

Nangia Andersen LLP

Communiqué

Your Quarterly TP Tabloid

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A member firm of **ANDERSEN GLOBAL**



Foreword

In this phase of global public health emergency and the accompanying unprecedented challenges created by the COVID-19 pandemic, we send our best wishes for everyone's good health and well-being. Amidst the global spread of this pandemic, the outlook on the global economic growth is dramatically downgraded, wherein the International Monetary Fund has projected the global economy to contract sharply by 3 percent in 2020, which is much worse than during the 2008–09 financial crisis and is being compared to the great depression in 1929.

Meanwhile, we have come up with this quarterly issue with an endeavour to keep you updated with the current developments in the Transfer Pricing (TP) landscape at both Indian and global fronts.

At India level, at the outset, we have discussed how Multi-National Enterprises (MNEs) need to acclimatise to the fast-evolving business environment due to COVID-19 - a topic that is being hotly debated in every virtual board room today. Further, key developments in last quarter, like Budget 2020 pronouncements and enactments, Frequently Asked Questions (FAQs) issued on the Vivad se Vishwas Scheme (VsVs) by Central Board of Direct Taxes (CBDT) related to TP and progress that traditional dispute resolution mechanisms have seen recently have been detailed. We have also discussed significant Indian rulings pronounced in this quarter.

At global level, significant TP centric news and rulings across the globe such as Organisation for Economic Co-operation and Development's (OECD) release of the landmark Final Report (the Report) on Financial Transactions (FTs), Canada Revenue Agency's (CRA) publication of 2018 Mutual Agreement Program (MAP) statistics, Automatic Exchange of Information Peer Review Group (APRG) publication of 2019 implementation report, Swedish Tax Agency's pronouncement in the case of Puma Nordic AB, have been discussed in this 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:

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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.

Wishing everyone safe and healthy days ahead.

Rakesh Nangia
Chairman,
Nangia Andersen Consulting Pvt. Ltd



India Updates

▪ **Acclimatizing TP of MNEs to COVID-19 Environment!**

Everyone is praying to God to reload 2020 as the current version has virus in it! The onset of new decade received a deadly blow with COVID-19 pandemic which has disrupted the entire socio-economic landscape world-over in no time. The domino effect of the lockdowns and crisis management measures by all countries have put all economies and financial markets in a black hole situation.

With the increase in globalization, integration of world trade, dilution of geographical boundaries, work on the go and emergence of new business models, the MNE's have restructured and modified their operating structures in a way to ensure decentralization and distribution of functions across geographies. Functions like product design/ intellectual property management, procurement functions are typically housed in a centralized entity while other members of the MNE group may perform contract manufacturing, contract research and development services and routine sales and distribution activities in different geographies. In this integrated and inter-dependent world, cross border TP transactions among group entities have a far-reaching impact on the global economy, MNE operations, financial flows as well as each country's tax ecosystems.

The measures taken by various governments to control this pandemic (including nationwide lockdowns) has created significant business disruptions impacting liquidity, organizations supply chain operations, cross border and in-border restrictions on movement of people creating demand and supply imbalances, and deep dent in output and consumption.

From TP perspective, this has an immediate impact as organizations would now need to quickly and closely look into some of the critical elements from short, medium and long-term strategy perspective.

While liquidity, operationalization of supply chain especially the manufacturing units and sustainability remain the immediate focus, Groups will also have to re-look at the existing modus operandi and acclimatize its TP policy and design to the post COVID-19 environment.

Accordingly, the key TP related aspects which MNE group and its members will have to evaluate for its business operations in light of the current business environment are existing supply chain redesign, impact assessment for intra-group FTs, global TP policy redesign, revision/ termination of inter-company agreements, re-evaluation of Advance Pricing Agreements (APA) option, analysis of Permanent Establishment Risk arising from virtual working and E-decisions made by key personnel from remote locations and impact on TP documentation and re-looking entity level profitability.

As the world weathers through the COVID-19 storm, MNEs should proactively and at an early stage undertake detailed analysis, create business conversion documentation package and positions in a holistic manner and implement the same on a timely basis in its compliance requirements globally. All businesses would need to bite the bullet and brace themselves for the times ahead.

In this regard, we have discussed the above key TP implications in an article published on April 6,2020 on Taxutra website. To read the full article, click on the below link:

<https://tp.taxsutra.com/experts/column?sid=565>

Further, we have discussed in detail on adapting TP policies in Response to COVID-19 in a flyer which can be accessed through the link stated below:

<https://bit.ly/3aXWRsR>

▪ Budget 2020 – The TP Facets!

The Hon'ble Finance Minister, Nirmala Sitharaman, on February 1, 2020, presented the first budget of the decade, aspiring a 5 trillion dollar economy by 2025. However, amidst the Covid-19 pandemic, the worldwide economies being dragged into a phase of recession, it is hard to see this aspiration coming true by 2025.

Nonetheless, focused on growth, ease of compliances, reduction in litigation and rationalization and simplification of tax structures, the finance bill received Presidential assent on March 27, 2020 and has been enacted as Finance Act, 2020.

Below are the major TP centric amendments under the Income Tax Act, 1961 (the Act):

- APA and Safe Harbour Rules to Allow Certainty for Attribution of Profits to Permanent Establishment;
- Antedating of Due Date for Certain TP Compliances; and
- Rationalisation of Interest Deduction Limitation u/s 94B of the Act.

