Nangia Andersen LLP

Communiqué

Your Quarterly TP Tabloid

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Foreword

Hope everyone is in good health and coping up with the unprecedented challenges thrown at us by this unforeseen pandemic. Meanwhile, in this phase of unlocking the world guardedly, Governments around the world are also looking for ways to reignite their respective economies and shore up tax revenues. Amidst such hustle, with an endeavour to keep you updated and provide insights into recent developments in transfer pricing (TP), we bring to you another quarterly issue with news at both Indian and Global fronts.

Alongside putting the best foot forward to tackle the Covid-19 pandemic by easing certain statutory compliances for the taxpayers, notifying safe harbour provisions for AY 2020-21, etc., the Government of India is also making continuous effort to align Indian TP regulations with the Base Erosion Profit Shifting (BEPS) initiatives such as amending the Mutual Agreement Procedure (MAP), enacting Multilateral Instruments (MLI), etc. We have also discussed about the list of harmful regimes shared by the Central Board of Direct Taxes (CBDT) with the tax authorities and certain significant Indian rulings pronounced in this quarter.

On the global front, amendments to Advanced Pricing Agreement (APA) mechanism made by Canada and USA have been discussed. Further, significant TP centric news across different parts of the world including the issuance of the transfer pricing guidelines in light of COVID-19 by the Australian Tax Authorities and various rulings across the globe, et al., have also been covered 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:

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 India Pvt. Ltd

A Relief for Time Barring Assessments!

The Coronavirus pandemic is not only resulting in catastrophic effect on human lives but also causing severe economic breakdown and market turmoil. The pandemic has led to a struggle for the government of each and every affected country to find the delicate balance between larger interests of public health and economic stability. Government of India has already taken several measures to provide relief in the taxation laws for the taxpayers. One such measure is the extension of time limit for completion of time-barring assessments by CBDT vide its notification [CG-DL-E-24062020-220145] dated June 24, 2020. The amendment would apply to the assessments pertaining to financial year (FY) 2016-17 [i.e. assessment year (AY) 2017-18].

The extension of the time limit for assessment has a consequent impact on the assessments involving TP matters for the AY 2017-18. An analysis of the Section 153 read with Section 92CA(3A) of the Income Tax Act, 1961 (the Act) articulates that the last date for the transfer pricing officer (TPO) to pass the order of assessment pertaining to AY 2017-18 that was October 31, 2020 now stands extended to January 31, 2021 vide the above-mentioned CBDT notification.

The detailed impact of the notification on the various compliance in India (including above) is encapsulated in our Newsflash that can be accessed through the link stated below:

https://bit.ly/30BD5li

Safe Harbour Rules (SHR) for AY 2020-21

Amidst tackling the Covid-19 pandemic, on May 20, 2020, CBDT issued notification [CG-DL-E-20052020-219455] that amends Rule 10TD and Rule 10TE of the Income Tax Rules, 1962 (the Rules) related to SHR to provide that the rates under SHR applicable from AY 2017-18 to AY 2019-20 will continue to apply for AY 2020-21 i.e. for one year only. Accordingly, SHR for AY 2021-22 and onwards would be notified by the authorities in the future.

Details on the Safe Harbour regime for AY 2020-21 in light of the recent notifications have been captured in our NewsFlash that can be accessed through the link stated below:

https://bit.ly/3igMLaH

Further, given current economic situation, we have analysed the Safe Harbour regime, a dispute resolution mechanism, in India and globally, recent development, open points that need to be addressed to make this option attractive in the future and some of the relevant points to ponder by the Company's Management as it determines strategies for the near future, in our article published on May 27, 2020 on Taxsutra website. To read the full article, click on the below link:

https://bit.ly/3kp6OFJ

Evolution of MAP

As a dispute resolution mechanism, embedded in the contours of Article 25 or Article 27 (as the case may be) along with reference to Article 9(2) (which provides for corresponding adjustment) of the Direct Tax Avoidance Agreement, MAP has been instrumental in resolving many disputes and helped Multinational Enterprises (MNEs) avoid economic double taxation by allowing corresponding adjustment in the other Contracting States. It gained more traction when in the Press Release on 27th November, 2017, CBDT issued a clarification, for relaxing India's position on the acceptance of TP applications for MAP cases and Bi-lateral APA in cases of countries where Article 9(2) of OECD Model Tax Commentary is absent.

However, MAP did not gain the expected importance in India due to lack of clarity of procedure in the Rules along with absence of timeline to conclude MAP. So, with an intention to plug the gap and to align the provisions with minimum standards as laid down in the BEPS Action 14 in order to address the recommendations in the Peer Review Report released in 24 October 2019 by the OECD, the Indian government introduced amendments in MAP Rules. CBDT has also notified the revised Form 34F for applicants seeking to invoke MAP.

CBDT released notification for amendments to MAP rules on May 06, 2020. Details of the amendments been captured in our NewsFlash that can be accessed through the link stated below:

https://bit.ly/2PDbtpF

In this regard, amendment in Indian MAP rules against MAP evolution along with the measures taken by OECD to strengthen the effectiveness and efficiency of MAP process have been discussed in our detailed article published on May 18, 2020 on Taxsutra website. To read the full article, click on the below link:

https://bit.ly/2XCxnhb

MLI and its TP Impact

June 7, 2017, marked a turning point in the history of 68 jurisdictions (including India) that became signatories to the MLI. As regards the India's perspective, the Union Cabinet approved MLI on June 12, 2019 and consequently, on June 25, 2019, India deposited its instrument of ratification with the OECD. With the beginning of the fiscal year in India on April 1, 2020, MLI came into full force.

