Nangia Andersen LLP

Communiqué

Your Quarterly TP Tabloid

Issue 4, October - December, 2019

Foreword

At the outset, wishing everyone a very happy and prosperous 2020. New year always brings with itself new hopes and new opportunities. With Union Budget 2020-21 around the corner, the discussions on the Indian economy, the outlook by rating agencies, fiscal deficit, tax rate cuts, budget expectation, etc. are buzzing all over. Also, as we enter the last quarter for FY 2019-20, tax and related matters will again take center stage.

On a personal front, we are delighted to inform you that effective October 17, 2019 we have become full member firm of Andersen Global in India. This clearly demonstrates and reflects the recognition of our professional capabilities and synergies with Andersen Global which will open new doors in professional arena, global experiences, best practices, training and easy reach to our global clients.

Our endeavor in this issue of TP Communique is to highlight key events at India and global level in the area of Transfer Pricing (TP). At India level, the last quarter witnessed some clarifications and amendments on Secondary adjustment and Master File/ Country-by- Country Report. The Central Board of Direct Taxes (CBDT) inked the 300th advance pricing agreements (APAs) and published its third annual report for FY 2018-19 on the APA.

In the Global arena, The OECD - Unified Approach (Pillar 1) and GloBE Proposal (Pillar 2), proposals were released for public consultation. These can have a significant impact on international taxation and can lead to uniform tax approach if agreed to by all countries. Some significant TP rulings and updates in other countries around the world, are included in quarter's issue. Accordingly, towards our objective of being your value-added partners, we discuss the above significant events/ happenings in this quarterly issue as tabulated below:

We hope that our publications are beneficial and help you in understanding the potential impact (if any) of the changes with respect to your business in India. We look forward to your suggestions or feedback that you would like to share with us, at query@nangia.com. Kindly note that information contained within this issue is of general nature and reliance on the same should not be placed without seeking professional advice, especially on litigation matters.

Rakesh Nangia
Chairman,
Nangia Andersen Cosulting Pvt. Ltd

1. Secondary Adjustment Rules Amended

Vide notification dated September 30, 2019, Central Board for Direct Taxes amended Rule 10CB of the Income Tax Rules, 1962 (the Rules), which provides for computation of interest income pursuant to secondary adjustments. The said notification is effective with immediate effect i.e. from AY 2019-20 and onwards. Key changes made are as follows:

- **Time limit for the repatriation of money:**

Particulars	Old Provisions	New Provisions	Remark
Where primary adjustment to TP is determined by an advance pricing agreement (APA)	Shall be on or before ninety days: "from the due date of filing of return under sub-section (1) of section 139 **of Income Tax Act, 1961 ('the Act') ……"**	Shall be on or before ninety days: (a) from the **date of filing of return** under sub-section (1) of section 139 of the Act if the APA has been entered into **on or before the due date of filing of return** for the relevant previous year (b) from the **end of the month in which the APA has been entered** into if the said agreement has been entered into after the **due date of filing of return** for the relevant previous year	In order to provide for a uniform treatment in respect of various situations of primary adjustments as per Section 92CE(1) of the Act, the time limit for repatriation pursuant to secondary adjustment is set as on or before ninety days, in respect of various scenarios.
Where primary adjustment to TP is determined by an Mutual Agreement Procedure (MAP)	Shall be on or before ninety days: **"from the due date of filing of return under sub-section (1) section 139 of the Act ."**	Shall be on or before ninety days: "from the date of giving effect by the Assessing Officer under rule 44H to the resolution arrived at under MAP…."	

- Rule 10CB(2) of the Rules provides computation of the rate of interest to be charged on the excess money which is not repat riated into India within the prescribed time limit of 90 days.
- New sub-rule (3) has been inserted [Rule 10CB(3) of Rules] which provides the chargeability of interest.

Where a primary adjustment to TP	*Time limit of imputation of interest*
Suo motu adjustment in return of income [Rule 10CB(1)(i)] Determined as per an APA if the APA has been entered into on or before the due date of filing of return for the relevant previous year [Rule 10CB(1)(iii)(a)] Made as per Safe Harbour Rules [Rule 10CB(1)(iv)]	From due date of filing return under Section 139(1) of the Act.
Made by the assessing officer and accepted by the taxpayer [Rule 10CB(1)(ii)]	From the date of the order of AO or the appellate authority.
Determined as per an APA if the said agreement has been entered into after the due date of filing of return for the relevant previous year [Rule 10CB(1)(iii)(b)]	From the end of the month in which the APA has been entered into by the taxpayer.
Resulted from a MAP resolution [Rule 10CB(1)(v)]	From the date the resolution is given effect to by the Assessing Officer under Rule 44H of the Rules.

- The rate of exchange for the calculation of the value in rupees of the international transaction denominated in foreign currency shall be the telegraphic transfer buying rate of such currency on the last day of the previous year in which such international transaction was undertaken and the "telegraphic transfer buying rate" shall have the same meaning as provided in Explanation to Rule 26 of the Rules.