All the above seem to be welcome move of Indian government considering the need of the hour and implication of these amendments to the Indian tax regime. These amendments and their impact analysis have been discussed in detail in our budget statement for 2020 which can be accessed via the below link:

<https://bit.ly/2VSIxyF>

▪ CBDT Issues FAQs on VsVs

A plethora of cases amounting to INR 9.32 lakh crores worth of tax disputes are pending before various income tax forums and courts. Consequently, the Government, while presenting the Budget of 2020 announced a dispute resolution scheme "VsVs", which offers complete waiver of interest and penalty if the taxpayer makes a declaration and discharges the disputed tax liability within the prescribed time limits. On 4 March 2020, the CBDT issued 55 FAQs on the VsVs. The FAQs contain clarifications on scope, eligibility, calculation of disputed tax, procedure related to payment of disputed tax and consequential benefits to the declarant. One of the clarifications is that that provisions of secondary adjustment u/s 92CE of the Act would apply to taxpayers availing the settlement under the scheme while highlighting that primary adjustments for AY 2016-17 or earlier AYs are not subjected to secondary adjustment provisions. Accordingly, taxpayers evaluating to settle TP matter under this scheme need to be mindful of taking this factor into consideration in their decision making process as the scheme has now received presidential assent and notified on March 17, 2020. The rules and forms notified under the scheme can be accessed via the below link:

<https://bit.ly/2xo5xuY>



▪ RoadMap of Traditional Dispute Resolution Mechanisms in India Thusfar

CBDT published International Tax Bulletin for the month of January 2020 wherein it was informed that the a two-member delegation of the State Secretariat of International Finance, Switzerland visited India and the meeting from 7th to 9th January, 2020 resulted in resolution of 1 bilateral APA case and 7 MAP cases. Further, India also hosted a 5-member Her Majesty's Revenue and Customs (HMRC) delegation during 20th to 24th January, 2020, when 3 APAs and 10 MAP cases were successfully resolved with a unique feature that one of a MAP case resolution involved Advertisement, Marketing and Promotion (AMP) issue. Additionally, 1 concluded APA was revised to change the terms of the APA to accommodate changed economic circumstances and another APA was closed as the two sides could not reach an agreement.

So, overtime the traditional dispute resolution mechanism of APA and MAP have gained a lot of traction due to the government's conscious effort to promote along-with other Competent Authorities (CA) and taxpayers to conclude on the applications.

In fact, success of MAP mechanism can be gauged from the Annual Report of the Ministry of Finance for FY 2018-19, which states that between April 1, 2014 – December 31, 2018, approximately 600 tax disputes were resolved under MAP by the CA of India. Like-wise the numbers that highlight the success of APA as an instrument to reap benefit of certainty and dispute prevention as per the recently published third Annual Report on APA by CDBT were covered in our previous issue of the TP Tabloid which can be accessed through the below link:

<https://bit.ly/2y8v8st>

In fact, India tax ecosystem is now seeing ripple effect of the above dispute resolution mechanisms as increasingly Tribunal and Courts have drawn support from these to conclude on ongoing appeals/ cases for prior / subsequent years which were not covered by such MAPs and APAs.



India Tax Ruling

▪ Application of Prescribed Method u/s 92C of the Act Read With Rule 10B of the Rules

a. Toyota Kirloskar Auto Parts Private Limited vs DCIT – IT(TP)A No. 1915/Bang/2017 and IT(TP)A No. 3377/Bang/2018 accessed through the link stated below:

The Bangalore Income Tax Appellate Tribunal (ITAT) has accepted the Assessee's appeal by ruling that the TP Officer (TPO) had incorrectly applied Profit Split Method (PSM) instead of Transactional Net Margin Method (TNMM) (as applied by the Assessee) for benchmarking the royalty charges paid by the Assessee to its Associated Enterprise (AE) for using the AE's technology for manufacturing goods. The TPO in its order had mentioned that the AE's technology is in the nature of 'start-up technology' which are generic and proprietary in nature with economic life of not more than 5 years and hence payment of royalty on such technology is not appropriate as the useful life of such technology has already expired. Further, the TPO and DRP concluded that the royalty paid by the Assessee to the AE was for technical upgrades and knowhow on better technology and accordingly applied PSM as Most Appropriate Method (MAM) as Comparable Uncontrolled Price (CUP) method could not be applied due to information constraint and TNMM cannot be applied due to expiry of the economic life of the technology resulting in the same been categorized as technical knowhow which is unpatented.

In this regard, the ITAT observed that the TPO and DRP did not had any basis to conclude that the technology under question had useful life of only 5 years. The ITAT further opined that the Revenue's contention on non-application of TNMM due to expiry of useful economic life of the technology is not tenable as the passage of time cannot be the basis to reject TNMM as MAM. Coming to the application of PSM on the royalty transaction, the ITAT referred to Rule 10B(1)(d) of Income Tax Rules, 1962 (the Rules) and opined that for considering PSM as MAM there is a requirement that there should be contribution by each party to a transaction for earning profits, and as in Assessee's case, use of AE's technology in manufacturing goods contribute only to the profit of the Assessee and there is nothing for the AE except for royalty payment, it can be reasonably concluded that in the Assessee's case the requirement laid down in Rule 10B(1)(d) of the Rules for considering PSM as MAM is not satisfied. The ITAT acknowledged the Assessee's contention that the PSM can be used only in a case involving transfer of unique intangibles or in multiple inter-related international transactions which cannot be valued separately. Further, referring to the OECD guidelines & OECD revised guidance (June 2018) on the application of transactional PSM, the ITAT stated that in order to determine the profits to be split, the crux is to understand the functional profile of the entities under consideration. Accordingly, considering the facts of the case, the ITAT concluded that in the instant case the Assessee leveraged on the use of technology from AE and did not contribute any unique intangibles to the transaction based on which the PSM could be considered. Hence, the ITAT rejected application of PSM as MAM.

Nangia Andersen LLP's Take

The ITAT in this ruling has emphasized on the importance of accurate delineation of international transaction for application of MAM and arriving at the Arm's Length Price (ALP). The importance of Function, Asset and Risk (FAR) analysis and applicability of TP methods as per the Indian regulations have been explicitly discussed in the ruling along with a reference to the OECD TP guidelines.

The important principle that is derived from the ruling is that even though the comparability analysis is at the heart of the application of the arm's length principle, however, a FAR analysis has always been a cornerstone of the comparability analysis. Accordingly, it is important for the Taxpayers to maintain appropriate TP document and check alignment with the Group's Master File to safeguard their position during TP audits.

