

TransPrice Times

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Merck Ltd – Bombay High Court

Outcome: In **favour** of the taxpayer

Category: Quality Adjustment under CUP Method

The taxpayer is engaged in the business of manufacturing, trading and marketing of drugs and pharmaceuticals, having a presence in Healthcare, Life Science and Performance Materials sectors. The taxpayer imported active pharmaceutical ingredient ('API') from its Associated Enterprise ('AE') to manufacture pharmaceutical formulations. The manufactured products were subject to stringent quality control requirements and were demonstrably superior to locally manufactured products in India. The Comparable Uncontrolled Price ('CUP') Method was chosen as the most appropriate method to benchmark the transaction.

The Tax Tribunal allowed the quality adjustments applied in accordance with the Income-tax Rules, 1962 in light of the facts as above. The Tax Tribunal observed that when two companies produce identical products, similar in nature and quote different prices respectively in the open market, then the arm's length price of the could factor in the adjustment in respect of difference due to quality control of the taxpayer's products.

Allcargo Logistics Ltd – Mumbai ITAT

Outcome: In **favour** of the taxpayer

Category: Interest on Share Application Money and Chartered Engineer Valuation Certificate

The taxpayer provides logistic services in the domestic and international markets and primarily operates in multimodal transport

operations ('MTO') and container freight station ('CFS') activities. The taxpayer had purchased two cranes from its AE and benchmarked the same under the CUP Method providing a Chartered Engineer's Valuation Certificate.

The Tax Tribunal observed that the Chartered Engineer's Certificate provided was qualified, though the intermediate authorities held the Certificate as valid. The Tax Tribunal, although agreeing with the Revenue that details of AE's purchase price were unavailable in few cases and instructing to recompute ALP, allowed for giving effect to a 10% depreciation before such re-computation.

Another matter was whether interest should have been received by the taxpayer on the share application money paid to its AE by considering the same as loan, due to non-allotment of shares. The Tax Tribunal ruled in favour of the taxpayer relying on its own ruling in taxpayer's own case of prior years, wherein it was considered that such a deeming of share application money as an international transaction of loan given by the taxpayer to its AE merely because of delay in allotment, is not tenable. The transaction is of subscription of capital and cannot be recharacterized as a loan.

Johnson Matthey India Pvt Ltd – Delhi ITAT

Outcome: In **favour** of the taxpayer

Category: Applicability of penalty in case of adjustment due to change in most appropriate method

The Tribunal opined that it is a settled principle of law that when substantial question of law has been framed by the Tax Court as a result of an appeal filed by the taxpayer challenging the

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addition made by the tax officer and confirmed by the Tax Tribunal, the matter turns debatable and no penalty in such circumstances can be levied. Furthermore, the Tax Tribunal observed that any further transfer pricing adjustment made due to changing the most appropriate method by the tax officer is an outcome of a change of opinion and would not sufficiently invoke the 'concealment of income' penalty provisions.

The Tax Tribunal supported its decision on basis of various co-ordinate bench decisions and concluded the matter in favour of the taxpayer.

Chemtex Global Engineers Pvt Ltd – Mumbai ITAT

Outcome: In **favour** of the taxpayer

Category: Internal vs. External comparison

The taxpayer is engaged in the provision of basic and detailed engineering services to its AE and non-AEs. It used the Internal Transactional Net Margin Method ('Internal TNMM') method to benchmark the said transaction.

The taxpayer proved that the ratio of chargeable hours for the AE and non-AE projects is 76:24, based on the actual man-hours spent for provision of services to the AE and non-AE projects. The results of segmental based on actual employee cost allocation and allocation of other expenses in actual man-hour ratio were provided by the taxpayer.

The tax officer contended that the actual employee cost ratio i.e. 55:45 instead should be considered as an allocation basis for other expenses as well. The taxpayer refuted this point since such an allocation ratio would indeed result in an increase in the profitability of the AE segment.

In the end, the tax officer rejected the Internal TNMM and applied an External TNMM and calculated the arm's length margin and applied it to the entire cost of the taxpayer. The taxpayer contended that such an adjustment by the tax officer should have been restricted only to the AE segment and even if done so, the actual international transaction would be higher than the arm's length value so computed.

The Tax Tribunal appreciated the allocation of employee cost at actuals and validated the calculation and usage of the actual man-hour ratio for other expenses, since a detailed logbook with a record of hours spent project-wise was maintained on a scientific basis for the same, by the taxpayer. Hence, the Tax Tribunal accepted the taxpayer's Internal TNMM calculation. Further, the Tax Tribunal agreed that even if all the expenses are to be allocated on actual employee cost ratio basis as contended by the tax officer, then the same would result in increased margins in the AE segment.

In respect of the application of External TNMM by the tax officer, the Tax Tribunal observed that when internal segmental workings are available, such internal comparability should be preferably taken into account for benchmarking rather than applying external TNMM. The Tax Tribunal relied on the third member decision of co-ordinate Tribunal Third-Member decision in the case of Technimont ICB India. Further, the Tax Tribunal agreed with the taxpayer regarding the restriction of adjustment to AE segment and that the adjustment was not warranted in the instant case even if the External TNMM is applied to the AE segment.

Accordingly, the Tax Tribunal concluded the matter in favour of the taxpayer.

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