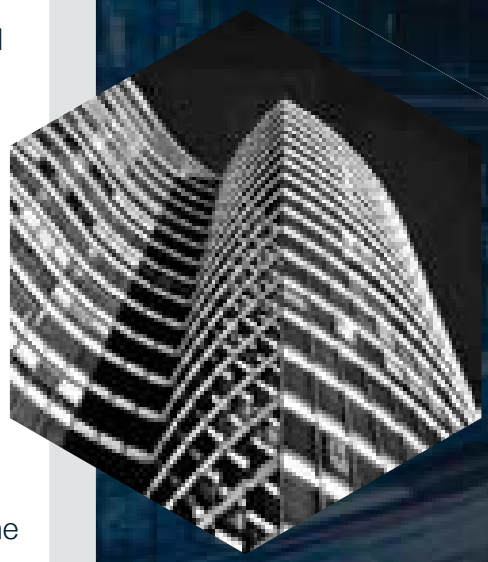
Nangia Andersen's take

The notification was very much required as it puts to rest the ambiguities present in the former rule, and it also provides clarity on aspects not covered under the former rule. This is a significant notification that would help both the tax authorities and taxpayer to avoid unintentional interpretation challenges during compliance that could have given rise to protracted litigation. However, one aspect which require further clarification is on the use of a prescribed rate of exchange for determining the value of international transaction as this would lead to differences from the values of the same transaction in the taxpayer's financial books vis-à-vis that considered form determination of secondary adjustment.

2. APA: The Progress So Far..

September 2019 witnessed CBDT hit a significant landmark of inking 300th as part of the Indian APA Program. In October 2019, CBDT signed the complex bilateral APA with JCB, a UK head quartered heavy equipment manufacturing company, covering technology and trademark royalty transaction. In the said APA, arm's length price for royalty payment was determined through profit split method resulting in step royalty structure for the company.
The Bilateral APA (covering 5 years) was completed in 32 months, making it one of the fastest Bilateral APA resolutions in recent times.

Given the above, CBDT's third annual report for FY 2018-19 that encapsulate the key trends witnessed and interesting insights as the Program gets administered for the seventh year is a useful reference point to encourage taxpayers and tax consultants to keep making use of APAs to reap the benefits of certainty and dispute prevention.



Key Findings in the Annual Report

Some of the interesting findings of the Annual Report are as below:

- The wide adoption of this Program by the Indian taxpayers can be estimated from the number of applications - close to 1,155 applications filed thus far since the launch. Of the 170 applications filed during FY 2018-19, 47 applications were bi-lateral. The reasons for increase in bi-lateral APA (BAPA) application are – successful closure of BAPA by Indian Competent Authority (CA) with CAs of UK, US, Australia, etc., provides relief from double taxation,

India willing to accept BAPA with all treaty partners in the absence of Article 9(2) and the United States (U.S.) CA opening up the Bilateral APA Program (BAPA) between the two countries from February, 2016. The report indicates that the increased intention to go for bilateral route for the afore-said reasons can also be determined from significant trends seen in that filing of BAPA applications has continued to increase in number from previous years and 42 unilateral APA applications have been converted to BAPA applications with almost 85% of total BAPA applications with U.S., United Kingdom (UK), Singapore and Japan.

- At the end of last fiscal year, there were 802 APA applications under process compared with 1,155 filed by end of FY 2018-19.

- The report boosts of 52 signed APAs (41 Unilateral and 11 Bilateral) during FY 2018-19, taking the total APA tally to 271 (240 Unilateral and 31 Bilateral) and with that the CBDT has succeeded in providing certainty for 1,779 years to taxpayers on a cumulative basis (including 477 years covered as part of the roll back option). The report acknowledges that this is the second year when compared to the immediately preceding year this stat has plummeted but, this is attributable largely to increase in complexity of cases handled and shortage of manpower in the APA teams. Compared to its 271 APAs in 6 years, China managed to sign only 156 APAs in the 14 years between 2005 and 2018.

- The report further indicates that average time to conclude 41 Unilateral APAs in FY 2018-19 was 45.22 months (which is more than the combined average time taken in previous 5 years), however it highlights a highly credible achievement that “more than 90% of the unilateral APAs entered into have been concluded within 4 years of the filing of applications and 23% of unilateral APAs have been entered into within 2 years”. But, an area of concern is that 4% of the unilateral APAs could be finalised only after the expiry of the APA term. Even the average time to conclude Bilateral APAs has gone up to 51.82 months in FY 2018-19. These timelines are understandable considering the efforts involved in complex transactions and finding a solution amidst the litigations on many issues.

- The Report indicates that the spectrum of the APA Program be it in terms of methods agreed for analysis, nature of international transactions, location of associated enterprises, industry or types of players in an industry, has significantly increased over the earlier years. Having said this, some aspects that remained in forefront like Transactional Net Margin Method in terms of Methods, Information Technology (IT) / IT Enabled Services (ITeS) services in terms of transaction and industry, and, United States (U.S.) and United Kingdom (UK) in terms of country (of the 41 unilateral APAs entered into in last fiscal, 29 have AE of the Indian applicant based in the U.S., followed by the UK with 17 applications. Further, out of the 11 BAPAs signed with Indian taxpayers, 4 pertained to Japan and 3 to Australia).

- The Report also states that “It is conservatively estimated that the 271 signed APAs have resulted in additional income of about Rs. 10,000 Crore. This translates to a tax payment of about Rs. 3,600 Crore without getting into any litigation or there being any dispute”. This definitely lends credibility to

the Program, which came as a welcome alternative to the protracted litigation for many companies. Though the number of Agreements entered into in FY 2018-19 fell short of what had been achieved in FY 2017-18 and FY 2016-17, but, given the far-reaching benefits of the APA Program the Government is committed to strengthening the programme by providing it with adequate human and physical resources.