▪ Evaluation of AE Relationship u/s 92A of the Act

b. Kaybee Private Limited vs ITO – ITA No. 2165/Mum/2015

The Mumbai ITAT has upheld the Assessee's contention of reading Section 92A(1) and 92A(2) of the Act in conjunction. The Assessee had entered into certain business transactions with Singapore based entity Kaybee Exim Private Limited (KE-S) which had a common director who held 99.9% shares in the Assessee and was also the Chief Operating Officer in KE-S. Based on the common directorship the TPO considered KE-S as the AE of the Assessee by virtue of Section 92A(1)(b) of the Act. The TPO also relied on the ITAT rulings in Assessee's own case for other AY's wherein this issue was ruled in favour of the Department, i.e. KE-S was considered as an AE. Further, the TPO also placed reliance on Diageo India [TS-507-ITAT-2011 (Mum) - TP] ruling to support its argument with regards to interpretation of Section 92A(1) and (2) of the Act on independent basis. Aggrieved by the TPO's approach, the Assessee filed an appeal with the Commissioner of Income Tax-Appeals (CIT(A)), however, the CIT(A) upheld the approach of the TPO.

In this regard, the ITAT noted that the Assessee has countered the contentions of the Revenue by relying on the rulings in case of Veer Gems [TS-545-HC-2017 (GUJ) – TP and TS-2-SC-2018-TP], Page industries [TS-382-ITAT-2016(Bang)-TP] and Orchid Pharma [TS-943-ITAT-2016(CHNY)-TP] wherein reliance was placed on amendment set out in Finance Bill 2002 to insert the words "For the purpose of sub-section (1) of Section 92A" and according to the memorandum to the Bill the reason for such amendment was explained as "It is proposed to amend sub-Section (2) of the said Section to clarify that the mere fact of participation by one enterprise in the management or control or capital of the other enterprise, or participation of one or more persons in the management or control or capital of both the enterprises shall not make them associated enterprise, unless the criteria specified in sub-Section (2) are fulfilled."

The ITAT also took cognizance of the CBDT Circular No. 8 dated 27 August 2008 wherein the CBDT clarified that both Section 92A(1) and (2) of the Act should be read in conjunction. The ITAT noted that the facts of amendment and Circular was never presented to or identified by the Tribunal while passing the Diageo India ruling and ruling in Assessee's own case for other AY's. Further, with regards to the Veer Gems Ruling and its applicability on Assessee's case, the ITAT conceded that in the hierarchical system of courts, it is necessary for each lower tier (including High Court (HC)) to accept loyally the decision of the higher tiers, accordingly, in case of Assessee even though the ruling of Veer Gems is of non-judicial HC, the same will prevail over the jurisdictional ITAT rulings relied upon by the Department even though the same falls under Assessee's own case. The ITAT also noted that the HC has admitted Assessee's appeals against the ITAT order for earlier AYs and are pending for hearing. Accordingly, taking the above facts into consideration, the ITAT passed an order in favour of Assessee by holding that KE-S does not qualify to be an AE of Assessee as the same do not fall under any of the clauses as mentioned in Section 92A(2) of the Act.



Nangia Andersen LLP's Take

Our detailed analysis of this ruling and our take on the same can be accessed at

<https://bit.ly/3fh0Ggi>



c. Sovereign Safeship Management Private Limited vs ITO – ITA No. 2070 Mum/2016

The Mumbai ITAT accepted the Assessee's contention that Sovereign Ship Management Ltd, UK (Sovereign UK) and Premier Ship Management Ltd, UK (Premier UK) cannot be deemed to be AEs of the Assessee u/s 92A(2)(c) of the Act and hence no ALP adjustment is warranted in respect of transactions entered by the Assessee with them. The TPO in its order noted that the Assessee did not work only for the above two AEs but for others as well and accordingly the TPO concluded that the Assessee in India was formed to serve the mutual interest and thus held that Sovereign UK and Premier UK are AEs of the Assessee as per Section 92A(2)(m) of the Act (which provides that two enterprises can be termed as AEs "if there exists between the two enterprises, any relationship of mutual interest, as may be prescribed"). The TPO further relied upon the disclosures made by the Assessee in Form 3CEB wherein the advances received from these two entities were disclosed as an international transaction by considering these two entities as AEs. However, the Assessee before the DRP disputed TPO's contentions and thereby submitted detailed arguments on absence of mutual interest between the 2 entities. In this regard, the DRP had taken a totally different view and held that as the two entities did not receive any services from the Assessee, the amount received by the Assessee from these entities cannot be considered as advances and should fall under the category of loans. Further, the DRP opined that since the 2 entities had jointly given loans of more than 51% of the book value of total assets of the Assessee, they would become AEs of the Assessee u/s 92A(2)(c) of the Act by deeming fiction.

Taking all of the facts on record, the ITAT opined that the language of Section 92A(2)(c) of the Act is unambiguous and clear in stating that in order to fall within the ambit of deeming fiction of becoming AEs, either of the two entities i.e. Sovereign UK or Premier UK, should have independently advanced loan to the Assessee which amounts to more than 51% of book value of total assets of the Assessee. The ITAT also provided reasons for rejecting the DRP's contention of considering such advances as loans and thereby wind down the question of application of Section 92A(2)(c) of the Act in Assessee's case. The ITAT provided relief to the Assessee by relying upon the facts discussed above and rulings in case of Veer Gems [TS-7-ITAT-2017(Ahd)-TP] (upheld by HC and SC) and Kaybee Pvt Ltd [TS-161-ITAT-2020(Mum)-TP] wherein it was held that Section 92A(1) of the Act could not be applied on standalone basis and had to be essentially considered in conjunction with Section 92A(2) of the Act i.e. 2 entities can be held to be AEs only when it satisfies at least one of the conditions set out in Section 92A(2) of the Act.