Now, with the enactment of the MLI in India, its impact on TP needs to be factored in the below areas:

- **Impact on APA**

  The MLI resulted in widening the scope of permanent establishment (PE) and impacted the definition of activities considered 'preparatory and auxiliary' till date. Although, MLI has been in discussion for some time now and OECD has been circulating the drafts for public review, the authorities that have negotiated/ signed the APAs would otherwise also have taken this into consideration and accordingly determined an adequate arm's length remuneration. However, in case the level of functions/ activities of the Taxpayer increase and/ or on account of enactment of MLI wherein the expansive scope includes some activities which may lead to a potential PE creation of foreign entity in India or the violation of the critical assumption of the existing APA and/ or impact the comparability analysis, in which case the Indian APA authorities can look at invoking the provision/ clause for revision of APA.

- **Impact on MAP**

  On the clauses contained in the MLI for MAP, India has reflected its choice on agreeing/ not agreeing to the suggestions made by the articles in MLI. The summary of India's positions on the MAP in the ratified MLI is discussed in our article published on May 18, 2020 on Taxsutra website. This aspect has already been covered on the article mentioned above on evolution of MAP.

Measures by CBDT to align with BEPS Action Plan 5

In April 2020, CBDT (Foreign Tax & Tax Research Division) published International Tax Bulletin for the month of March 2020. Among many covered areas, the bulletin highlighted that CBDT has shared a list of harmful regimes with the Pr. CCIT (International Taxation) in March 2020, with an advisory that Assessing Officers (AOs) and TPOs, should be vigilant on encountering transactions with entities present in tax haven jurisdictions and classified as harmful regimes. The board insisted on the deeper scrutiny of the transactions having no economic substance and commercial rationale behind it. The measure is in line with the progress made by the OECD in implementing BEPS Action 5 (Harmful Tax Practices). The OECD had released various reports for its progress for the preferential regimes with latest being in July 2019[1]. In the same, OECD incorporated the latest results after review of jurisdictions' domestic laws conducted by the OECD Forum on Harmful Tax Practices (FHTP). Results of FHTP's review gives insight to AOs and TPOs on possible base erosion and profit shifting activities.

Newly Notified ITR forms for AY 2020-21

With an intent to increase disclosure compliance, the CBDT vide notification [CG-DL-E-30052020-219667] dated May 29, 2020, proceeded to notify the new Income Tax Returns (ITR) forms applicable for AY 2020-21. Along with other changes, the ITR forms 3, 5 and 6 were also amended to give effect to the amendment made in Section 92CE(2A) [Secondary adjustment in certain cases] vide Finance Act (No. 2) of 2019. The amended forms introduced Schedule TPSA, seeking details pertaining to taxpayer’s choice of paying additional income tax in case of non-repatriation of primary adjustment within the prescribed time limit.

The detailed discussion on the notified ITR forms for AY 2020-21 by Firm’s Partner has been covered in Financial Express that can be accessed using the below link:

https://bit.ly/31DR8ps

[1] https://bit.ly/3gFfwNO

India Tax Ruling

▪ Ruling on revised return filing post MAP resolution

a. Dell International Services India Pvt. Ltd vs DCIT – IT(TP)A No. 879/Bang/2018

The Bangalore ITAT has accepted the arguments of the assessee and declared that assessee is eligible to claim benefit u/s 10A of the Act in respect to enhanced income arrived at in pursuant to MAP for AY 2007-08. The Tribunal observed that the resolution under the MAP reached by the Competent Authorities of US and India, requires the assessee to modify its returned income in conjunction with amount agreed under MAP and subsequently requires additional invoicing in respect of such enhanced income by the assessee and repatriation of the required foreign exchange into India (such requirement is not warranted where the price is determined by the AO). Further, the Tribunal also noted that assessee had satisfied the condition under Subsection 3 of Section 10A of the Act regarding repatriating the foreign exchange into India, within the stipulated time i.e. repatriate the required sum within such time as may be allowed by competent authority. Accordingly, the Tribunal rejected the Revenue's claim and held that the proviso to Section 92C(4) (which provides that no deduction u/s.10A or u/s 10AA or u/s 10B or under Chapter VI-A of the Act shall be allowed in respect of the amount of income by which the total income of the assessee is enhanced after computation of income considering the ALP determined by the AO) cannot be applied to the present facts of the case as the enhanced income is computed based on MAP resolution and not independently by the AO, thus the action of the AO in disallowing the deduction on the enhanced income is bad in law. The Tribunal placed reliance on Dar Al Handasah Consultants (Shair & Partners) case while arriving at its decision.

Nangia Andersen LLP's Take

Resolution reached in accordance with MAP may not be equated with ALP determined by AO/TPO. MAP requires Competent Authority of two tax jurisdiction to enter into negotiation to reach to a conclusion. Further, the MAP resolution requires the assessee's acceptance of amount determined and withdrawal of pending litigation. The MAP resolution also require the assessee to alter its returned of income in accordance with the MAP decision and thus can partake the nature of voluntarily adjustment while claiming the deduction on enhanced income which is not the case where the ALP is determined by AO/TPO. Accordingly, in cases where the resolution is reached under MAP and the terms and conditions of the resolution has been adhered by the assessee, then any deduction which the assessee is eligible to claim on such enhanced income shall be allowed to the assessee, while filing the revised return of income.

