

Transfer Pricing Alert

1. Summary of Case Laws

SL. No.	Case Law	Outcome
a.	Ariba Technologies India (P.) Ltd v. Income Tax Officer	Software products companies not comparable with software development services. Companies cannot be rejected for high working capital adjustment.
b.	Bartronics India Ltd v. Deputy Commissioner of Income tax, Circle-1(2), Hyderabad	Corporate guarantee is not international transaction retrospectively. Interest on trade receivables cannot be charged when no such interest is charged with Non AEs.
c.	Benetton India (P.) Ltd v. Deputy Commissioner of Income-tax, Circle 2(1), New Delhi	Payment of software expenses cannot be nil, as assessee was in receipt of services.
d.	Bombay Dyeing & Mfg. Co. Ltd v. Deputy Commissioner of Income-tax, Range 2 (1) (1), Mumbai	Imputed interest cannot be charged when the AE statutorily not required to pay.
e.	Cadence Design Systems (India) (P.) Ltd v. Deputy Commissioner of Income-tax, Circle-3(1), New Delhi	Companies engaged in different functional activities cannot be compared with Software / BPO services.
f.	Cairn India Ltd v. Deputy Commissioner of Income tax, Circle-1(1), Gurgaon	Receipt of services is a separate transaction. However, the same cannot be determined at nil.
g.	D.E. Shaw India Advisory Services (P.) Ltd v. Deputy Commissioner of Income-tax, Circle-7(1), New Delhi	In depth analysis required to consider imputed interest on outstanding receivables.
h.	Kadimi Tool Manufacturing Co. (P.) Ltd v. Deputy Commissioner of Income-tax, Circle- 5 (1), New Delhi	Imputed interest on outstanding receivables not tenable.
i.	Maruti Suzuki India Ltd v. Additional Commissioner of Income-tax, Range-6, New Delhi	Adjustment on AMP expenses and royalty towards brand rejected and relief given to the assessee.
j.	Teva API India (P.) Ltd v. Additional Commissioner of Income-tax, Special Range-9, New Delhi	Companies engaged in similar activity cannot be rejected.
k.	Toyota Kirloskar Motor (P.) Ltd v. Additional Commissioner of Income-tax - LTU, Bengaluru	Separate benchmarking needs to be made for payment of royalty for technology.

Case Laws

a. Ariba Technologies India (P.) Ltd v. Income Tax Officer, Bangalore AY 2009-10 Bangalore Tribunal

Facts of the case:

The company is engaged in providing software development services, cross appeals have been filed by the assessee and the tax authorities against the order of the CIT(A). The assessee contented for the exclusion of the one of the comparable company 'Bodhtree consulting' and inclusion of two additional comparable companies which was rejected by the TPO for high working capital adjustments.

Held

The ITAT considering the rival arguments of the appellant and the department has held as follows:

- a. Bodhtree Consulting to be excluded as the company is mainly engaged in software products;
- b. The ITAT held that comparable companies cannot be rejected on the quantum of working capital adjustments as similar adjustment was made to the assessee and hence remanded the case back to the AO for inclusion.

b. Bartronics India Ltd v. Deputy Commissioner of Income tax, Circle-1(2), Hyderabad – AY 2012-13 Hyderabad ITAT

Facts of the case:

The company was engaged in Software development services and bar coding services, the case was referred to the Transfer Pricing Officer and during the assessment scrutiny, the TPO made the following adjustments:

- a. The TPO considered the Corporate Guarantee as an international transaction and as the assessee has not charged any guarantee commission made adjustment of 2% of the amount for which Corporate Guarantee given;
- b. The company had made certain advances to the AE for investments, the TPO considered that as 'loans and advances' and made adjustments for interest on the said advances given;
- c. The company had outstanding receivables and as the company had not provided the date of receipt the TPO made adjustments considering outstanding for 18 months.

The Assessing Officer while passing the draft order also issued tax demand notice and penalty notice.

The assessee aggrieved by the order appealed before the DRP and also appealed that the Assessing officer order suffered from jurisdiction error as the AO had passed the final order wherein it was required to file the draft assessment order. The DRP provided its directions confirming the order of the Assessing Officer including transfer pricing adjustment.