Nangia Andersen LLP's Take

Determination of AE relationship forms the premise for applicability of TP principles for arm's length analysis. In most cases, the relationships can be explicitly determined based on shareholding pattern. However, in the complex diversified structure of MNEs global operations, there can be relationships or arrangement which may not be prima facie evident and some India specific regulations like deeming provisions under Section 92B(2) of the Act are difficult to identify. Further, the ambiguity of application of Section 92A(1) and 92A(2) of the Act [whether cumulative or mutually exclusive] seems to have reached a finality in its application by recent judicial rulings. Accordingly, Taxpayers while undertaking the TP analysis should be careful in identifying all parties which may get covered under the AE relationships taking into account both the Sub-sections of Section 92A of the Act into holistic considerations.

▪ Controversy Related AMP Adjustment

d. NGC Networks (India) Private Limited vs ACIT – 6829/Mum/2012

The Mumbai ITAT deleted the AMP adjustment for the Assessee engaged in channel distributor and selling advertisement airtime. The ITAT observed that as the owner of the distribution and advertisement income, the Assessee incurred AMP expenses, which would only benefit itself through increased distribution and advertisement sales. The ITAT noted that in consideration for purchase of distribution and advertisement rights from the AE, the Assessee has paid a fixed fee and not a share/ percentage of revenue and disclosed it appropriately in its TP documentation, hence, any increase in the distribution and advertisement revenues on account of AMP expenses was fully retained by the Assessee itself and no benefit could be said to accrue to the AE. The ITAT also acknowledged that the Assessee incurred the AMP expenses to make the customers aware of the programs being telecasted on the channels, give program time details, etc. to the viewers and these advertisements had a short shelf life (till telecast of the program) and were published by the Assessee only a few days prior to the telecast of the program on the channel to help create viewers/ advertiser's awareness of the program.

The ITAT opined that the advertisement published by the Assessee is not for brand building but is focused on program being telecasted. The ITAT relied on Third Member decision in the Assessee's own case for earlier AY which was later upheld by the Bombay HC, wherein it was held that the AMP expenses are for the benefit of the Assessee. The ITAT after accounting all the facts and the judicial precedents, concluded that it is up to the Assessee to strategize for marketing their program and quantum of AMP expenses that they intend to incur. Further, the ITAT noted that the Revenue has failed to establish any arrangement/ agreement between the Assessee and its AE for undertaking such AMP expenditure. Accordingly, the ITAT ruled in favour of the Assessee and held that the AMP expenditure will not qualify as an international transaction.

e. DCIT vs General Mills India Private Limited – IT(TP)A No. 249 & 5668/Mum/2017 and IT(TP)A No. 5228/Mum/2016

The Mumbai ITAT has ruled in favour of the Assessee on two important issues i.e. (i) Allowing the economic adjustment on the excess AMP spent vis-à-vis the comparables and (ii) Deleting TP adjustment on AMP expenditure. The Assessee while determining the ALP for the import transaction with the AE for relevant AY had excluded the AMP expenditure, however, the TPO argued that such AMP expenditure is revenue in nature and should be included while determining the ALP and accordingly rejected the AMP adjustment made by the Assessee. In this regard, the ITAT noted that the Assessee had claimed economic adjustment on account of AMP expenditure stating that the ratio of such expenditure to operating income for the Assessee was significant as compared to the selected comparable companies. The ITAT observed that the TPO in earlier AY has allowed such adjustment to the Assessee. Accordingly, the ITAT allowed the economic adjustment to the Assessee on account of difference in AMP expenditure.

The ITAT also addressed to the TP adjustment made on account of AMP expenditure incurred by the Assessee wherein the TPO stated that such expenditure is made on behalf of the AE and the Assessee should be appropriately compensated for the same. In this regard, the CIT(A) did not concur with the contention of the TPO and deleted the TP adjustment by relying on the ruling in case of Maruti Suzuki India Ltd [TS-595-HC-2015(DEL)-TP] where in it was held that incurring of AMP expenditure towards payment made to third parties in India cannot be considered as international transaction. The ITAT also placed its reliance on the ruling in case of Kellogg India Pvt Ltd [TS-695-ITAT-2019(Mum)-TP] wherein it was held that the burden on proving existence of an arrangement between the Assessee and the AE was entirely upon the TPO. In this regard, the ITAT observed that there is no agreement that obligates the Assessee to incur AMP expenditure to improve the Brand of its AE, and further, the TPO is unsuccessful in proving that there was any arrangement/ agreement between Assessee and AE to incur such AMP expenditure. The ITAT took cognizance of the facts that the Assessee is dealing in new product which necessitate such high AMP expenditure and further the Assessee has provided enough evidence on the impact of such expenditure on its sales. After considering the facts of the case and relying on the appropriate judicial precedent, the ITAT upheld the CIT(A) order.



f. Diageo India Private Limited vs ACIT – ITA No. 1228 & 1813/Mum/2015

The Mumbai ITAT upheld the AMP adjustment for the Assessee engaged in manufacturing and distribution of alcoholic beverages. The ITAT observed that there was an existence of a mutual agreement between Assessee and AE to incur AMP expenses & allocate/ apportion AMP cost based on benefit received. The ITAT overruled the co-ordinate bench ruling in the Assessee's own case for earlier AY (wherein TP adjustment on AMP expenditure was deleted) on the grounds that in earlier AY there was no agreement between the parties to incur the AMP expense. The ITAT opined that considering that such an obligation is created by way of amendment in the agreement between the parties is sufficient for treating such AMP expenditure as international transaction for which determination of ALP is warranted. The ITAT further referring to the agreement pointed out that it defies logic that overseas AE will pay gratuitous sum to the Assessee, without any benefit to itself, hence, it can be reasonable construed that such an expense will benefit the AE. Accordingly, based on the facts of the case the ITAT remitted ALP determination on such AMP expenditure transaction back to AO with direction to follow ratio laid down by Delhi ITAT in BMW India (ITA No. 1514/Del/2016) ruling.

Further, with regards to AO disallowing royalty paid by Assessee to its AE u/s 37(1) of the Act, the ITAT observed that the matter with regards to TP issues were referred the TPO wherein the TPO after perusing the records submitted by the Assessee has not made any TP adjustment with regards to payment of royalty charges by the Assessee. Accordingly, the ITAT held that in case there is no adjustment made by the TPO on royalty chargers, it is not open for the AO to apply benefit test and make disallowance u/s 37(1) of the Act without proper examination of all aspects of the claim. Hence, the ITAT remanded the issue on claim of royalty payment back to the files of the AO.