Rulings in relation to AMP adjustments

b. Make My Trip (India) Pvt. Ltd vs DCIT – ITA No. 2307, 2692, 4757& 4974/Del/2013

The Delhi ITAT has upheld the decision of CIT(A) and rejected the contention of the department in respect of AMP expenses transaction for AY 2007-08 and 2008-09. The Tribunal discounted the argument of the Revenue regarding the AMP expenditure being excessively incurred for promoting the 'Make My Trip' (MMT) brand, and held that it is evidently clear that the assessee is the sole owner and beneficiary of MMT brand as the trademark is registered in assesse's name. The ITAT further rejected the TPO/AO view that MMT Mauritius (AE) shares listing on premium at NASDAQ is linked to excessive AMP incurred by assesse, wherein the ITAT took cognizance of the CIT(A) observation that the share issued at premium doesn't accrue any benefit to the assessee but to the shareholders at the time of sale of such shares. Furthermore, the ITAT also held that AMP expenditure is revenue in nature as it is incurred to increase the sale of products and no permanent advantage is achieved from the same thereby dismissing the Revenue's capital expenditure argument. Also, the Tribunal observed that from AY 2010-11 to 2016-17, the TPO has not considered AMP expense as international transaction and hence that view should be consistently applied. Accordingly, considering all the above factors, the ITAT deleted the AMP adjustment made by the TPO/AO.

Nangia Andersen LLP's Take

There has been a dilemma in the Indian TP ruling landscape in providing authoritative ruling on whether the AMP expenditure is an international transaction or not and there are contradictory views that exist regarding the same. Besides there is no specific provision in Indian TP regulation to determine a quantitative TP adjustment and it can be seen from many ruling where different approaches have struck down but no approach as been suggested as the yardstick. Having said this, it is a well settled issue that where the brand is registered under the assessee's name then the AMP adjustment is uncalled for.

c. Reckitt Benckiser (I) Pvt. Ltd vs DCIT – ITA No. 404 & 529/Kol/2015 and 518 & 625/Kol/2016

The Kolkata ITAT scrapped the TP adjustment with respect to AMP expenses incurred and royalty payment made towards AE in case of assessee (part of Benckiser group) engage in manufacturing and trading of FMCG products in India for AY 2010-11 and 2011-12. With regards to royalty payment, the TPO selected CUP method and adopted benefit test approach while rejecting the TNMM of assessee to benchmark the royalty transaction, and in process the TPO restricted ALP of royalty payment to 1.5% in accumulation with determination of Nil ALP of royalty payment in respect of certain products. In compliance with DRP direction, TPO deleted the Nil ALP determination, however the DRP confirmed the remainder of the adjustment. The Tribunal emphasizing on the principle of consistency put reliance on Hon'ble SC ruling in case Radhasoami Satsang vs CIT. and held that that assessee has been paying royalty for earlier years too where the department has not objected the same and thus the department should not take a contrary view for the year under consideration unless there is a change of facts, which is not the case here.

Besides, the Tribunal also observed that it's a common phenomenon where one person makes a payment to others for the use of brand name and it's not a dispute that IPR's are registered and the said brand is owned by its AE, and further, it's not the case that the product sold by assessee is without the same brand. With regards to the AMP expenses, the TPO relying on SB ruling in case LG Electronics India Pvt. Ltd applied the bright line test and accordingly made AMP adjustment in respect of excessive AMP expenses incurred by assessee. The same was also confirmed by the DRP. However, the Tribunal has distinguished the ruling of LG electronics from the present case and held that unlike in SB ruling, the assessee is under no obligation (no terms or condition between parties) to incur AMP expenses for its parent entity, and its parent entity has no say on the same. The Tribunal further added that the assessee is engaged in only product promotion and not brand promotion. Also, while analyzing the definition of transaction u/s 92F(v) of the Act, the Tribunal concluded that the unilateral action cannot be consider as an arrangement or understanding to get covered under the definition, as there should be a mutual agreement between the parties which is not there in the present case. The Tribunal opined that the assessee had incurred such expenditure only to attract Indian customer and boost its sale in India and for that matter the assessee hold the complete autonomy in incurring expenditure of such nature. Accordingly, the Tribunal relying on the facts of the case deleted the AMP adjustment and Royalty adjustment made by the TPO.

Nangia Andersen LLP's Take

Plethora of judicial precedents in the past has consistently ruled out that the business and commercial expediency cannot be a only reason for making a TP adjustment with regards to the expenses (like royalty charges, etc.) incurred by the Taxpayer to carry out its business. It is not up to the Department for determining the need for availing IP or the benefit it derived from the same. Doctrine of res-judicata is inapplicable in income tax proceeding but principle of consistency is consistently followed in assessment proceedings and where the department deviated from its previous action without any change of facts are frequently gets deleted by higher appellate forum. Further, the business prudence for incurring of AMP cost cannot be disputed merely on the ground that the assessee is part of the international group. There should be substantial evidence to be identified by the Department and material available on record to substantiate that such AMP expenses are for promoting the brand of the Group and not for assessee's business interests in India. However, whether for royalty charges or services of AMP nature, the assessee should cautiously prepare detailed back-up documents to substantiate their position for incurring such cost.