Held

The assessee aggrieved by the order of the Assessing Officer has filed an appeal before the ITAT, the ITAT has held as follows:

- a. The Assessing Officer has passed the draft assessment order and attaching the tax demand and penalty proceedings is only a procedural defect and hence the order cannot be invalidated for the same;
- b. The ITAT held that the Corporate guarantee given is considered to be an international transaction with amended made vide Finance Act 2012 with retrospective effect from 2002. It was held that the said transaction cannot be an international transactions for the years prior to the amendment as the assessee cannot be made to do which he is not aware;
- c. The ITAT observed that the advances made to the Associated enterprises is towards the investments and not a trade advance and it was also supported in the subsequent year wherein the assessee was allotted shares in respect of the said advance amount. The advances disclosed is as per the requirements in the financial statements and hence it was held that interest on such advances is not tenable;
- d. In respect of interest of trade receivables it was noted that the assessee was not charging any interest on outstanding receivables from Non AEs hence it was concluded that the interest on receivables from AEs is not required.

c. Benetton India (P.) Ltd v. Deputy Commissioner of Income-tax, Circle 2(1), New Delhi – AY 2009-10 Delhi ITAT

Facts of the case

The company is engaged in manufacture and trading of readymade garments. The company had paid royalty and reimbursement of expenses of software costs. The TPO during the assessment proceedings rejected the payment of royalty and software expenses and concluded to be nil and determined the TP adjustment of INR 9 cr. The assessee further appealed before the CIT(A), the CIT(A) provided relief in respect of royalty transactions and not for software expenses.

Held

The ITAT considering the rival arguments held that transactions relating and royalty and software expenses cannot be nil as the assessee was able to provide the substantial details for the said transactions.

d. Bombay Dyeing & Mfg. Co. Ltd v. Deputy Commissioner of Income-tax, Range 2 (1) (1), Mumbai – AY 2012-13 Mumbai Tribunal

Facts of the case:

The company has entered into a Joint venture agreement in Indonesia and the Joint venture had incurred huge losses and subsequently was not in a position to make remittances relating to technical know-how fee to the assessee. The assessee has approached RBI wherein the said payments were converted into shareholder deposits. The TPO during the assessment proceedings has taken the following views and made requisite adjustments accordingly:

- a. The TPO imputed notional interest on the outstanding shareholders fund due from the JV to the Assessee;
- b. The TPO made adjustments for the non-receipt of technical know-how fee;

The assessee aggrieved by the order of the TPO, made an appeal before the DRP, the DRP confirmed the same. The assessee has subsequently appealed before the ITAT.

Held

The ITAT considering the argument has held as follows:

- a. The interest on outstanding share-holders funds was not rejected and it was held that interest on hypothetical transactions cannot be made as the JV is not statutorily not required to pay any interest and the hence the transfer pricing provisions cannot be applied which is not permissible;
- b. As there was significant uncertainty in receiving the technical know-how fee and hence did not represent any income accrued to the assessee. Hence, the said adjustment was tenable.

e. Cadence Design Systems (India) (P.) Ltd v. Deputy Commissioner of Income-tax, Circle-3(1), New Delhi - Delhi Tribunal

Facts of the case:

The company was engaged in software development and IT back office support services. The TPO during the assessment proceedings modified the comparable companies considered by the assessee and considered a fresh set of comparable companies and net margin for software was at 23.45% and for back office support services was at 71.11%. The assessee aggrieved by the order has appealed before the DRP, the DRP excluded few comparable companies and retained the remaining set of comparable companies. The assessee has further appealed before the ITAT.

Held

The ITAT has held as following in respect of the comparable companies:

Software development

- a. Functionally dissimilar – Bodhtree Consulting,
- b. Significant intangibles – Infosys
- c. RPT greater than 25% - Sonata Software
- d. Goldstone Technologies segment data to be considered.

Back office support services

- a. Inorganic growth - Accentia Technologies Ltd
- b. Substantial outsourcing of activity – Cosmic Global Ltd, Coral Hub Ltd
- c. KPO Operations - Eclerx
- d. Microland Ltd and Microgenetics Ltd to be verified and included if necessary.

f. Cairn India Ltd v. Deputy Commissioner of Income tax, Circle-1(1), Gurgaon – AY 2011-12 Delhi Tribunal

Facts of the case

The company was engaged in business of drilling and marketing of minerals, oils and related products. The company was in receipt of services and the same was aggregated with other transactions. The TPO rejected the aggregation approach and determined the value of transactions at nil.

Held

The ITAT observed that approach adopted by the TPO considering the receipt of services as a separate transaction was valid. However, as the company was in receipt of valuable services the determination of arm's length price at nil is not tenable.

g. D.E. Shaw India Advisory Services (P.) Ltd v. Deputy Commissioner of Income-tax, Circle-7(1), New Delhi – AY 2010-11 to 2012-13 Delhi Tribunal

Facts of the case:

The main argument of the assessee was in relation to comparable companies considered by the TPO in arriving at the arm's length price and also the calculation of imputed interest on the outstanding receivables as the TPO has considered as international transactions and rejected the contention of the assessee that once the working capital adjustments are made the same need to be computed.