Nangia Andersen LLP's Take

The above judgements have addressed two of the most controversial issues. The issue with regards to AMP expenditure has also been under the scanner, however, these ruling have clearly provided the very basic requirement for avoiding TP adjustment on similar kind of issues i.e. exhaustive documentation for justification of such expenditure. Even though the burden of proof is on the Revenue to establish an arrangement or agreement between parties for the AMP expenditure, however, it is extremely important for the Taxpayers to evaluate the finer aspects related to obligatory expenditure that they have to incur along with its litigative impact while preparing the inter-company agreements. Also, the Taxpayers should have a detailed analysis in place to justify such expenditure. Though the issue of AMP is subjudice and all eyes are on the SC hearings, but the back-up documentation and the material on record would be critical for determining the exact nature of expenses.

Further, with regards to economic adjustment, the facts of the case will have utmost importance on whether such an adjustment is warranted. It is important for the Taxpayers to have a thorough analysis conducted while availing such economic adjustment. Needless to add, the test of reasonableness and accuracy have to be cleared for applicability of economic adjustments.

▪ Necessity of Economic Adjustment

g. ACIT vs Swatch Group (India) Private Limited – 2264/Del/2009

The Delhi ITAT has dismissed Revenue's appeal and upheld the CIT(A)'s grant of custom duty adjustment while benchmarking import of watches/ spares for resale by Assessee. The CIT(A) in its order mentioned that the high custom duty rates in India (above 50% of total cost of goods sold) are bound to have significant bearing on the gross margins as well as operating margins of the Assessee vis-à-vis Italian comparable companies (who enjoy benefit of NIL or negligible customs duty) and accordingly held that reasonable quantitative adjustments should be made to arrive at the ALP. Accordingly, the CIT(A) granted customs duty adjustment (normalizing to 5% purchase value) to the Assessee.

The ITAT not only concurred with the views of the CIT(A) but also went ahead explaining the requirement of such adjustment. The ITAT referred to Rule 10B(3)(ii) of the Rules which provides for making reasonably accurate adjustments for eliminating material differences between two transactions being compared, and further, clarifies that the regulations do not restrict or provide that adjustments cannot be made on the results of the tested party. Accordingly, relying on Rule 10B(3)(ii) of the Rules, the ITAT conceded that for certain types of adjustments the relevant data for comparable companies may either not be available in public domain or may not be reliably determinable based on information available in public domain, and accordingly, it may be possible to make equally reliable and accurate adjustments on the tested party whose data would generally be easily accessible. Considering the facts of the case, the ITAT was convinced that the custom duty adjustment is warranted for arriving at the accurate ALP due to huge difference in the custom duty charges between the countries, and accordingly upheld the CIT(A) order of allowing custom duty adjustment in the tested party margins.

Nangia Andersen LLP's Take

Considering the current COVID-19 impact on every taxpayer, the need for undertaking economic adjustment to normalize the arm's length computations has risen multi-fold. While Taxpayers can undertake various forms of economic adjustment like capacity utilization, depreciation adjustment, foreign exchange adjustment, rates/ taxes/ custom duty adjustment, etc. to normalize the impact of difference in some the key factors impacting the profitability, the key will be to aptly identify and carve out the back up data for performing such analysis and documenting the business & economic rationale to undertake such adjustment. Lack of reliable and rationale basis will lead to non-acceptance of such adjustments in appellate proceedings.



▪ Issues Related to Re-Characterization of International Transaction(s)

h. Bialkhia Holdings Private Limited vs ACIT – ITA No. 507/Ahd/2013, ITA No. 1415 & 1416/Ahd/2015 and ITA No. 795/Ahd/2016

The Surat ITAT deleted TP adjustment on account of interest free loan advanced to its AE by the Assessee for the purpose of redeeming preference shares held by Assessee. The ITAT rejected the TPO's approach to re-characterize the redemption of preference shares transaction to a pure loan simplicitor as given by a financial institution. The ITAT noted that the AE was a Special Purpose Vehicle (SPV) formed to hold investment with no purpose to engage in any other activity, and further, the fact that the Assessee wound up the AE and all the capital was remitted and gains on disposal of investments had been completely brought back to India and taxes paid there on, should be sufficient reason to consider such investment as a quasi-equity in substance. Further, the ITAT observed that these transactions of advancement of loan for purpose of redemption of preference shares are closely linked/ integrated transactions in terms of Rule 10A(d) of the Rules, and related to shareholder's function, accordingly, such transactions should be considered as quasi-equity capital for the purpose of determining ALP.

In this regard, the ITAT relied on the Tribunal ruling in case of Cadila Healthcare (2017 80 taxmann.com 24) wherein the Tribunal ruled that the substantive reward for Assessee's loan was not interest but an opportunity to redeem its preference share capital and bring back the same into India. The ITAT also concurred with the Assessee contention that the amount representing loan was towards investment in share capital of the subsidiaries outside India as the transactions are not in the nature of transactions referred to in Section 92B of the Act and the TP provisions are not applicable as there is no income. Accordingly, taking the above facts under consideration, the ITAT ruled in favour of the Assessee by rejecting Revenue's argument on re-characterization.

