

TransPrice Times

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WNS Global Services Pvt Ltd – ITAT – Mumbai

Outcome: In **favour** of taxpayer

Category: Different Tested Parties for Different Business Models

History: The taxpayer is a part of an International Group which is engaged in IT-enabled Business Process Outsourcing ('BPO') services. Taxpayer performs activities of export of Information Technology enabled Services ('ITeS') comprising data processing and transfer.

Facts and contentions: The taxpayer operates under two Business Models ('BM'):

BM-1: As an entrepreneur undertaking ITeS activities for its customers, having outsourced limited marketing support services to its Associated Enterprises ('AEs') for which the AEs are remunerated at a cost plus 6% basis; and

BM-2: As a captive service provider rendering services as required by its AE for which it is compensated on a full time equivalent basis.

For BM-1, the taxpayer considered the AEs as the tested party and documented foreign benchmarking studies by taking into consideration the tax jurisdictions of such AEs. For BM-2, the taxpayer chose comparables and undertook a domestic benchmarking by considering itself as the tested party.

The taxpayer contended that the above approach ensured the selection of least complex entity as the tested party and is justifiable due to the considerable difference in the functions performed, assets employed and risks assumed, for both of these business models.

The intermediate tax authorities dismissed selection of the AEs as tested parties by the

taxpayer for BM-1, and instead, aggregated the international transactions under BM-1 and BM-2, comparing the taxpayer's margin as a whole with that of the third parties engaged in ITeS business.

Ruling: The Tax Court ruled in favour of the taxpayer by upholding the latter's contentions. It stated that both the business models of the taxpayer were disparate in their functional analysis. In BM-2, the taxpayer was exposed to limited risks and thus, was the least complex entity, while its AE took on the entrepreneurial role. Whereas, in BM-1, significant risk and hence the reward, belongs to the taxpayer who remunerates its risk-insulated AEs. Thus, the AEs are the least complex parties with respect to transaction under BM-1. It further asserted that for each international transaction, the taxpayer operated with different functional profiles and thus, such dissimilar transactions cannot be clubbed, but need to be benchmarked separately. Hence, the case got concluded in favour of the taxpayer.

Wolters Kluwer (India) Pvt Ltd – ITAT – Delhi

Outcome: In **favour** of taxpayer

Category: Rule of Consistency, FAR Analysis

History: The taxpayer renders business support services to its AEs, mainly comprising marketing support services.

The taxpayer carried out a Transfer Pricing analysis comparing 'Operating Profit/Operating Cost' ('OP/OC') margins of itself with 14 comparable entities under TNMM and concluded that its transactions were at ALP.

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In doing so, the taxpayer applied a quantitative filter of 'service income to total income' > 50% for such selection of comparables.

The Taxpayer also provided its functional analysis ('FAR analysis') outlining its operations with respect to the transaction under consideration.

Facts and contentions: The intermediate tax authorities accepted the application of OP/OC under TNMM but rejected 13 of the comparables accepted by the taxpayer (which were accepted by the authorities in subsequent years) and included 9 new comparables, to compute the ALP by adopting various filters which included, inter alia, a filter of 'service income to total income' > 75% and made a corresponding Transfer Pricing adjustment to the tune of INR 48,26,992/-.

The taxpayer defended that the filter ratio of 50% was justified as segmental information of such entities may provide the necessary comparison data and lead to selection of an appropriate comparable entity.

Also, the authorities, while deciding on the ALP, based the selection criteria on a FAR analysis conducted by them, which apparently contained certain assumed functions, against which the taxpayer contended that such selection of comparables by the authorities is based on a wrong FAR analysis by assuming wrong functions of the taxpayer.

Ruling: The Tax Court upheld the taxpayer's application of 50% in relation to the filter of 'service income to total income' as it enabled the selection of a broader comparable base which

could then be subject to further filters and analysis.

Also, as to the dismissal of comparable entities by the authorities but which have been accepted in subsequent years, the Tax Court stated that such rejection cannot be sustained, following the rule of consistency, as there had been no change in the business of the taxpayer.

The Tax Court further asserted that the Transfer Pricing study of the intermediate tax authorities involved drafting and relying on an erroneous FAR analysis without considering the reality, which ultimately resulted in a futile determination of ALP and directed the exercise to be carried out afresh.

RECENT NEWS

Re-configuring the e-commerce Industry – A brief on the recent Draft e-commerce Policy:

Ever since e-commerce has been industrious in gathering significance for itself in the market, the Government has constantly been on its toes to solidify the e-commerce idea by encouraging and implementing requisite schemes for its development. The virtual industry has thus, succeeded in expanding its roots, thanks to the Government bracing it up at appropriate intervals.

To throw more light on the intent of e-commerce industry in India, the Government has been instrumental in bringing up new recommendations through a draft of e-commerce policy released on July 31, 2018.

The said draft inclines more towards the Indian founders of the e-commerce with minority stake,

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giving a tough time to the foreign-owned e-commerce companies that are operating in India. Prohibiting the e-commerce companies from directly or indirectly influencing the sale price is one of the basic recommendations of the draft.

The negative implications of transfer pricing have been foreseen, as a result of which, the draft attempts to limit the retail strategies of e-commerce players with their subsidiaries. Bulk purchases of white goods, mobile phones, fashion items by related parties would lead to mispricing in the market.

Indian-owned and Indian-controlled e-commerce companies are allowed to hold inventory as long as products are 100% domestically produced. However, such relief is not available for e-commerce entities having foreign investment. This aspect of the draft makes it favourable for Indian-owned e-commerce firms or companies.

The essence of the draft has outspread over all the aspects of the e-commerce industry. It gives Indian founders more control by giving differential voting rights. An Indian e-commerce firm has been defined as an entity wherein foreign investment does not exceed 49%, the founder is an Indian resident and is controlled by Indian management.

The recent acquisition of Flipkart by Walmart has forced the e-commerce arena to ponder about mergers and acquisitions. The draft promotes investment by Indian investors in order to expand the industry, by eradicating entry barriers which were levied through additional costs.

The data localization aspect of the draft mentions that only personal or community data collected by the ecommerce entities shall be stored in India, which will be made mandatory after two years. GST strand has also been smoothed by allowing centralized registration instead of local registration.

The draft suggests a sunset clause for deep discounts, where ideal maximum duration must be set. Also, while determining Permanent Establishment for allocating profits of MNCs between resident and source countries, the economic presence has to be gauged. Improvising legal fragmentation covering laws of ecommerce must be seen as one of the vital points of the draft, since the governance of e-commerce would wholly revolve around the laws concerned.

To infer, the draft has justified all the feathers of the e-commerce industry, giving India a broader scope and vision to invest in this sphere of industry.

The OECD releases public comments:

The Organisation for Economic Co-operation and Development ('OECD') had earlier welcomed public comments on *Chapter IV – Administrative Approaches* of the *2017 OECD TP Guidelines* to check out the possibilities of revising the same. The public comments received by the OECD have now been released in the public domain. In order to understand the standpoints of entities/ public on various Transfer Pricing aspects, click [here](#).

Special Edition by TransPrice:

To read our Special Edition TP Times Article titled 'Changing Colours of Indian Tax Audit (3CD)', click [here](#).