Nangia Andersen's take

On an overall basis, the APA Program has indeed matured well over the past seven years with complex issues also now finding a resolution at this forum. It (an alternate dispute resolution mechanism) is one of the major initiatives undertaken by the Government of India in the recent past to herald a non-adversarial regime and certainly the above findings in the report resolves its intent and commitment towards such a regime. Although, as the APA Program now enters a phase of renewals, it would be interesting to see how many companies opt for renewals and the approach adopted by the APA teams for the same.

3. Amendment to Master File and Country-by-Country Report (CbCR)

Recently, CBDT has amended Rule 10DA in relation to the MF and Rule 10DB of the Income Tax Rules, 1962 ("the Rules") with regards to CbCR compliances in India vide Notification No. 03/2020/F No. 370142/19/2019-TPL dated January 6, 2020. The amendment is effective from April 1, 2020, accordingly, the same will be applicable from AY 2020-21. Though the amendments are more on simplification of language used in the provisions, still, there are room for interpretation in few cases which require CBDT's attention.

To read the detailed analysis of this notification, kindly refer our News Flash at below link:

https://bit.ly/2uAmiS5

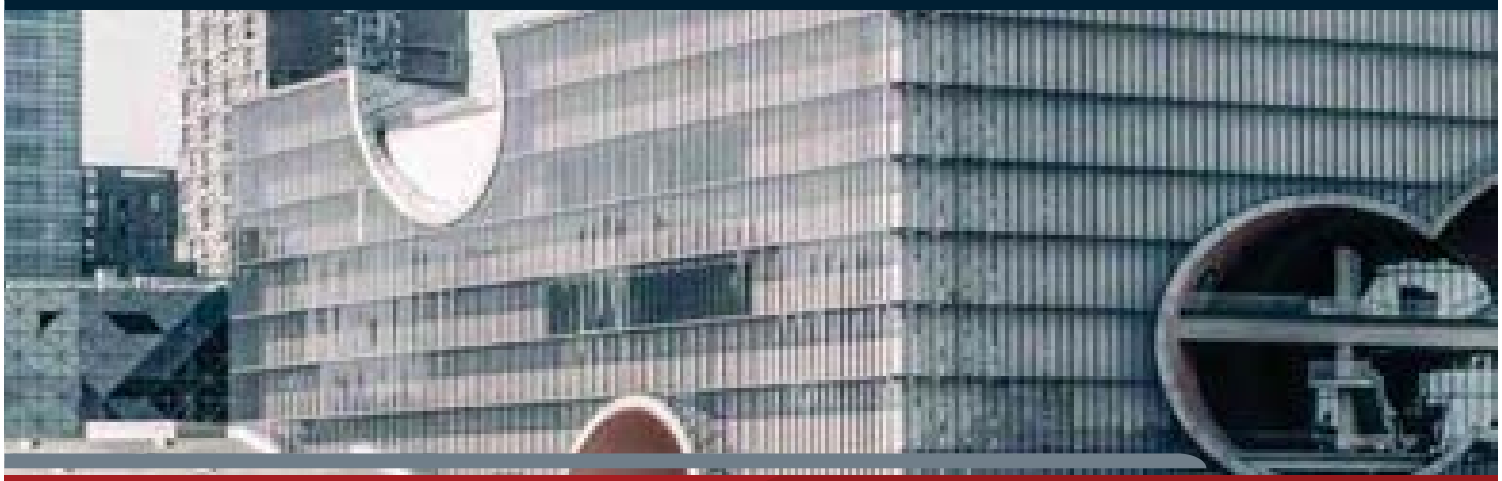
A. Ruling related to reference to APA and Section 10A

1. Dar Al Handasah Consultants (Shair & Partners) India Private Limited vs DCIT – ITA No. - 1413/Pun/2019

Income Tax Appellate Tribunal (ITAT), Pune has accepted the assessee's appeal by ruling that the Assessing Officer (AO) cannot trigger the proviso to Section 92C(4) stating disallowance of deduction u/s 10A in respect of additional income determined by the AO or Transfer Pricing Officer (TPO) u/s 92C(3)/92CA(3) in relation to additional income declared by the assessee in the modified return in respect to international transaction in accordance with signed APA. As the additional income has been computed by assessee in accordance with APA, the scope of AO is restricted to determination of arm's length price (ALP) and nothing more. Further, the Pune ITAT also mentioned that assessment u/s. 92CD, elucidates that the proviso denies deduction only when, first, there is computation of income under sub-Section (4) of Sec 92C/92CA i.e. TP-addition is made by AO, and second, when income total is enhanced because of such computation by virtue of TP-adjustment. However, if any additional income is offered in the modified return by the assessee for complying with the APA, then such additional income cannot be construed as TP-addition made by AO as the same is additional TP income offered by assessee in consonance with the APA which shall be eligible for deduction u/s 10A by virtue of Section 92CD(2).

Nangia Andersen's take

It is clear from the reading of Section 92CD(2) that modified return filed as per the APA provisions should be construed as return filed u/s 139 and accordingly all the other provisions of the Act shall apply to such modified return as it would have applied for return filed u/s 139. Accordingly, Section 92CD(2) empowers the assessee to claim deduction for the TP-additions made in the modified return filed as per the APA provisions. It is imperative to note that the TP-additions made by the assessee in such modified return cannot be construed as TP adjustment made by the TPO/AO, and hence, the AO/TPO cannot disallow the eligible deductions claimed by the assessee in the modified return on the TP-additions suo-moto made by the assessee pursuant to the APA. Further, the other requirement for claiming deduction u/s 10A i.e repatriation of sales proceeds in India in foreign currency within specified period, shall be complied with in cases where the APA have the clause for raising additional invoice for the TP additions and repatriation of the same within period mentioned under APA which most likely will be lesser than the period specified u/s 10A i.e. within 6 months or such further period the competent authority may allow.