Nangia Andersen LLP's Take

The facts of the case and the documentation maintained by the Taxpayer play a key role in the characterization of a transaction. It is of utmost importance that the facts presented by the Taxpayer are aligned with the actual transaction failing which the TP adjustment or protracted litigation will be inevitable. The re-characterization can be invoked in case the Taxpayer has not correctly analysed or represented the FAR of the transaction. Accordingly, to avoid any of such unwarranted re-characterization of transactions it is essential for the Taxpayer to have a deep dive look into the facts of the transaction, analyse TP implication and document the same accurately.

i. Tata International Limited vs ACIT – ITA NO. 4376 & 4451/Mum/2010 and Cross Objection No. 223/Mum/2013

The Mumbai ITAT has accepted the contention of the Assessee and thereby upheld the CIT(A) order of rejecting the treatment of Letter of Comfort (LOC) issued by the Assessee to the bankers of AE as international transaction. The TPO in this case had considered such LOC as benevolent advantage provided to the AEs by the Assessee in obtaining credit facility from the banks on better terms and accordingly equated it with guarantee and benchmarked it as international transaction adopting guarantee fees charged by HSBC bank as comparable under CUP method. However, the CIT(A) after considering the Assessee's submissions analysed the difference between LOC within Intra Group and corporate guarantee, and accordingly, opined that such transaction had no bearing on the profit, income or loss as the Assessee did not incur any cost or expenditure and hence it did not constitute international transaction u/s 92B of the Act.

The ITAT noted the relevant points that the CIT(A)'s had considered of differentiating the guarantee and LOC was based on the legal enforceable rights, wherein, the guarantee has the legal enforceable rights, however, the LOC do not. The ITAT also noted that Karnataka HC in case of United Breweries (Holding) vs. Karnataka State Industrial Investment and Development Corporation (M.F.A. No. 4234 of 2007) held that LOC merely indicates Assessee's assurance that respondent would comply with the terms of financial transaction without guaranteeing performance in the event of default. The ITAT also finds support from the co-ordinate bench in case of India Hotels Co. Ltd (ITA No. 9087/Mum/2010) which relied on Karnataka HC ruling in United Braveries (supra) and held that LOC does not constitute international transaction. Taking the relevant facts into consideration and judicial precedent into record, the ITAT upheld the CIT(A) order and accordingly rejected Revenues contention of re-characterizing the LOC as guarantee.

Nangia Andersen LLP's Take

The above ruling weathers away the doubt on characterization of LOC since such a transaction does not create any legally enforceable rights which may require compensation. The LOC merely indicates the appellants assurance that respondent would comply with the terms of financial transaction without guaranteeing the performance in the event of default. Further, as per the latest OECD guidelines on the financial transactions it is clear that the LOC do not contain significant risk which may require compensation.



j. AGC Networks Limited vs DCIT – ITA(TP) No. 2059/Mum/2017

The Mumbai ITAT rejected the Assessee plea that the support services provided by the Assessee to its AE is a shareholder function and no allocation or mark-up is required on the same. The ITAT noted that the Assessee has accepted that it is guiding and monitoring the functions of the AE and for this purpose Assessee's CEO, CSO, and other personnel are spending time. Accordingly, the ITAT opined that the services provided by the Assessee to its AE fall under the realm of international transaction and hence determination of ALP is required. Accordingly, the ITAT has pronounced the order in favour of the Revenue wherein the ITAT has considered the intra-group services provided by the company to be non-shareholder activity for which determination of ALP is warranted.

Nangia Andersen LLP's Take

Based on the facts of the case, the services provided by the Assessee was not under the ambit of the shareholder activity as the level of functions performed by the key employees of the Assessee were more in controlling nature. It is important for the Taxpayers to accurately characterize the transactions entered with the AE based on the applicable TP regulations along with referring to external guideline such as OECD TP guidelines. The OECD has clearly provided for the functions that will be covered under exclusion category of the intra-group services for which the determination of ALP will not be warranted, accordingly, it is the responsibility of the Taxpayer to identify the exact characteristic of the transaction or structure the transaction in a way as the same will fall under the exclusion category.

▪ Issue Related PE Evaluation

k. CMA CGM SA vs DCIT – ITA No. 6095/Mum/2018

The Mumbai ITAT ruled in favour of the Assessee by holding that its Indian agent (CMA CGM Agencies (India) P Ltd) cannot be considered as its agency Permanent Establishment (PE) when it has been remunerated at ALP. The Assessee is a tax resident of France and is engaged in shipping business in International Waters and availed services from an Indian agent. The ITAT noted that Assessee has paid remuneration of 18% to its Indian agent which was as per the APA entered between the Indian Agent and CBDT and accordingly holds that the Indian Agent of the Assessee cannot be considered as an agency PE. The ITAT relied on the coordinate bench decision in Assessee's own case for other AYs where it was held that if the Indian agent has been remunerated at arm's length, then the agent shall be construed as agent of independent status and accordingly no agency PE would exist in terms of India-France DTAA. Further, the ITAT held that the question on existence of PE arises only if any part of its income is liable to be taxed as business income and since Assessee's income is eligible for relief u/s 9(1) of the India-France DTAA, no income of the Assessee is liable to be taxed as business profits in India and hence, the question of existence of PE becomes academic. The ITAT after considering the facts of the case ruled in favour of the Assessee.

Nangia Andersen LLP's Take

Determination and profit attribution to a PE has always been a contentious topic. While determination of PE requires deep diving into the functional aspect, intensity of the activities performed and verification with the Treaty, the key question then arises on the profit attribution to such PE. It has been well accepted in various judicial precedence that if an arm's length remuneration is already established, then there should not be any requirement for additional attribution. Thus, the Taxpayers should take utmost care in analyzing its activities and operations for determining the PE status and subsequent attribution. This is also heightened by the fact that Multi-Lateral Instrument (MLI) which is signed by India has now been effective from April 01, 2020 for the identified Covered Tax Agreement (CTA) and with the expanded definition under MLI, some of the DTAA will stand modified. Accordingly, due precautions should be taken in undertaking the PE analysis.



▪ Others

I. Applied Materials India Private Limited vs ITO – IT(TP)A No. 1838/Bang/2016

The Bangalore ITAT has rejected Assessee's contention of treating sub-contracting cost as pass-through cost and thereby excluding the same from the operating cost of the Assessee for ALP computation. The ITAT relied on co-ordinate bench ruling in Assessee's own case, wherein it was noted that Assessee was charging a markup of 10% on cost from its AE and it was not acting as agent/ distributor of AE but a provider of services of its own and had therefore held that excluding such activity as pass through would amount to artificially inflating Assessee's margins for revenue from other services. Accordingly, the ITAT ruled in favour of the Revenue and directed to include such sub-contracting cost for determining the margin of the Assessee.

