

TransPrice Times

Edition: November and December 2019

MC Retail Pvt Ltd – Mumbai ITAT

Outcome: In **favour** of the taxpayer

Category: Application of most appropriate method

Disregarding the explanations of and benchmarking done by the taxpayer, The Transfer Pricing Officer ('TPO') determined the Arm's Length Principle ('ALP') in respect of the international transactions of the taxpayer as 'Nil' and went ahead to propose adjustment equal to the transaction amounts.

The first level appellate authority namely, Dispute Resolution Panel ('DRP') also treated the book-entry of the write-off of expense as a separate international transaction and entirely disallowed the write-off of expense.

At the Tax Court, the taxpayer contended that the ALP as determined by the TPO pursuant to DRP's directions was without following any methodology prescribed in the regulations.

The Tax Court observed that the TPO is mandatorily obligated as per the transfer pricing regulations in the statute, to determine the ALP only by applying any of the methods laid down under the regulations as the most appropriate method and then, propose to make any adjustment. The Tax Court opined that adjustments proposed without following the prescribed methods vitiates the order.

The case of the taxpayer is also supported by the decision of the Hon'ble Bombay High Court in the cases of Johnson and Johnson Ltd and in Kodak India Pvt. Ltd. In both cases, the Hon'ble Bombay High Court has held that it is obligatory on the

TPO to follow one of the methods as mandated by the transfer pricing provisions of the statute.

Gujarat NRE Coke Ltd – Kolkata ITAT

Outcome: In **favour** of the taxpayer

Category: Interest on foreign currency loan

The taxpayer had advanced an Australian Dollars loan ('AUD Loan') to its Associated Enterprise ('AE') carrying an interest of Bank Bill Swap Bid Rate (BBSY) + 2.5%.

The Tax Court observed that that the transaction of a cross-border loan in foreign currency to the AE could be benchmarked against AUD LIBOR+2% as a general consensus among Hon'ble Benches of the Tax Court, and also supported by Reserve Bank of India Circular. On the other hand, the transfer pricing authorities contended to apply a hypothetical interest rate by considering the average cost of borrowed funds of the taxpayer's domestic interest rates and added an arbitrary spread of 750 basis points to the same.

The Tax Court opined that the interest charged by the taxpayer to the AE is higher than the arm's length rate of AUD LIBOR+2%. Thus, the Tax Court held that no adjustment can be made on a hypothetical interest rate against the actual rate of interest on the AUD Loan.

Arkay Logistics Ltd – Mumbai ITAT

Outcome: In **favour** of the taxpayer

Category: Internal-CUP preferred over TNMM

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The taxpayer is engaged in the logistics business. Among other activities, the taxpayer provided ship broking services to its AE - Essar Steel Minnesota LLC ('ESML') by hiring vessels on voyage charter basis from unrelated parties and supplying the same to ESML on a back-to-back contract basis.

The taxpayer benchmarked the aforesaid transaction with the AE by primarily applying the Transaction Net Margin Method ('TNMM') as the most appropriate method. Further, the same was corroborated by an alternative benchmarking under the comparable uncontrolled price ('CUP') method. Under CUP method, the taxpayer compared the price charged by the third party suppliers towards the hire of vessels as an internal CUP vis-à-vis the hire charges earned from the AE and since the latter was more than the former, the transaction with the AE was inferred to be at arm's length under the CUP method also.

During the discussions, the TPO rejected the CUP analysis outright without any strong backing and went ahead to modify the TNMM and proposed adjustment. The taxpayer backed the adoption of the above-mentioned internal CUP method, being directly and validly applicable, considering the back-to-back nature of transactions. The taxpayer contended that although it had selected TNMM as the primary method in the study, it had been corroborated with Internal CUP and hence, Internal CUP should be foremost applied when validly available.

The Tax Court stated that the CUP method, being a more direct method than TNMM, would gain precedence if a valid CUP is available. The TPO could not have rejected the CUP method merely

because the taxpayer itself had selected TNMM as the primary method in the study. Further, the Tax Court noted that Co-ordinate Bench in a different case, had held that in case of back-to-back transactions, CUP is the most appropriate method. Therefore, the Tax Court accepted the Internal CUP applied by the taxpayer.

India Medtronic Pvt Ltd – Mumbai ITAT

Outcome: In favour of the taxpayer

Category: Comparability Analysis

The taxpayer is engaged in the business of distributing life-saving medical devices, manufactured by its parent company i.e. AE. The taxpayer applied the TNMM to benchmark the import of such finished goods from its AE. The TPO rejected the TNMM and went on to adopt RPM as the most appropriate method. Further, in doing so, for comparison, the TPO considered margins drawn on the basis of gross margin earned by its other AE, thus using controlled transactions as comparable for benchmarking the transaction with AE.