Rulings in relation to Comparable companies' selection

d. Mott MacDonald Pvt. Ltd vs DCIT – ITA No. 1524/Mum/14

The Mumbai ITAT disposed of the various reasoning of the Department regarding the rejection of internal CPM used by the assessee for benchmarking the provision of engineering consultancy services to its AE for AY 2009-10. With regards to the Department's contention of volume difference between the related and unrelated transactions, the Tribunal was of the opinion that the volume difference has an impact on degree of comparability, however, such volume difference doesn't have a material impact on the comparability of comparable itself. Further, with regards to the Department's argument of significant difference in FAR assumed by the assessee with respect to related transaction, the Tribunal held that the TPO had not demonstrated the nature of such differences. Further, with respect to the TPO's objection that projects with unrelated party suffered because of client's funding and environment clearance problems, the Tribunal noted that such problems may have impact on project completion/ project milestones and thereby affect the earnings but will not impact pre-negotiated profit element embedded in the revenue. Also, the TPO's claim of difference in market condition prevailing because of different geographies between AE and non AE's which influences the profit margin, the Tribunal was of the view that geographical location is one of the criteria but not the sole factor in determining the comparability of uncontrolled transaction. The Tribunal distinguished between physical product and services, and observed that in contrast to physical product, market of service transactions is not restricted to a single geography. The Tribunal further explained that unless the market conditions in which uncontrolled transactions have taken place are materially different vis-à-vis conditions in which international transaction has taken place, the comparability of the comparable should not be questioned. Accordingly, the Tribunal rejected all the arguments of the Department with regards to use of internal CPM by assessee to benchmark the engineering consulting services rendered to its AE.

Nangia Andersen LLP's Take

Section 92C(3) of the Act does vest power in TPO to reject the method adopted by the assessee if the TPO during the proceeding is of the opinion that method of computation of ALP is not the most appropriate method in accordance with Section 92C(1) and 92C(2) of the Act. However, TPO must be precise in its reasoning in discarding the assessee's method and also demonstrate that the method adopted by the TPO depicts more accurate picture under the given economic circumstances. Further, there is no requirement laid down in the Act which specifies that the benchmarking analysis should be done based on the comparable set of geographies in which the international transaction has been entered, accordingly, the comparable companies entering into similar transaction as that of tested party should be considered as comparable irrespective of the geographical location. However, wherever required, based on the facts of the case, comparability adjustment should be carried out to enhance the comparability analysis.

Rulings in relation to Interest Free Loan

e. United Spirits Limited vs DCIT – IT(TP)A No. 489/Bang/2017

The Bangalore ITAT rejected the contention of the assessee and ruled in favor of the Department with respect to the application of Chapter X provisions on interest free loan granted by the assessee to its AE for AY 2012-13. The Tribunal rejected the argument of the assessee that Chapter X is a machinery provision and cannot overtake the principle laid down in charging provisions i.e. Section 4, Section 5, Section 15, etc. The Tribunal held that the provisions laid down in Chapter X are special provisions relating to Avoidance of Tax, and accordingly, general provisions should give way to such special provisions. The Tribunal further elucidates that Chapter X brings in a legal fiction/ deeming provision and the same is required to be complied with to arrive at the total income chargeable to tax. The Tribunal also noted that Finance Act 2012 vide amendment, has brought the loan transaction within the ambit of definition of international transaction with retrospective effect and accordingly even if the loan transaction is not accruing any income, it has to be tested as per the provision laid down in Chapter X. The Tribunal relied on the decision of Instrumentarium Corporation Ltd [ITA Nos. 1548&1549/kol/2009] and held that enactment of TP provision was to prevent profit sifting and Chapter X being a special provision overrides general provision, hence, interest free loan should be construed as zero interest loan and accordingly apply arm's length principle even if no interest is contemplated between the parties. Further, with respect to assessee's proxy contention that such loan being in the nature of quasi capital and hence TP provision should not be applicable, the Tribunal held that there was no contractual obligation or option for converting the loan into equity. Accordingly, the Tribunal rejected assessee's claim with regards to interest free loan.

Nangia Andersen LLP's Take

With dwindling tax collection and increase in financial transactions such as Compulsory Convertible Debentures, Masala bonds, etc., taxing the interest and interest in taxing, both have gained traction. Also, as the world weathers through the Covid-19 storm, these would garner more attention. Thus, MNEs should proactively and at an early stage undertake detailed analysis of interest free loans and other FOC transactions such as guarantee without consideration, not cross-charging management services, service cross-charges without mark-up, royalty/ interest moratorium, etc. from the prism of points elucidated above and beyond (including and not limited to positions adopted in GST, regulatory, etc.) to avoid protracted litigation. The key aspect of all TP analysis will be to prepare robust documentation having regards to commercial/ business rationale for intra-group business dealings.

Detailed analysis of the ruling can be accessed using the below link:

https://bit.ly/3a1MHc7

Rulings in relation to Intra-group services

f. DCIT vs Teradata India Pvt. Ltd – ITA No. 2397/Del/2017

The Delhi ITAT has validated the decision of the DRP and ruled in favor of the assessee in respect of subvention income received and intra group services. After perusal of records, the Tribunal noted that the assessee is a limited risk distributor and is guaranteed 3% profit margin from its distribution activities and any shortfall will be made good by its AE in the form of subvention income. However, the Tribunal observed that the TPO has considered the same under BPO segment instead of distribution segment, and accordingly, held the action of the TPO as invalid. Further, the Tribunal deleted the Nil ALP determined by the TPO with regards to intra group services wherein the TPO treated the same to be duplicating service. In this regard, the Tribunal noted that the assessee had entered into an agreement with its parent for share service cost arrangement and is being remunerated in the form of cost plus basis, accordingly, any payment made by the assessee contribute to its cost base and such an adjustment will lead to double taxation effect. The Tribunal further noted that for AY 2008-09, the DRP under similar circumstances has deleted the Nil ALP determination. Hence, the Tribunal accepted the assessee's contentions and allowed the appeal.