Nangia Andersen LLP's Take

In the Indian TP Regulations, there has been no reference or guidance on the treatment of the pass-through costs. However, the Indian judiciary has made a reference to the concept of pass-through costs which is in accordance with the OECD's view in several case laws. It is common for Taxpayers to appoint sub-contractors in order to render their services or delivery of products. However, there may be instances wherein the appointment of the sub-contractor is at the specific instruction of the AE and the services of such sub-contractors may not be directly linked to the services of the Indian Taxpayers. In such a scenario, such costs may be treated as pass-through in nature, depending upon the facts of the case. However, appropriate documentation and correspondence will need to be prepared to show-case the level of involvement of AE and the India Taxpayer to claim such cost to be pass-through nature.



▪ **OECD Guidance on FTs – A Big Step Ahead**

OECD in its Base Erosion and Profit Shifting (BEPS) initiative has been continuously working to maintain minimum standards and uniformity in the approach on TP issues. On 11 February 2020, OECD has released the Report on FT as part of BEPS Action Plan 4, 8-10, incorporating the principles outlined in Draft Discussion Paper of July 2018, which will be enshrined in TP Guidelines (TPG) of 2017. The Report covers specific issues relating to the pricing of loans, cash pooling, hedging, financial guarantees and captive insurance.

Given the complexities involved in financial arrangements, the guidance could be a “game changer” to reduce potential litigation, APA, finalization of resolution of MAP cases and maintain uniformity of approach. However, being cautious that many countries have their separate TP regulations and do not strictly follow the OECD TPG, the OECD has explicitly clarified that the guidance in the Report does not prevent countries from implementing approaches to address the balance of debt and equity funding of an entity and interest deductibility under their domestic legislation.

The key principal laid down in the Report with regards to FTs are elucidated in one of our articles which can be reached out through the link stated below:

<https://bit.ly/2KRVMk>

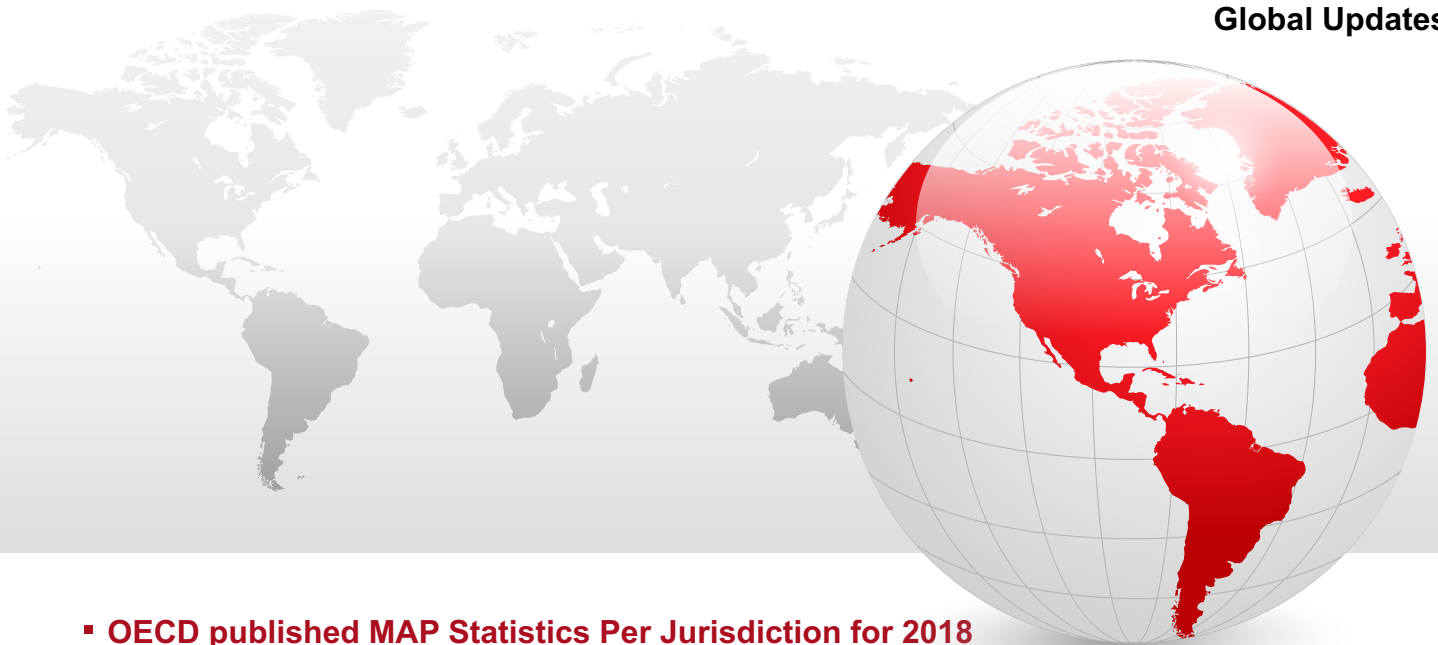
▪ **Canada 2018 MAP Program Report**

In January 2020, CRA published 2018 MAP statistics. A summary of the key findings of the MAP program for the period from January 1, 2018 to December 31, 2018 is provided below:

- CRA had 176 negotiable MAP cases on 1 January 2018 and accepted 97 new MAP cases.
- In 2018, the CRA closed 126 MAP cases, 97 (77%) of which were initiated by Canada and remaining 29 (23%) were initiated by other countries.
- Of 126 MAP cases, 101 negotiable cases (80.2%) resulted in full relief from double taxation, 8 cases (6.3%) resulted in unilateral relief. Further, in 12 cases (9.5%) either the objection was not justified or resolved via domestic remedy or withdrawn by the taxpayer.
- Average completion time was 22.8 months for negotiable MAP case.
- Currently, CRA is engaged in negotiating MAP cases involving taxpayers from 26 different jurisdictions including India, with the majority of MAP cases with the United States at 54%.

