

TransPrice Times

Edition: 16th to 31st July 2020

Honda Cars India Ltd –Delhi ITAT

Outcome: In **favour** of the taxpayer

Category: Profit attribution to PE

The taxpayer is engaged in the business of manufacturing and sale of premium segment passenger cars in India and outside India. During the year, the taxpayer had entered into the international transaction of sale and purchase of spare parts, raw material, capital goods and export commission with its Associated Enterprises ('AEs').

With respect to the international transactions entered by the taxpayer with its AEs, the tax officer noticed that the AEs of the taxpayer have a business connection in India and hence, have a permanent establishment ('PE') in India as per the Indian tax law and relevant tax treaties ('DTAAs'). The tax officer further noticed that the taxpayer has made payments to its AEs for above international transactions without withholding taxes on these payments under the relevant provisions of the Indian tax law which also leads to disallowance of such expense for computation of income purposes, in the taxpayer's case. The tax officer initiated the proceedings under the relevant provisions of the Indian tax law and made additions to the total income of the taxpayer.

In response to the tax officer's decision, the taxpayer filed an appeal with the intermediate tax authority. The intermediate tax authority sustained the tax officer's addition made on account of disallowance of expense made under the Indian tax law. The taxpayer further filed an appeal with the Tax Court against the decision of intermediate tax authority.

The Tax Court observed that the transfer pricing officer ('TPO') had held that all the transactions entered by the taxpayer with its AEs are at arm's length price ('ALP') and this fact was not considered by the tax officer as well as by the intermediate tax authority. The Tax Court noticed that a similar situation was covered in the AE's case i.e. Honda Motors Co. Ltd., Japan where the Supreme Court had stated that when international transactions are at ALP, there cannot be further profit attribution to a person even if it has PE in India. Further, the Tax Court also observed that a similar situation was covered in taxpayer's own case in different assessment years, where it was held that the AEs (except Honda Motors Co. Ltd., Japan) of the taxpayer, do not have a PE in India and hence, no withholding of taxes is required under the relevant provisions of the Indian tax law on payment made to AEs. Further, in respect of Honda Motors Co. Ltd., Japan, the Tax Court had referred to the Jurisdictional High Court ruling in case of Herbalife, wherein the Tax Court noticed that payments for purchases were covered by non-discriminatory provisions of the DTAA and hence, the benefit of such non-discriminatory provisions was available to the taxpayer.

In view of the above, the Tax Court concurred with the cited case laws and ruled in the favour of the taxpayer concluding no further profit attributable to a person if transactions at ALP, even if it has a PE in

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India; and further, deleted the additions made to the total income of the taxpayer on the account of the disallowance of payment made to AEs under the provisions of the Indian tax law.

Powernetics Equipments India Pvt. Ltd. – Mumbai ITAT

Outcome: In **favour** of the taxpayer

Category: Determination of ALP

The taxpayer is engaged in the business of manufacturing of uninterruptible power source ('UPS'), primarily for Indian Railways. The company has undertaken an international transaction with its AE, M/s. Powernetics Ltd. in the nature of supplying UPS and payment of service charges on a cost plus 10% markup basis.

The tax officer made a transfer pricing adjustment to the profit margin on the international transaction by considering the gross profit (GP) margin earned by the taxpayer in the subsequent year i.e. 15%, as the appropriate arm's length margin on the international transaction of sale of UPS and payment of services charges. The taxpayer's appeal was dismissed by the intermediate tax authorities. The appeal was then filed by the taxpayer before the Tax Court.

The taxpayer explained before the Tax Court that the TPO had considered the GP margin of the taxpayer of the subsequent year which was impacted due to gain on sale of asset i.e. factory building and sundry balances written back along with fixed deposit interest - which are non-operating in nature for transfer pricing purposes. The taxpayer also justified that if the above non-operating items are excluded from the calculation, there would be a gross loss. Also, the taxpayer contended that since it has incurred a gross loss in the financial year under consideration, the submitted margin of cost plus 10% is appropriate and at arm's length.

The Tax Court ruled that estimating the GP for the financial year under consideration on the basis of the GP earned by the taxpayer in a subsequent financial year is not permissible. The Tax Court also stated that inclusion of non-operating elements does not depict the true picture of the operating profits. Further, the Tax Court noticed that the taxpayer had not provided complete details which are necessary as per the Transfer Pricing regulations. Hence, the Tax Court remitted the issue back to the TPO and directed for providing a reasonable opportunity for hearing the taxpayer.

FIS Global Business Solutions India Pvt. Ltd. –Delhi ITAT

Outcome: In **favour** of the taxpayer

Category: Consideration of APA beyond rollback years

The taxpayer operates as a software development center for group companies. It is also engaged as a dedicated provider of Business Process Outsourcing (BPO) services to its AEs. The taxpayer operates through two business divisions namely Software Development Centre (SDC), Chennai and Shared Services

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Centers (SSC), Gurgaon. During the AY 2010-11, the taxpayer entered into international transactions of provision of Software Development Services (SDS), Business Process management (BPM) and call center services. The taxpayer adopted transactional net margin method (TNMM) for benchmarking international transactions. The taxpayer has entered into an advance pricing agreement (APA) for FY 2014-15 to FY 2018-19 and for consecutive 4 years from FY 2010-11 to FY 2013-14 (referred to as 'Rollback years').

For AY 2010-11, the tax officer directed the TPO to determine ALP for the international transactions entered by taxpayer with its AEs. After considering the various filters enumerated in TP order, the TPO proposed TP adjustments for international transactions. The taxpayer filed an appeal with intermediate tax authority against the TP adjustment proposed by the TPO. After excluding some comparables the intermediate tax authority reduced the TP adjustments proposed by the TPO.

The tax officer after giving effect to the intermediate tax authorities order, passed rectification order and rectified the amount of ALP adjustment. Hence, the taxpayer and the tax officer filed a cross appeals against the order of intermediate tax authorities with the Tax Court. The taxpayer contended that the tax officer has failed to consider that the taxpayer has entered into an APA with CBDT for identical international transactions in the period covered in the APA. Further, taxpayer also contended that the APA is appropriately applicable to the international transactions entered into between the taxpayer and its AEs and there is no change in the Functions, Assets & Risks (FAR) of the taxpayer during the year under assessment vis-à-vis years covered under APA for which the taxpayer has given reference to jurisdictional High Court decision in PCIT vs. Ameriprise India Pvt. Ltd.

The tax officer contended that since APA has been entered into between the taxpayer and the CBDT for specific years, the same cannot be applied to the years under assessment. Further, revenue also stated that ALP rate agreed upon in the APA for earlier and subsequent years cannot overrule the statutory determination of ALP made by the TPO. By giving reference to rulings of the jurisdictional High Court and coordinate Tax Court in PCIT vs. Ameriprise India Pvt. Ltd. and 3I India Private Ltd. vs. DCIT respectively, the Tax Court stated that since there is no change in FAR as well as the ALP determined by the taxpayer is much more than the consolidated margin agreed upon between the taxpayer and the CBDT for the years covered under APA contentions of revenue are not tenable. Further, it also stated that even though APA is not specifically applicable to the year under assessment, it has a persuasive value for other assessment years if there is no change in the FAR and nature of international transactions.

Since the consolidated ALP determined by the taxpayer for relevant assessment year is more than as agreed under APA, which is having persuasive value for the relevant assessment year, the Tax Court concluded that the TP adjustments proposed by either TPO or tax officer by applying Transfer Pricing principles is not sustainable.

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