited the assessee, Considering continuous losses
- TPO observed that assessee failed to demonstrate actual benefit. Therefore ALP determined at Nil

Conclusion

Delhi HC – EKL Appliances P. Ltd. [TS-206-HC-2012(DEL)-TP]

- Rejected the disallowance made by TPO for royalty payment for Kelvinator brand
- TPO can examine only quantum of expenditure, but can't judge allowability as business expenditure
- HC extensively relied upon OECD TP Guidelines, which discourage re-structuring of legitimate business transactions
- Criterion of expenditure being 'wholly and exclusively' for business under IT Act is also found in OECD guidelines
- Royalty/brand fee deductible as assessee furnished valid reasons for suffering losses continuously

Developments

Mumbai ITAT –SGS India P. Ltd. [TS-19-ITAT-2013(Mum)-TP]

- License fee paid by assessee @ 3% held to be at arm's length
- Rejects TPO's disallowance of excess license fee by applying brand-royalty limits of 1% / 2% set by Govt
- Payment also in accordance with FIPB and Commerce Ministry norm; rejects Revenue's argument that FIPB can't be taken as benchmark
- In SKOL Breweries case [TS-10-ITAT-2013(Mum)-TP], Mumbai ITAT held that Commerce Ministry Press Note No. 9 prescribing royalty rate irrelevant for ALP computation

Delhi ITAT – Reebok India Co. [TS-160-ITAT-2013(DEL)-TP]

- Lower profitability not enough to conclude that assessee derived no benefit from royalty payment
- SIA approval though not conclusive, had to be considered in determining ALP

**RULINGS:
+/- 5% BENEFIT**

Delhi ITAT – IHG IT Services India P. Ltd.
[TS-92-ITAT-2013(DEL)-TP] – Special Bench

Conclusion

Delhi ITAT – IHG IT Services India P. Ltd. [TS-92-ITAT-2013(DEL)-TP] – Special Bench

- Benefit of 5% not “standard deduction” for the period prior to 2009 amendment
- ITAT cannot adjudicate on constitutional validity of amendment as the Tribunal is not a constitutional but statutory authority
- Overruled Pune ITAT ruling in Piaggio Vehicles [TS-534-ITAT-2012(PUN)]

Thank You

Notes for the readers

- This presentation and use of graphs/diagrams therein is purely for academic purposes.
- This presentation should not be construed as any advise.
- Views, if any, are personal.