Held

The ITAT considering the rival arguments has relied on the case of *Kusum Health Care Pvt Ltd*, wherein it is held that there has to be a proper inquiry by the TPO by analysing the statistics over a period of time to discern a pattern which would indicate that vis-à-vis receivables for the supplies made to AE, the arrangement reflected international transaction intended to benefit the AE in some way and also the impact of the working capital of the assessee will also have to be studied. The ITAT in this case directed the TPO to do an in depth analysis of the outstanding receivables before concluding the impact of outstanding receivables.

h. Kadimi Tool Manufacturing Co. (P.) Ltd v. Deputy Commissioner of Income-tax, Circle- 5 (1), New Delhi AY 2010-11 Delhi Tribunal

Facts of the case:

The TPO has made certain adjustments on the outstanding receivables from the group entities. The assessee appealed before the DRP, the DRP confirmed the adjustments. The assessee has further appealed before the ITAT.

Held

The ITAT considering various earlier case laws has held that there is not requirement of transfer pricing adjustments for outstanding receivables.

i. Maruti Suzuki India Ltd v. Additional Commissioner of Income-tax, Range-6, New Delhi AY 2008-09 Delhi Tribunal

Facts of the case:

In this case, the company is engaged in the manufacture of automobile cars and components, the case was referred to the TPO and during the assessment the two main contentions of the TPO was that the company has incurred Advertisement, Marketing and Promotion (AMP) expenses beyond the ratio of expenses of comparable companies in similar activity and the expenses is for the benefit of its AE in Japan. The second main contention of the TPO was that the company has paid royalty for technical know-how and brand, the TPO rejected payment of royalty for brand to the extent of 48% of the total royalty considering the same to be attributable towards brand. Aggrieved by the same the assessee appealed before DRP, the DRP has not provided any relief and hence appeal is before the ITAT.

Held

The ITAT has considered the rival arguments from the assessee's representative and the Departmental representative has held as follows:

a. AMP Expenses: The ITAT placed reliance on various case laws of the assessee and the assessee's own case and concluded as follows:

- To make an adjustment relating to AMP expenses it is required to demonstrate from the revenue authorities that the said transaction is an international transaction;
- The quantum of international transactions itself does not justify that the said transaction is an international transaction for the benefit of AE;
- Bright Line test adopted by the TPO is not a valid method prescribed by the tax regulations;
- The assessee has an economic ownership of the brand towards which the expenses are incurred;
- After considering the expenses the net margin is higher than the comparable companies.

Hence, the said adjustments were deleted.

b. Payment of Royalty on Brand: The ITAT relying on the earlier case of the coordinate bench in the assessee's own case has held as follows:

- The brand for which the payment is made by the assessee is valuable and has significant value;
- If the transacted value is not separately available or cannot be precisely determined from a combined value of royalty paid, then the entire process of determining the ALP fails.

Hence, the said transaction was allowed.

j. Teva API India (P.) Ltd v. Additional Commissioner of Income-tax, Special Range-9, New Delhi AY 2012-13 Delhi Tribunal

Facts of the case:

The assessee was engaged in manufacturing of Active Pharmaceutical Ingredient (API), other intermediaries and bulk drugs and was also providing Contract R&D services for in-house use and for group companies. The R & D Services were compensated with a mark-up of 20% and the margins earned from manufacturing activity were 9%. The TPO during the transfer pricing assessment observed that there were two segments, however the TPO considered single benchmarking for these two major international transactions viz., manufacturing and R & D. The TPO rejected certain comparable companies and considered a fresh set and made transfer pricing adjustments. The assessee appealed before the DRP, the DRP provided certain relief. The assessee has further appealed before the ITAT.

Held

The ITAT considering the rival contentions has held as follows:

- a. Auro Laboratories Ltd was to be included as the comparable company was passing through all the filters applied by the TPO;
- b. Neuland Laboratories Ltd was to be included as the company was functionally similar as was also engaged in the manufacture of bulk drugs and not only APIs.

k. Toyota Kirloskar Motor (P.) Ltd v. Additional Commissioner of Income-tax - LTU, Bengaluru AY 2005-06 Bengaluru Tribunal

Facts of the case:

The assessee was engaged in manufacturing of multi utility vehicles and the case was referred to the TPO, the TPO during the assessment proceedings accepted all the transactions to be at arm's length. However, the payment of royalty made by the assessee to its group companies for usage of technology was disallowed. The assessee appealed before the CIT(A), the CIT(A) accepted the assessee's contention that the company is in receipt of the technology, however directed the TPO to consider the appropriate comparable companies/ transactions for the determining the arm's length price. Both the department and the assessee have filed cross appeals before the ITAT.

Held

The ITAT considering the rival contentions has held that the assessee failed to demonstrate how the payment of royalty was inextricably linked with the other activities of the assessee and has confirmed the order of the CIT(A), wherein the case was remitted to the TPO to arrive at the appropriate comparable transactions.