Detailed report can be accessed at:

<https://bit.ly/2Yv1p7s>



▪ **OECD published MAP Statistics Per Jurisdiction for 2018**

Country-wise 2018 MAP statistics under OECD BEPS Action 14 - Making Dispute Resolution Mechanisms More Effective, which includes timely and complete reporting of MAP statistics pursuant to an agreed reporting framework has been provided below:

<https://bit.ly/3bQdbNI>

▪ **APRG Conducts Meeting and Publishes 2019 Implementation Report**

Recently, an APRG has been established by the 34 member Global Forum on Transparency and Exchange of Information for Tax Purposes to ensure effective implementation of the Standard for Automatic Exchange of Financial Account Information in Tax Matters (the AEOI Standard).

APRG conducted its first meeting from 16-18 March 2020 attended by 90 delegates from across the world virtually considering Covid-19, wherein the framework has been established to finalise the first round of peer reviews with regard to the AEOI Standard. This covers both the legal assessments conducted over recent years and the practical effectiveness reviews which will commence shortly, with specific focus on addressing issues with respect to confidentiality and data safeguards. The potential impact of Covid-19 on this work was also a key issue in the discussions.

2019 AEOI Implementation Report has been issued which states that in 2019, 94 jurisdictions have made around 6100 bilateral exchanges, which is 36% increase vis-à-vis previous year. The exchanges include detailed information on the financial accounts held in the information sending jurisdiction by tax residents of their partner jurisdiction. This Report provides list of the number of partner jurisdictions to which each jurisdiction sent information in 2018 and 2019 respectively. For instance, India has sent information to 67 partners in 2019 vis-à-vis 60 partners in previous year. For detailed report, please refer link:

<https://bit.ly/3c0LbY0>



▪ South Korea

Recently, South Korea enacted several amendments in its TP rules applicable from 1 January 2020 that includes simplification of reporting requirements i.e. taxpayers required to submit Masterfile and local file are exempt from submitting the TP disclosure form, tax authority to undertake assessment and determine ALPs based on their own comparable data where insufficient/ no documentation is submitted by the taxpayer, increase in penalties for failure to comply with TP documentation submission requirements in line with BEPS and adoption of simplified TP rules for low value-adding intra-group services (i.e. no benchmarking required for such transactions in case mark-up does not exceed 5%, subject to certain criteria) in line with BEPS Action Plan 8-10.

▪ Turkey

On 24 February 2020, Turkey passed a Decree prescribing the 3 tier documentation (as well as notification) requirements in line with OECD BEPS Action Plan 13, wherein tax year 2019 is the first year for Masterfile (to be submitted on request) and Country by Country Report (CbCR) (to be submitted by 31 December 2020). The Decree also amended the Turkish TP rules by adding reference to OECD TPG wherever the rules are aligned, recognition of profit based methods (i.e. transitional net margin method and PSM), elimination of hierarchy of methods, introducing rollback provisions in APA thereby increasing APA period from 3 years to 5 years to name a few.

▪ Uruguay

Effective 1 January 2020, Uruguay's tax authorities have aligned the low- or no-taxation (LONT) countries and jurisdictions list for tax purposes with TP list wherein the transactions with these LONT jurisdictions are deemed to be controlled from TP perspective. A jurisdiction is considered LONT in case effective tax rate of less than 12% applies to income from activities performed in Uruguay or information exchange agreement/ clause that is not in force/ does not apply to all the taxes.

▪ Puerto Rico

On 1 January 2020, Puerto Rico amended its income tax law allowing full deductibility of the inter-company expenses in case TP documentation is filed by the Puerto Rican taxpayers along with their income tax return for the fiscal year ending 31 December 2019, with due date of 15 April 2020. Earlier, 51% of the inter-company expenses were disallowed. As per the amended law, in case group has US operations, the TP documentation must follow US TP regulations else OECD TPG.

▪ Denmark

On 31 March 2020, Danish Minister for Taxation postponed the FY 2019 due date for tax return of companies with earlier due date of 31 March 2020 or later to 1 September 2020 considering Covid-19. This mean the finalization of the contemporaneous TP documentation for FY 2019 also got postponed from earlier 30 June 2020 for companies following the calendar year.

▪ South Africa

South African Revenue Service (SARS) indicated that no extensions/ relief shall be granted for the late or non-submission of returns including TP compliances on account of Covid-19. Thus, the Masterfile and/ or Local file must be prepared and filed as well as CbCR (wherever applicable) must be submitted to SARS within 12 months from the end of the relevant assessment year.



Rulings Across the Globe

▪ **Swedish Tax Agency's TP Ruling in Case of Puma Nordic AB**

In December 2019, Swedish Tax Agency (STA) made adjustment of ~€10 mn in case of Swedish distributor Puma Nordic AB, engaged in marketing and selling of PUMA branded products (purchased from its German sourcing company under cost based fee arrangement) in its local market during tax years 2015-17. Puma Nordic AB also paid license fee on external revenue to PUMA SE for the use of the PUMA brand and related marketing material during these years and was incurring continuous losses. STA characterised Puma Nordic AB as a Limited Risk Distributor (not carrying local market risks), resulting in TP adjustment for each of the said years. Detailed analysis of the ruling can be accessed at

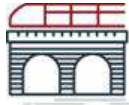
<https://tinyurl.com/yadmengu>

▪ **Nigerian Tribunal's First TP Ruling in Case of Prime Plastics Nigeria Limited**

On 19 February 2020, Nigeria's Tax Appeal Tribunal (TAT) delivered its first TP ruling in case of Prime Plastics Nigeria Ltd (Appellant engaged in trading of imported plastics and petrochemicals) v/s Federal Inland Revenue Service, wherein the TAT upheld the Federal Inland Revenue Service's TP adjustment of ~\$4.8 million, adopting TNMM with gross margin as the profit level indicator for benchmarking the inter-company transaction of purchase of plastics and petrochemical products by the Appellant from its overseas related party. Detailed summary of the decision can be read at

<https://bit.ly/2SqaMY>

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