Nangia Andersen LLP's take

The issue with regards to the subvention fee is settled by SC in case of Siemens Pub Communication Network Private Limited [SPL (C) Nos. 6946/ 2014], wherein the SC held that the subvention fee received by the Taxpayer was in nature of capital receipt as such voluntary payments made by the parent company to the Taxpayer is to make good its losses with a view to protect its capital investment in the Taxpayer. However, the case in hand makes it clear that subvention income in operating in nature for TP purposes and can be capital in nature for corporate income tax purposes. Also, it is important for the Taxpayers to maintain details of such fee received and the segment for which it is received (where the Taxpayer is into multiple segment), from TP documentation and litigation standpoint.

Rulings in relation to operating margin computation

g. Trident Microsystems India Pvt. Ltd vs DCIT – ITA No. 842/Bang/2016 & 2020/Bang/2017

The Bangalore ITAT has ruled in favor of the assessee and held that operating cost incurred in relation to operating revenue generated by the assessee during the month of April and May alone (as the assessee stopped business operation beyond May but continue to incur expense post May) for AY 2013-14 should not be considered for the purpose of calculating operating margin i.e. operating profit/ operating cost. The Tribunal accepted assessee's argument that considering the expenses incurred by the assessee in subsequent months i.e. beyond May, where no revenue was generated, would result in distorted picture of operating margin. However, the Tribunal also noted that if any expenditure for the first two months is accounted by the assessee beyond May then the same should also be considered for the operating margin computation. Hence, the Tribunal rejected the Revenue's method of considering expense for the entire year instead of only April and May for operating margin computation.

Nangia Andersen LLP's take

Once the business operations are ceased and the agreement with the related party terminated for provision of services, then even though certain recurring and fixed expenses may be incurred, these should be outside the purview of cost base for the purpose of charging a mark-up. However, if the Company is being wound up by the Group or functions solely as a captive service provider who has for many years provided services only to its associated enterprises, then based on TP principles, such additional cost should be reimbursed by the associated enterprises. Thus, an analysis should be undertaken, based on the facts of the case, to analyse such transactions in detail. This ruling can be of significant importance in times to come where the business operations are disrupted due to COVID-19 pandemic.

h. Applied Materials India Pvt. Ltd vs DCIT – IT(TP)A No. 2687/Bang/2017

The Bangalore ITAT denied the argument of the assessee, who is a captive service provider to its AE, for not considering the sub-contracting charges paid to third party while calculating the operating margin of the assessee. For this, the Tribunal relied on assessee's own case for AY 2011-12 and 2012-13 wherein the coordinate bench observed that the assessee charges 10% of mark-up to its AE for rendering software development services and is therefore not acting as an agent or distributor of AE. Accordingly, the cost of sub-contracting is thus also charged with 10% markup to its AE. Hence, the Tribunal was of the view that the sub-contracting cost cannot be construed as pass through cost. The Tribunal further observed that the sub-contracting cost is a part and parcel of overall cost of providing the services to its AE and thus cannot be separated from operating cost and revenue of the assessee. Accordingly, the Tribunal rejected the arguments of the assessee and upheld the approach of the TPO of considering sub-contracting cost while computing the margin of the assessee.

Nangia Andersen LLP's Take

Pass through cost are those cost which are incidental or ancillary in nature and doesn't add any value to the transaction. Accordingly, it is important for the assessee to analyse every cost incurred for rendering of service or sale of goods to identify whether the same should be operating in nature or not. Once a value chain is drawn and analysis undertaken as to who bears the risk and associated liabilities with such outsourcing, the way forward would be much clearer.

▪ Rulings in relation to Stay of Demand

i. Steria (India) Ltd vs ACIT – Stay Application Nos. 225/Del/2020, 226/Del/2020 & 227/Del/2020 (In ITA No. 741/Del/2017, 3992/Del/2017 & 5745/Del/2018)

The Delhi ITAT taking cognizance of the extraordinary situation due to COVID-19 decided to extend the interim order of stay of demand (corresponding appeal to which is pending before the Tribunal) till the next day of hearing i.e. 17th June 2020. The Tribunal arrived at its conclusion after observing that the stay of demand granted by the Bench in November 2019 which was expiring on 12th April 2020 stand extended up to 15th May 2020 in the light of the order of the Hon'ble Supreme Court in W.P. (Civil) No. 3/2020 dated 23rd March 2020 extending the period of limitation till further notice and the order of Hon'ble Delhi High Court in W.P. No. 2/2020 dated 25th March 2020 asserting all the interim order will still be subsisting till 15th May 2020. Further, the Tribunal also noted that the Delhi High court vide order dated 15th May 2020 extended the currency of such interim order till 15th June 2020. The Tribunal also took into consideration the Central Action Plan issued by CBDT for Q1 of 2020 which refrain from any communication with the assessee having an adverse effect on them.

Nangia Andersen LLP's Take

Unprecedented time warrants unprecedented action. The key to this is to have a pragmatic response to such an unexpected situation where the entire nation is facing the heat of pandemic. Due to the disruption of day-to-day Court functioning, it would only be rational to extend all the interim order until the functioning of the Court comes into full force. Further, the financial hardships that the assessee was facing have to be considered while deciding on the stay, as that will not only have an impact on the day-to-day functioning of the assessee's business but also can have severe impact on the employees of the assessee as any substantial demand payment may severely affect the fund availability of the assessee to disburse salaries.

j. Tata Education and Development Trust vs ACIT – SA Nos. 147 and 148/Mum/2020 (IN ITA Nos. 1423 and 1424/Mum/2018)

The Mumbai ITAT referred the matter for consideration of a special bench with regards to the issues arising from the amendment introduced in the Finance Act 2020 in section 254(2A) of the Act, requiring the assessee to mandatorily deposit minimum of 20% of disputed tax demand as a pre-condition for obtaining stay of recovery before the ITAT. The Tribunal heard the assessee's argument that the said amendment to Section 254(2A) of the Act is directory and not mandatory, hence the amendment does not curtail the powers of the Tribunal to grant stay. The Tribunal also noted assessee's contention that holding the provision of Section 254(2A) as mandatory would result in patently incongruous legal position resulting in a situation which is completely arbitrary, unconstitutional and contrary to the well settled scheme of law. The Tribunal further noted that with regards to the security to be furnished pursuant to the amendment under Section 254(2A) of the Act, the assessee opined that it could be in various forms including bank guarantee, bond, mortgage, lien, charge or pledge or even an undertaking by the assessee that it will not sell off certain assets to secure the demand, but ultimately should be at the discretion of the Tribunal to decide as to what is reasonable security.