2. DCIT vs Festo India Private Limited – ITA No. - 969, 1028/B/2014 & 209(B)/2015, CO No.74(B)/2017

Bangalore ITAT has partly ruled in favour of the assessee by agreeing that if the nature of international transaction entered by assessee with its Associated Enterprise ("AE") for relevant assessment year are identical to the nature of international transaction covered under APA then the issue for the relevant assessment year can be resolved in line with the terms and conditionof APA even though no rollback provision for year under consideration was entered into. However, Bangalore ITAT remit the issue to TPO/AO for verification of FAR analysis for year under consideration and for years APA entered into. Bangalore ITAT has relied on various judicial precedents for arriving at the conclusion.

Nangia Andersen's take

The APA may be applied to AY's not falling under the APA period (including roll back) only if international transaction(s) are of same nature and FAR analysis are materially in line as documented in the APA i.e. international transaction must be identical in terms of functions performed and risks assumed.

3. Doshi Accounting Services Private Limited vs DCIT – ITA No. - 1352/Ahd/2011, 1285/Ahd/2012, 1822 & 1874/Ahd/2014

Ahmedabad ITAT has rejected the arguments of assessee by stating that provision of Transfer Pricing covered under Chapter X of the Act shall be invoked for assessee registered u/s 10A of the Act by referring to the proviso contained u/s 92C(4). Furthermore, the intention to introduce Section 10A was to bring foreign exchange in India and if the transaction are not determined under arm's length price, then Indian entity will not be able to bring the higher foreign exchange in India and the very purpose of inserting Section 10A will stand defeated. Also, Ahmedabad ITAT considered that assessee can manipulate ALP by claiming exemption u/s 10A thereby shifting dividend in the form of profit and thus escaping Dividend Distribution Tax u/s 115-O of the Act which might be the reason to inserting proviso to Section 92C(4).

Nangia Andersen's take

Proviso contained to Section 92C(4) gives us the impression of the lawmaker intention that Transfer Pricing provision shall be applicable to all international transaction covered u/s 92 of the Act, irrespective of whether the said transaction qualifies u/s 10A of the Act. The purpose of Indian transfer pricing regulations is to be regulate the transactions entered into between unrelated parties and verify whether the same are conducted at arm's length price irrespective of whether such income will be taxed or not.

B. Ruling related to penalty proceedings

4. Juvalia Sales Private Limited vs ACIT –ITA No. - 7201 & 7202/Del/2018

Delhi ITAT has ruled in favour of the assessee by accepting the arguments of the assessee with regards to belated filing of form 3CEB and thereby quashing the penalty order passed by the AO u/s 271AA and 271BA. The ITAT was of the view that the TPO has passed an order based on such belated filed Form 3CEB and the AO completed its assessment u/s 143(3) accordingly, thereby, indicating that at the time of passing of order by the TPO all the requisite documents were available to complete the assessment and also no adverse remark was made by the TPO in its order regarding the document and its maintenance. Further, ITAT also observed that no intention of dishonesty was present on the part of the assessee for filing belated form 3CEB. Delhi ITAT has followed the previous judicial ruling having similar circumstances.

Nangia Andersen's take

No penalty should be imposed by the AO on technical or pardonable breach of provision of the Act. In cases where the breach is immaterial to the assessment proceedings, a cautious call needs to be taken by the AO whether to initiate penalty proceedings considering the conduct of the assessee during the assessment proceedings along with the information/documents provided by the assessee to the AO/TPO. Initiating penalty proceedings for trivial issues would only lead to protracted litigation.

5. Sitel India Limited vs DCIT – ITA No. – 1675/Mum/2013

Mumbai ITAT has ruled in favour of the assessee by stating that explanation 7 of Section 271(1)(c) requires that penalty cannot be imposed if arm's length price is computed in accordance with provision of Section 92C with due diligence and good faith. However, the onus is on the assessee to prove that the transfer pricing documentation is in compliance with Section 92C and further the same is prepared with due diligence and good faith. Accordingly, based on materials on record if it is implied that there is no dispute between the assessee and the TPO/AO regarding the compliance of Section 92C then the AO should not initiate penalty proceedings on mere difference of filters and comparable used by the assessee in TP study and TPO in TP order until and unless due diligence and good faith from assessee is compromised and the same is documented in the penalty order passed by the AO.

Further, inclusion of new set of comparable companies by the TPO cannot be regarded as contravention of provision of Section 271(1)(c). Mumbai ITAT has also relied on previous judicial proceeding in reaching at the conclusion.

Nangia Andersen's take

Term Good faith & Due diligence has not been defined in the Act or Rules, however as per General Clause Act and jurisprudence available on this, term good faith & due diligence means act done with honesty & proper care. Accordingly, act done by assessee without involving dishonesty cannot attract penalty. It is important to note that an incorrect claim in law cannot be tantamount to furnishing incorrect particulars. Also, economic analysis is very subjective in nature as far as Indian transfer pricing regulation is concerned as there is no clear cut provisions for use of filters, etc., while carrying out economic analysis and only available guidance is under Rule 10B(2) and Rule 10B(3). Accordingly, inclusion of new set of comparable companies by the TPO based on different filters and additional criteria's cannot be regarded as contravention of provision of Section 92C which will attract penalty provision u/s 271(1)(c).