The Tax Court observed that the margins computed by the TPO were merely a group target margin and not the actual margins. Further, it opined that controlled transactions cannot be used as a comparable for benchmarking international transactions. Additionally, since sufficient information relating to gross margins in comparable transactions was unavailable, a fresh benchmarking under RPM would not serve any purpose, and hence, TNMM is to be applied as the most appropriate method, thereby ruling in favour of the taxpayer.

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Bayer Vapi Pvt Ltd (formerly known as Bilag Industries Pvt Ltd) – Surat ITAT

Outcome: Against the taxpayer

Category: Application of Internal CUP

The taxpayer adopted TNMM as the most appropriate method and concluded the transaction of exports to be at ALP.

The TPO contended that the taxpayer is engaged into similar transaction with third party as that of its AE. Further, contended that data pertaining to both transactions are available. Hence, Internal CUP by considering unrelated exports should be considered for benchmarking the transaction.

The Tax Court after considering the facts and circumstances, upheld the decision of the TPO whereby Internal CUP as MAM is valid and appropriate, in the presence of valid CUP data.

IBM Daksh Business Process Services Pvt Ltd – Delhi ITAT

Outcome: In favour of the taxpayer

Category: Mutual Agreement Procedure ('MAP')

The taxpayer is engaged in provision of BPO services. In respect of the above services, the taxpayer had achieved resolution through a MAP with its AEs in the USA and UK.

The TPO opined that since the MAP resolution only covered USA and UK AEs, it could not be applied to transactions with AEs in other countries, since they are not covered by the MAP resolution.

The Tax Court concluded that as the said international transactions are settled by a MAP resolution (for UK and USA AEs), further also

considering the similarity in nature of transaction, business profiles and tested party in respect of transactions with AEs in other countries, the latter should also be seen in the same view as that under MAP settlement.

Star International Movies Ltd – Mumbai ITAT

Outcome: In favour of the taxpayer

Category: Applicability of Profit Split Method ('PSM') to AE and non-AE transactions

The taxpayer is engaged in distribution of channels and advertising. The taxable income of the taxpayer for AE transactions was determined under PSM. The TPO was of the view that the determination of the ALP under PSM was supposed to be restricted to AE transactions only, and thus, proceeded to estimate taxable profits in respect of non-AE transactions separately.

The Tax Court opined that the combined net profits which are considered for PSM are derived holistically, by taking into consideration transactions of both - AEs as well as non-AEs – since they are both factored into all the costs and revenue. Hence, bifurcation of non-AE transactions for the above-mentioned profits as done by the TPO is incorrect.

Nycomed Pharma Pvt Ltd – Mumbai ITAT

Outcome: In favour of the taxpayer

Category: Internal CUP

The taxpayer, which is a wholly owned subsidiary of Nycomed GmbH Germany i.e. AE, runs a research and development centre pertaining to pharmaceutical drugs and is also an export oriented unit. Further, the taxpayer is also

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engaged in licensing/sub-licensing of its parent's proprietary and patented compound drug 'Pantoprazole'. The taxpayer earned royalty income from sub-licensing the manufacturing and sale of Pantoprazole to unrelated third parties and in turn, paid royalty to the AE after retaining 1% of the sale proceeds received from sub-licensing.

Considering that there did not exist any agreement between the taxpayer and its AE pertaining to such payment of royalty, the TPO determined the arm's length price of such royalty payment to be nil and thereby, proposed an equivalent adjustment.

The Tax Court noted that the Agreement between the taxpayer and its AE was put into effect in subsequent periods while covering the past period as well. Also, without prejudice to this fact, the Tax Court stated that there is no requirement of a written agreement as per the transfer pricing regulations and hence, held that the TPO's contention was untenable.

RECENT NEWS

Third annual peer review reports released by Inclusive Framework on BEPS:

Pertains to calendar year 2018 and relates to exchange of information on tax rulings between 112 jurisdictions, highlights as at the year end. The report further contains 52 jurisdiction-specific recommendations. In respect of India, Report mentions that India has met all aspects of the terms of reference (ToR) except for timely exchange of information on future APAs; however, India has addressed the other two recommendations from last year's peer review. During the review year, India has exchanged 454 unilateral APAs/ transfer pricing rulings and 21 PE rulings, which indicates a 40% increase as compared to last year.

Additional guidance on CbCR data inclusions by OECD:

Certain interpretation issues related to data to be included in the Country by Country Report (CbCR) have been clarified by additional guidance released by the OECD. Under such guidance, it is explained that the automatic exchange of CbC reports filed by entities of an MNE group, other than the ultimate parent, under the applicable local filing rules could result in multiple and confusing reports of the same MNE group, while overwhelming tax administrations. The guidance elaborated that automatic exchange of a CbCR report filed by the ultimate parent of an MNE group is at the 'heart of the minimum standard' envisioned under BEPS Action Plan 13.

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