After considering legal history of the entire matter, spate of past amendments that impacted the powers of the Tribunal and the legal position of the power of Tribunal to grant stay in deserving matters, the Tribunal identified two significant aspects of the controversy, namely – (i) Legal impact of amendment in first proviso to Section 254(2A) of the Act, on the powers of Tribunal under Section 254(1) of the Act to grant stay, and (ii) If there is a legal impact then whether the amendment is directory in nature or mandatory.

Considering that this issue will have far reaching consequences in pan India, the Tribunal decided to have the benefit of arguments from stakeholders in different part of the country, and therefore, the Tribunal referred the matter to Hon'ble President for consideration of constitution of a larger bench and to frame questions for the larger bench's consideration. The Tribunal posted the matter tentatively for July 6. The Tribunal in the interest of assessee and the department granted interim stay to the assessee under condition that the assessee will furnish an undertaking setting out complete details of investments of amount not less than INR 100 crores (approx.) (which is the disputed demand) which the assessee will not encash till the stay applications are disposed of. The interim stay will remain in force till the related stay applications are disposed of, or till appeal are disposed of, or till further orders, whichever is earlier.

Nangia Andersen LLP's Take

Considering the current COVID-19 times, most of the taxpayers are facing severe cash flow issues and any payment of tax on the demand raised by the Department will further impact the functioning of the business of the Taxpayers. Prior to the amendment, the stay of demand was decided at Tribunal's discretion based on various factors such as litigation history, cash flow situation of the Taxpayer, primar facie merits of the case, etc. Thus, there was no minimum payment stipulated in the law, however, the mandatory payment of minimum 20% of demand will create an unnecessary burden on the Taxpayers and raise many other challenges such as priority of stay granted matters, painting everyone with same brush, etc. Considering in the given case, the matter was referred to the Special Bench consideration, all eyes will be on the ruling as both parties are equally impacted, and the current COVID-19 environment has added to the woes.

Detailed analysis of the ruling can be accessed using the below link:

https://bit.ly/3fGt6iB

Global Updates

▪ Canada 2019 APA Program Report

In June 2020, Canada Revenue Agency (CRA) published 2019 APA statistics. A summary of the key findings of the APA program for the period from January 1, 2019 to December 31, 2019 is provided here:

- CRA had active inventory of 71 APA cases on 1 January 2019 and in 2019 accepted 7 new APA cases (against 32 APA cases accepted in 2018), completed 12 cases (against 25 APA cases completed in 2018), resulting in closing inventory of 66 APA cases for 2019.
- Average completion time for a bilateral APA in 2019 was 51.1 months.
- Currently, CRA is engaged in bilateral or multilateral APA cases involving taxpayers from 26 different jurisdictions including India, with the majority of APA cases with the United States at 50%.
- As on 31 December 2019, 47% of the APA cases involved transfers of tangible property, followed by intangible property (27%), intra-group services (23%) and financing arrangements (3%).

Detailed report can be accessed at:

https://bit.ly/30BpDxN

▪ US APA Update

On 11 May 2020, US IRS published modifications to file MAP and APA requests and Annual APA reports. Given current Covid-19 environment, as part of temporary guidance issued on 27 March 2020, IRS has clarified that MAP and APA requests may be filed electronically with hard copy filing not required. IRS has also responded on queries received on the Advance Pricing and Mutual Agreement Program (APMA), which includes:

- APMA is in active discussion with its treaty partners in current economic conditions on issues that includes, but not limited to, application of TP method, impact of economic distress on specific industries/ taxpayers/ regions, etc.
- APMA also provided to contact specific APMA program manager depending on issue such as queries related to concluded APAs with 2020 as covered year to be directed to concerned APMA Assistant Director and queries for pending APAs covering 2020 to be directed to concerned APMA team leader.

Country Round - Up

US

US Internal Revenue Service (IRS) recently released 6 Frequently Asked Questions (FAQs) on TP documentation related to best practices and common mistakes made by the taxpayers in preparation of TP documentation, which can be accessed at:

https://bit.ly/3fGtnC9

The detailed analysis of the TP documentation best practices by Andersen US can be read at:

https://bit.ly/3fvNB1C

Australia

On 19 June 2020, the Australian Taxation Office (ATO) released guidance named “COVID-19 economic impacts on transfer pricing arrangements” that lays the rules on the types of analysis that it would expect to be performed to assess the impact of COVID-19 on a Company and the evidence it may seek to review when evaluating a Taxpayer’s approach to managing its TP during this period. The detailed ATO instructions can be accessed at:

https://bit.ly/31uncvX

Further, the detailed analysis of the ATO’s guidance can be accessed at:

https://bit.ly/3ag4XyF

On 25 June 2020, the ATO has updated the instructions for e-filing of Local file for reporting periods starting on or after 1 January 2019 during 2020. The Local file may be filed separately or along with the Master File and forms part of a combined form that contains Master File as well. The detailed ATO instructions can be accessed at:

https://bit.ly/3a4pPZh

Sweden

In April 2020, Swedish Tax Agency (STA) published its revised guidance on TP of financial transactions relying on the Chapter X of the Guidelines on Financial Transactions published by Organisation for Economic Cooperation and Development (OECD) in February 2020. STA stated that arm’s length pricing of financial guarantees going forward needs to be relooked as against earlier position adopted in Sweden of charging for financial guarantees only in case of financial business or wherein the guarantor for providing guarantees incurs specific costs or relinquishes specific income.