C. Other

6. ADIT vs. The Hongkong and Shanghai Banking Corporation Limited – ITA No. - ITA No.3857/Mum/2006 & ITA No.4565/Mum/2009 , ITA No.3401/Mum/2006 & ITA No.3996/-Mum/2009

Mumbai ITAT has accepted the arguments raised by the assessee and holds that no mark-up should be charged on the attribution of costs towards incidental marketing activities undertaken by the assessee in connection with the said activities as they are reciprocal in nature. The ITAT observed that assessee received similar services (marketing support services) and benefits from the overseas HSBC branches and states that assessee and the overseas HSBC offices being a part of the HSBC group derived reciprocal benefits and thus the non-charging of costs for providing the incidental marketing support services to overseas HSBC entities would not cause any prejudice to the interest of the assessee as well as the revenue. The ITAT also mentions that incase the TPO had accepted the main transaction i.e. banking transaction, of the assessee at ALP the incidental activities pertaining to that main transaction cannot be separated as non-routine functions and benchmarked independently. The ITAT of Mumbai has relied on various judicial precedents to upheld assessee contentions.

Nangia Andersen's take

In cases where the group entities are providing services to each other of similar nature and the entities are deriving benefit out of that, then no cross charge with mark-up is warranted as all the entities fall part of global conglomerate and are benefitting from such reciprocal services of similar nature. Further, in cases where the main transaction is at ALP, then the incidental transactions which are closely linked to the main transactions cannot be benchmarked on separate basis as without the existence of the main transaction the incidental transactions will not exist.

7. DCIT vs Verizon Data Services Private Limited – ITA No. – 3090/CHNY/2017

Chennai ITAT agreed with the appeal of the Revenue and held that interest on delayed realization on receivables is a separate international transaction and requires separate benchmarking irrespective of assesee's operation being carried on with debt free fund. The Chennai ITAT relied on the explanation inserted to Section 92B vide Finance Act, 2012 where expression of International Transaction includes capital financing in the form of any other debt arising during the course of business. Further, the Chennai ITAT dismissed the contention of the assessee that the Working Capital Adjustment (WCA) will subsume the delay in receivables by stating that WCA is confined to principal international transaction and not on transaction in relation to interest on delayed realization of receivables.

Nangia Andersen's take

The expression 'debt arising during the course of business' as per Section 92B will include delayed realization of receivables from the sale/purchase of goods or services with AEs and hence any interest on such delayed realization will fall under the definition of international transaction. Further, it is irrelevant whether the assessee is debt-free assessee or not as the transfer pricing regulations of India do not exclude such assessee from the purview of Section 92B. However, there are judicial precedents at ITAT, HC and SC level where the contrary view has been taken and outstanding receivables form AE is not treated as a separate international transaction.

8. Samsung India Electronics Private Limited vs ACIT – ITA No. 3248, 3410/DEL/2012, 5856/Del/2010, 5315/Del/2011,52/Del/2013, 1567/Del/2014, 6741/Del/2014, 868/Del/2016 & 2511/Del/2018

Delhi ITAT agreed with the appeal of the assessee and held that Advertisement, Marketing and Promotion ("AMP") expenditure incurred by the assessee beyond the reimbursement from its AE under Marketing Development Fund agreement will be considered as International Transaction only if the revenue can demonstrate that there exist an agreement, arrangement or action in concert between Associated Enterprises and such expenditure is incurred not on behest of Indian entity but on the volition of foreign entity. Further, Delhi ITAT has rejected Bright Line Test (BLT) approach as untenable in law not only for AMP transaction with AE but for any other international transactions. Furthermore, ITAT has rejected the Revenue's approach of segregation of individual item of AMP for separate benchmarking in case Transactional Net Margin Method (TNMM) is applied on entity level as net margins in TNMM are arrived after considering the entire operating expenditure which includes AMP. Also, ITAT declare that brand building cannot directly relate to AMP expenditure particularly for licensed manufacturer bearing full risk and reward. The Delhi ITAT relied on various judicial precedents to allow the appeal in favour of the assessee.is confined to principal international transaction and not on transaction in relation to interest on delayed realization of receivables.

Nangia Andersen's take

For transaction to fall under the ambit of Section 92 of the Act, there must be an agreement, arrangement or action in concert and not any unilateral action on part of one party not having corresponding binding obligation on the other. Accordingly, until and unless there is any agreement or arrangement between the related parties to incur AMP expenses, the AMP expenses cannot be put under scanner by the revenue authorities. Further, the BLT has be a big failure to arrive at the arm's length price and the same is reiterated in the above case law. Many judicial precedents in the recent times has deleted AMP expenses incurred by the Indian subsidiaries considering such expenses to be incurred by the assessee for their own benefit.