Bangladesh

Recently, Bangladesh's National Board of Revenue's (NBR) TP Cell has enquired 921 MNCs operating in Bangladesh about TP related queries. NBD has also decided to form another TP Cell for its customs and VAT wings to curb trade based money laundering through transfer mispricing between the associated enterprises.

Saudi Arabia

In May 2020, Kingdom of Saudi Arabia's General Authority of Zakat and Tax (GAZT) published second edition of the TP Guidelines subsequent to the first edition released in March 2019. The guidance clarifies that there is no materiality threshold for complying with TP guidelines except when taxpayer can demonstrate absence of 'effective control'; stresses on performance of Development, Enhancement, Maintenance, Protection and Exploitation (DEMPE) functions for ownership of intangibles and grants exemption w.r.t. CbCR filing in case the ultimate parent entity is not obliged to file CbCR report in its own jurisdiction owing to threshold limits.

Oman

Oman is slated to amend its Income Tax Law for introduction of TP Guidelines, documentation regulations, Automatic Exchange of Information (AEOI) and Country-by-Country reporting, amongst others.

Nigeria

Nigeria's Federal Inland Revenue Service launched electronic portal for filing TP disclosure forms, CbCR forms and CbCR notification forms for assessment year 2020.

Ireland

On 24 April 2020, the Irish revenue commissioners published guidelines for correlative adjustment claims made by Irish taxpayer to address double taxation resulting from additional foreign tax from reassessments of an Irish taxpayer's affiliate by a foreign tax authority. The said unilateral relief is provided to Irish taxpayer under the terms of the Double Taxation Agreement (DTA) with another country as treaty partner. The guidelines for correlative adjustment claims can be accessed at:

https://bit.ly/31DWJMv

Bahrain

On 1 April 2020, Bahrain's National Bureau for Revenue published guidance on MAP providing the taxpayers with necessary information to consider before requesting a MAP to resolve double tax treaty disputes. The guidance covers applicability, steps involved and timelines for MAP amongst others. For details, please refer link below:

https://bit.ly/3a8mjxe

Rulings Across the Globe

▪ Danish HC TP ruling on goodwill amortisation

Danish High Court made adjustment for years 2006-09, considering goodwill amortisation as operating expense, in case of an assessee engaged in distribution of goods purchased from related party manufacturer using net margin analysis under TNMM. Goodwill of DKK 913.6 million was computed based on income valuation approach after the merger of other entities into the assessee in 2006 under share purchase transaction, which was to be amortised at DKK 57.1 million p.a. over an expected residual life of 16 years. The assessee while computing Earnings before interest and tax (EBIT) considered goodwill amortisation as non-operating expense. HC held that 'the goodwill in question had to be regarded as an operating asset, and therefore the depreciation had to be regarded as operating expenses when calculating the net profit (EBIT margin)', thereby adjusting the taxable income of the assessee for 2006-09.

Detailed analysis of the ruling can be accessed at:

https://bit.ly/2XEz9OD

▪ Polish Court's TP ruling on intra-group services

Polish Court, in case of a Polish shared services entity engaged in provision of support services to its AEs, allows expenditure on intra-group services establishing 'functional relationship' of such expenses with shared services remuneration. Polish Court states that the value of the shared support services provided is based on the benefits derived from the intra-group costs, thereby allowing the intra-group service charges.

Detailed analysis of the ruling can be accessed at:

https://bit.ly/3a4qVEm

▪ Norwegian SC ruling on cost contribution arrangement

During fiscal years 2007-12, Norske Shell (appellant, an oil & gas company part of Shell group) participated in joint license agreement, wherein the costs of Research and development (R&D) would be borne by the operators (i.e. Appellant and other licensees) according to their share. Norwegian Supreme Court rules on allocation of R&D costs incurred by the appellant to its group companies based on the arm's length principle as per the cost contribution arrangement as enunciated by OECD TP Guidelines. SC states that the allocation of the R&D costs of the appellant should be based on the benefit derived from them. Detailed analysis of the ruling can be accessed at:

https://bit.ly/3ikR0ls

Zambian SC ruling in case of Mopani Copper Mines Plc

Zambian SC upheld Tribunal's decision for the period 2006-09 in case of Mopani Copper Mines Plc, the appellate engaged in coal mining in Zambia for sale to third parties and its Swiss parent company – Glencore International AG. Zambia Revenue Authority (ZRA) based on an audit in 2009 found that the price of copper sold to its AE was significantly lower than the price of copper sold to third parties violating the arm's length standard and resulting in lower tax liability and thereby tax avoidance in Zambia, for which the SC fined the appellate $13 million. The copy of the ruling can be accessed at:

https://bit.ly/3kfZCff

Danish SC ruling on royalty payment in case of Adecco A/S

On 25 June 2020, Danish SC held the royalty payment (of 2% in the industrial segment & 4% in the professional segment) for years 2006-09 by appellate (Adecco A/S, a loss making company) to its Swiss parent (a global temporary staffing agency) for use of the Adecco trademark, know-how, and access to customer referrals in Denmark under a license agreement, as deductible operating cost, thereby rejecting the HC's nil determination of arm's length price in a dispute of DKK 84 million (USD 12.6 million). SC held that the royalty payments helped in income generation to the appellate despite negative margins earned by it, thereby holding royalty payment in the nature of deductible operating costs. SC states that the late submission of internal comparable i.e. third-party license agreements should not lead to discretionary disallowance by the Danish Tax Agency. In this majority SC ruling, 3 out of 5 judges upheld the royalty rate of 2% as arm's length based on the available internal-comparables rejecting HC's ruling that the third party license agreements in a foreign country could not be considered appropriate comparable for the Danish market. The translated copy of the ruling can be accessed at:

https://bit.ly/3iiBw1E

Zurich Court's TP decision on attributing value-adding functions to Swiss company

Zurich Administrative Court ruled in favour of Zurich Tax Authorities (ZTA) in case of appellant, a Swiss company engaged in rendering investment advisory services under fund management agreement to its AE (under private equity structure) during 2008 and 2009. Zurich Court confirms ZTA's view based on thorough value chain analysis that all the value-adding functions (like capital raising, investor search, portfolio management, exit decision, etc.) and related risks were attributable to the appellant while the AE only carried out routine investment management functions with no risks, thereby rejecting profit sharing split of 70:30 fee between the appellant and the AE. Zurich Court upheld ZTA's decision of remunerating AE at 10% of its total costs and allocating the remaining entrepreneurial return to the appellant. The translated copy of the ruling can be accessed at:

https://bit.ly/31uz55i

▪ Finnish SC ruling on selection of foreign tested party

Finnish SC rules in favour of the appellant for selection of the tested party in case of AE purchases made from contract manufacturers in the group by appellant, a Finnish entity operating as sales and marketing company of the international group in Finland during years 2007-10. The appellant has been incurring losses (except in 2008) and thus the lower authorities considered that the testing of the appellant was required using TNMM to assess with sufficient reliability the reason for its long term losses as against analysis of contract manufacturing companies. Finnish SC rejects the lower court's decision stating that the appellant had business reasons for its loss (such as price competition in the sector and the inefficiency of the company's operations) and upheld that considering the activities performed, assets employed and risks borne by the appellant and its contract manufacturing AEs, the appellant should not have been chosen as the tested party rather than the contract manufacturers.

▪ US Tax Court's Whirlpool ruling on economic substance over form

US Tax Court imposed US federal taxes of ~$50 million on the sales income earned by Whirlpool Financial Corporation's (Whirlpool US) Luxembourg subsidiary (a Controlled Foreign Corporation - CFC) by treating the same as "Foreign Base Company Sales Income" (FBCSI) for financial year 2009. FBCSI is the income derived by a CFC from a purchase/ sale of personal property involving a related party in which the goods are both manufactured and sold for use/ consumption outside the CFC's country of organization. US Tax Court found that the income from sale of appliances had been allocated to Whirlpool Luxembourg through a manufacturing and distribution arrangement. As per the agreement, it was the nominal manufacturer of household appliances manufactured in Mexico (through a newly formed contract manufacturing entity using existing staff of Whirlpool Mexico), that were subsequently sold to Whirlpool US and Whirlpool Mexico. Under the said arrangement, using the Mexican Maquiladora structure, Whirlpool Luxembourg paid taxes at preferential rate, while it claimed its income in Luxembourg as exempt by obtaining a tax ruling from Luxembourg's tax authorities by arguing that none of the income derived from sale of manufactured goods was taxable as income from contract manufacturing was attributable to the PE in Mexico and in US. US Tax Court found that by adopting the maquiladora regime, Whirlpool Luxembourg was deemed to have no PE under the TP rules and thus, paid no taxes in Mexico on the sales income. US Tax Court thus stated that "By carrying on its activities "through a branch or similar establishment" in Mexico, Whirlpool Luxembourg avoided any current taxation of its sales income. It thus achieved "substantially the same effect"--deferral of tax on its sales income--that it would have achieved under U.S. tax rules if its Mexican branch were a wholly owned subsidiary deriving such income". US Tax Court stated that Whirlpool US fulfilled the 2 preconditions for application of FBCSI viz., (i) CFC carrying on activities outside its country of incorporation through a branch or similar establishment and (ii) the conduct of such branch is similar to the activities that would have been performed by the wholly owned subsidiary of the CFC. Basis this, the Court held that "The sales income attributable to the carrying on of activities through Whirlpool Luxembourg's Mexican branch..."shall constitute foreign base company sales income…". The ruling can be accessed at:

https://bit.ly/3fCtUoL

Nigerian Tribunal's first TP ruling in case of Prime Plastichem Nigeria Limited

On 19 February 2020, Nigeria's Tax Appeal Tribunal (TAT) delivered its first TP ruling in case of Prime Plastichem Nigeria Ltd (Appellant engaged in trading of imported plastics and petrochemicals) vs 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 analysis of the decision can be read at:

https://bit.ly/31wun75

Additionally, Andersen Global covered the Nigeria's maiden TP judgement recently through webinar, which can be accessed at:

https://bit.ly/33zItHg

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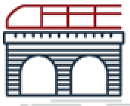

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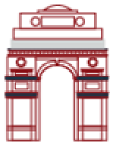

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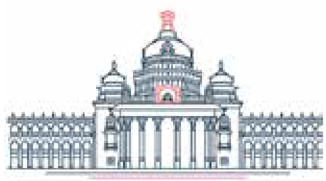

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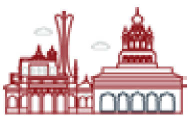

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