9. TCG Digital Solutions Private Limited vs ITO – ITA No. - 1571/Kol/2016

Kolkata ITAT has given its judgement in the favour of the assessee by stating that the revenue cannot reject assessee's plea of considering its foreign-AE as the tested party on the ground that assessee and its AE has different financial year ending as the source of identifying the tested party depends on FAR analysis and not on financial data. The Kolkata ITAT was of the view that for selection of tested party it is important that the AE is bearing none or moderate risk and should be least complex. Accordingly, if the foreign AE is a least complex entity with none or moderate risk then the same should be considered as tested party instead of the Indian entity which is bearing high risk with more complexity. Further, the Kolkata ITAT also mentioned that the assessee can change the tested party at later stage if the same can produce better or more appropriate ALP results. The Kolkata ITAT relied on various judicial precedents to allow the appeal of the assessee.

Nangia Andersen's take

The foreign AE can be selected as tested party in case where the functions performed by the foreign AE is less complex and bears none or moderate risk. Also, selection of tested party is based on factors such as least complex entity, availability of data of tested party, availability of comparables and their data, etc.

10. Global One India Private Limited vs DCIT – ITA No. – 1980/Del/2014

Delhi ITAT has confirmed the appeal of the assessee by ruling that the final assessment order passed by the AO without incorporating the directions given by the DRP u/s 144C is null and void. Further the Delhi ITAT has highlighted that the rectification order passed by the AO suo-moto u/s 154 incorporating the directions of DRP to show a valid assessment order does not stand good as the assessment order passed by the AO by not incorporating DRP direction is on deliberation and not by mistake. Accordingly, the Delhi ITAT quashed the assessment order passed by AO.

Nangia Andersen's take

Any direction issue by the DRP u/s 144C is mandatory and not optional on the part of the AO to incorporate such directions while passing the final assessment order u/s 143(3). Further, it is imperative on the part of AO to consider all the direction of the DRP even if the TPO has not incorporated the same in the order. Also, for rectification order to stand valid, there should be a mistake apparent from record and deliberation cannot be termed as mistake.

11. Essilor India Private Limited vs ACIT – Writ petition No. 43994/2019

Karnataka High Court ("HC") has disposed of writ petition in favour of the assessee on the ground that the AO has not acted per the law in referring the matter to the files of the TPO for making transfer pricing adjustment without addressing the preliminary objection raised by the assessee in reply to notice u/s 148 wherein the assessee has questioned the jurisdiction of the AO to reopen the case u/s 147. The HC believe that AO has acted premature and has not applied his mind before referring the matter to the TPO. Accordingly, the HC quashed the order passed by the TPO u/s 92CA subsequent to such reference as the same is not in line with the provisions laid down.

Nangia Andersen's take

In cases involving income escaping assessment u/s 147, it is important to note the AO is obligated to address all the objections submitted by the assessee in reply to notice issued u/s 148 and pass an order accordingly before making any references to the TPO for transfer pricing matters.

D. Power of Commissioner of Income Tax ("CIT") to invoke Section 263

12. Eveready Industries India Limited vs PCIT – ITA No. - 805/Kol/2019

Kolkata ITAT has concord with the grounds of appeal of the assessee by setting aside reason of issuing Show Cause Notice ("SCN") exercising revisional jurisdiction power u/s 263 of the Act by the CIT on the wrong presumption that assessee case was selected by CASS on a Transfer Pricing risk parameter where on contrary the CASS reason merely claimed the mismatch of amount paid to related party u/s 40A(2)(b) as reflected in Income Tax Return ("ITR") and tax audit report.
The Kolkata ITAT rejected the Principal CIT inference that the CASS parameter of mismatch of amount paid to related party constitutes 'transfer pricing risk parameter's so as to warrant mandatory reference u/s 92CA in terms of the Para 3.2 of CBDT Instruction No. 3 of 2016.
Accordingly, the Kolkata ITAT quashed the impugned revisional order issued on the ground of complete scrutiny for reference to the TPO being contrary to instruction 3 of CBDT of 2016.

Nangia Andersen's take

As per Para 3.3 of instruction 3 of CBDT of 2016, the reference u/s 92CA by the Principal CIT shall be mandatory in cases where transactions constitute transfer pricing risk parameter.

A. Global developments

Brazil issues report on convergence of its TP framework with OECD

OECD conducted a 15 month work programme with Receita Federal do Brasil (RFB) in 3 stages namely preliminary analysis of the legal and administrative framework of Brazil's TP rules, assessment of the strength and weaknesses of Brazil's existing TP rules and options for alignment with the OECD TP standards while enhancing the positive attributes of the existing framework. The preliminary analysis revealed certain weaknesses in Brazil's framework that results in BEPS and double taxation, which are on account of the absence of adherence to arm's length principles (i.e. use of fixed margin returns), absence of transactional profit methods (i.e. TNMM and PSM), absence of special considerations for specific transactions (such as business restructuring, intangibles, CCAs, etc.), freedom of choice in selection of method instead of most appropriate method, etc. For detailed report refer link below:

Netherlands

Netherlands authorities published its first redacted summaries of tax ruling issued to MNE groups. This has been done to provide the transparency of what types of rulings the tax authorities has concluded. Summary outlines 10+ advance pricing agreements and 50+ advance tax rulings. Summary has been published to provide transparency on the types of ruling requests the Dutch tax authorities have concluded. It also encompasses situations where no ruling was granted either on account of withdrawal by taxpayers (to avoid administrative burden or their inability to meet the minimum economic nexus) or rejection by the tax authorities on account of transaction with an AE residing in a low tax jurisdiction.

European Union's proposal for making CbCr information public - Not accepted by majority

On 28 November 2019, EU Competitiveness Council (COMPET) held a meeting to decide whether tax and financial information contained in CbCr should be made available to public. In order to pass this majority, favorable votes of 16 out of 28 current EU member states was required. However, only 14 members voted in favor and 12 members voted against the proposal. Moreover, Germany abstained from voting and United Kingdom failed to vote. So, the proposal was not accepted by the majority.

Thailand

On 18 November 2019, Thailand revenue department published TP disclosure form. All the taxpayers with revenue of THB200 million (US$ 6.6 million) or more shall be obliged to file disclosure form.

Philippines

Philippines issued guidelines relating to TP audits of the taxpayers who undertakes related party transactions (RPT) including cross-border transaction, domestic transaction and intracompany transaction in cases where a company has activities taxable under different rates; transactions undertaken by PEs, business restructuring and cost contribution arrangements. Three phase procedures undertaken by tax authorities for the TP audit namely preparation (i.e. gathering information on RPT), implementation (i.e. conducting arm's length analysis of RPT) and reporting (i.e. issuing written report after discussing audit findings with taxpayer).

Argentina

On 2 October 2019, Argentina's tax authority issued proposed guidance for public consultation, with significant changes in the TP laws for the local taxpayer, proposed to be effective for fiscal year beginning from 31 December 2018 to 31 May 2019. This includes selection of Foreign AE as tested party, use of accounting books (adjusted by inflation) instead of fiscal books (historical number) for TP analysis and introduction of benefit test for intragroup transactions. Further, use of credit rating of group is proposed to determine arm's length price of financial transaction, and need for explaining development, enhancement, maintenance, protection and exploitation of intangibles (i.e. DEMPE functions) in TP study. Threshold has been proposed for mandating the preparation of TP documentation and master file.

Draft toolkit for TP-documentation

In a joint initiative by International Monetary Fund, OECD, United Nations and World Bank, a draft "toolkit" has been released which provides help to the developing countries in designing its TP documentation rules. Purpose of this toolkit is to find out a right balance between what tax authorities requires with avoiding excessive compliance cost. For detailed report on draft update refer link below:

OECD - Unified Approach (Pillar 1)

In October 2019, OECD released a proposal on Pillar 1 for ongoing project titled "Addressing the Tax Challenges of the Digitalisation of the Economy". The proposal provides for the allocation of taxing right to the market jurisdiction irrespective of business residence or location. Further, it outlines three-tier mechanism:

- **Amount A** : the deemed residual (non-routine) profit allocated to market jurisdictions;
- **Amount B** : a fixed return for baseline marketing and distribution activities in market jurisdictions, which is based on arm's length principle;
- **Amount C** : where the market jurisdiction establishes that with respect to binding and effective dispute prevention, more functions pertains to this jurisdiction as compared to what has been considered for evaluating Amount B, and therefore additional amount has to be calculated for tax levy.

Further, proposal provides that entities over and above the threshold limit (potentially €750 million, US $834 million global revenue) would be impacted from this approach.

OECD - GloBE Proposal (Pillar 2)

In November 2019, OECD released public consultation document on Global Anti-Base Erosion under Pillar 2 for project titled "Addressing the Tax Challenges of the Digitalisation of the Economy".
Under this proposal, a set of global minimum tax rules has been developed in order to ensure that profits earned by the businesses operating globally should be subject to at least minimum rate of tax.

Further, it outlines four components which are as follows:

- An income inclusion rule - tax the income of foreign branch if that income has been taxed at rate which is below the minimum rate of tax;
- An undertaxed payments rule - under this there will be either denial of deduction or application of source based tax on the payment being made to related party, which are not subject to tax at or above minimum tax rate;
- A switch-over rule - rule that will permit resident jurisdiction to switch from exemption to a credit method in respect of profits attributable to a permanent establishment (PE) or derived from immovable property (which is not part of a PE), which are liable to tax rate below the minimum rate of tax;
- A subject to tax rule - to complement the undertaxed payment rule.

Shell Plc published its CbCR (filed in 2018), India's Contribution Stands Out

In FY 2018, Shell Plc published its CbC report for the FY 2018, taking a step towards more transparency. Shell reported that the highest revenue from operations has been earned from USA amounts to $ 191 billion followed by Singapore and UK i.e. $ 143 billion and $ 108 billion respectively. Taxes paid in these jurisdiction were around $ 251 million in USA, $ 8.3 million in Singapore and tax loss of $ 115 million in UK. Further, countries that received the highest taxes were Oman which amounts to $ 3.3 billion followed by Nigeria which received $ 1.3 billion and Norway around $ 1 billion. As far as India is concerned, report outlines that the revenue earned and taxes paid from India jurisdiction amounts to $ 1.5 billion and $ 23 million, respectively.

Shell's Report on country wise tax details for FY 2018 can be viewed at link below:

https://go.shell.com/2t5TeS4

B. Tax Rulings

i. Israeli Court rules in favour of Broadcom Corporation on Business restructuring case

Facts:

On 9 December 2019, Israel published its favourable ruling in case of Broadcom Semiconductor Ltd. (Company), which acquired Dune companies (engaged in the development, production, and supply of fast switches and router components) in November 2009. Post-acquisition, the Company changed its business model from an entrepreneurial entity to an entity providing cost plus services and entering into license agreements with its affiliates. The Israeli Tax Authority (ITA) contended that the change in business model implied recharacterisation of transaction i.e. sale of functions, assets and risks (FAR). The Company claimed that there was no sale of FAR and there was no restriction on commercializing its IP, through granting a license to use it; while providing R&D services to another related company that led to the development of new IP, based on the "old" IP it possessed (and licensed to another). The Company also placed on record that through the inter-company transactions, it has increased the volume of its activities, revenues, profits and headcount.

Findings:

Based on the above facts the court concluded that the Company did not sell any FAR to Broadcom US or any other AEs and the economic as well as commercial considerations can justify a change in Company's business model. Further, the Court held that if there were no material indication that the change of business model reflected a different transaction than the one presented by the parties, there should be no room for involvement of the ITA in the recharacterisation of the transaction, but only in the pricing of it based on TP rules.

ii. Hornbach- Baumarkt AG-German Court's ruling on guarantee arrangements

Facts:

Hornbach-Baumarkt AG, company incorporated in Germany, holds 100% shareholding in two Dutch companies namely, Hornbach Real Estate Groningen BV (HREG) and Hornbach Real Estate Wateringen BV (HREW), extended Letter of Comfort (LoC) to the Dutch banks, without any charge, in order to provide finance to these companies.

Tax officer, basis the provision of German External Tax Relations Act (AStG), made an upward adjustment in German Company's profits and held that if Hornbach-Baumarkt AG extend similar LoC to any unrelated third parties then it would have received certain fee for the benefit extended.
Tax payer put forward its arguments that the provision of AStG would not have been applied if the similar arrangement been entered with some domestic subsidiary.

Findings:

Court passed its ruling in the case of Hornbach- Baumarkt AG, wherein the matter is left to the national courts to decide whether the legislation at issue in the proceedings allows the taxpayers to prove that being shareholder of the non-resident company, it entered into arrangement which were agreed for commercial reasons only and therefore does not warrant any charge. Further, it held that extending these benefits to the non-resident subsidiaries would undermine the balance of allocation of power to tax whereas in case of resident subsidiaries such transaction would have been taxed which would restore the balance.

iii. Denmark Ruling on royalty

National Tax Tribunal of Denmark passed its ruling in the case of Danish Company wherein court deleted interest liability being imputed by SKAT (tax administration in Denmark) on account of re-characterising outstanding royalty receivable from its AE (a Venezuela based company) as loans provided to its AE.

Court held that non-recovery of royalty payment by Danish company from its AE due to unforeseen restrictions being imposed by Govt. of Venezuela is squarely covered under the force-majeure clause of inter-company agreement; wherein the payer is exempt from its liability/ performance of its duties under such agreement

Key Highlights

- Inter-company agreement, being the starting point of any intra-group transactions, plays a vital role in tax/ TP audits since the agreements are used by tax authorities to delineate the responsibilities, risks and anticipated outcomes between the group companies as provided in OECD Guidelines as well;
- Prepare contemporaneously and review periodically the rights and obligations of the parties in an inter-company agreement, taking into consideration the commercial, regulatory, legal and other key practical aspects.

iv. Eaton Corporation & Subsidiaries-US tax ruling

Eaton Corporation entered into an APA, being effective from 2001 to 2005, which was further renewed for 2006 to 2010 tax years as well. Later, Assessee determined that there was certain error in the APA TP methodology adopted in the APA and to rectify the same Assessee amended its return. However, IRS canceled both the APAs on the ground that Assessee did not comply in good faith with the terms and conditions. As a consequence of cancellation, IRS made TP adjustment u/s 482 along with penalty initiation u/s 6662.

Findings:

US court deleted penalty u/s 6662 levied by IRS on account TP adjustment being made due to impugned cancellation of APAs. Court held that the cancellation of APAs was an abuse of discretion and since no adjustments were made u/s 482, therefore Assessee is not liable for penalties.

Key Highlights

- Court held that if APA was effective, then no TP adjustments should be made u/s 482; consequently, no penalty should be levied u/s 6662.
- In order to exercise the power to cancel APA, IRS has the onus to prove the reasonability of its actions. Mere abuse of discretion is not tenable.

About Us

Nangia Andersen LLP is a premier professional services organization offering a diverse range of Entry strategy, Taxation, Accounting & Compliances and Transaction Advisory services. We are an Andersen Global tax consulting and Advisory firm in India. As a part of Andersen Global we have reach to more than 172 offices globally having presence in more than 71 countries. In India, Nangia Andersen LLP has a PAN-India coverage with offices in Noida, Delhi, Gurugram, Mumbai, Dehradun, Bengaluru, Chennai and Pune. Nangia Group has been in existence for around 40 years and has been consistently rated as one of the best tax and regulatory advisors in India.

Quality of our people is the cornerstone of our ability to serve our clients. For this reason, we invest tremendous resources in identifying exceptional people, developing their skills, and creating an environment that fosters their growth as leaders. From our newest staff members through senior partners, exceptional client service represents a dedication to going above and beyond expectations in every working relationship.

We strive to develop a detailed understanding of our clients' business and industry sector to offer insights on market developments and assist our clients develop effective strategies and business models. We have the resources and experience necessary to anticipate and competently serve our clients on issues pertaining to all facets of Tax and Transaction Advisory. We take pride in our ability to provide definite advice to our clients with the shortest turnaround time. The business and tax landscapes have changed dramatically , and the pace and complexity of change continues to increase. We can assist you navigate this shifting landscape.

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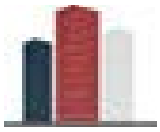

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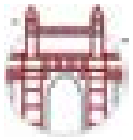

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