Nangia Andersen LLP

Communiqué

Your Quarterly TP Tabloid

Issue 8, October - December 2020

Foreword

It is budget time again but the sentiments are very different this year. The budget time coincides with the roll out of vaccine and the expectation would be similar from the upcoming India's Union Budget 2021, to relieve the economy from the effects of the pandemic. With the Country's economic health taking a severe hit due to covid in 2020, the pressure would on the Union Budget 2021 to not only revive the economy to pre-covid levels but to cover the losses as well. The focus of the Government should be on strengthening the manufacturing ecosystem, promoting research and development, incentivizing futuristic technologies, reviving the stressed industries, putting more disposable income in the hands of consumers and leading from the front in terms of infrastructure development activities.

Transfer Pricing (TP) regulations are intimately connected to the economic growth of the country and influx of foreign direct investments or outbound investments. So, this quarterly issue not only discusses expectation from the forthcoming budget in the area of TP but also, covers the small measures on the way that have been taken by the Indian Authorities towards above-mentioned objectives. Furthermore, we have discussed significant Indian rulings pronounced in the previous quarter that keeping setting principles in key areas of litigation.

At global level, the Organisation for Economic Co-operation and Development (OECD) has released the blueprint of Pillar 1 and 2, along with new methodology for peer review of Base Erosion and Profit Shifting (BEPS) Action Plan (AP) 13. Further, OECD has also actively released more reports and guidance which would have a ripple effect on non-OECD member countries as well. There have been some interesting developments all over the world due to the impact of Pandemic and some landmark judgements which would form basis of future litigation. All this and much more has 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:

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-andersen.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.

With a hope that Union Budget 2021 will usher in a brighter dawn for Indian Inc. we will now see you on the other side with our insights and cutting edge analysis.

Rakesh Nangia
Chairman,
Nangia Andersen India Pvt. Ltd

India-Japan Cooperation wins OECD Mutual Agreement Procedure (MAP) 2019 Award

On November 18, 2020, OECD released the 2019 MAP statistics and the winners of the MAP awards for several categories such as average time to close MAP cases, age of inventory, caseload management and co-operation. India with Japan won the collaborative award for highest agreement ratio of 64% being the pair of jurisdictions that dealt with their joint caseload of TP cases most effectively.

The details on MAP 2019 statistics and the winners of the MAP awards for several categories can be accessed through the below link:

https://bit.ly/3py036E

The Taxation and Other Laws (Relaxation and Amendment of certain provisions) Bill, 2020 receives presidential assent

On September 29, 2020, the President of India gave his assent to the Taxation and Other Laws (Relaxation and Amendment of certain provisions) Bill, which now becomes an act. The act makes necessary amendments so as to capture the insertion of new provisions and announcements made in ordinance and press releases in previous months. Moreover, the act provides detailed framework for faceless assessment which includes TP Litigations as well.

The details of the Taxation and Other Laws Bill, 2020 in relation to TP litigation has been captured in our quarterly issue of "Communique- Your Transfer Pricing Tabloid Issue- 7" that can be accessed through the link stated below:

https://bit.ly/3a8Gvzq

The Expectation continue….TP and 2021 Union Budget

The finance ministry is busy with the planning for the upcoming fiscal year with its hands full with the task to make palpably extraordinary efforts to counter the downturn with fiscal and monetary policy support. But it would be worthwhile to see below recommendations, both at policy level as well as to ease out challenges faced by the taxpayers to provide immediate relief, find their way in the upcoming budget to the pandemic related economic disruptions:

Recommendations to ease out TP related practical challenges faced by the taxpayers:

- **Use of Multiple years' vs Single year's data:** Given the latest year's margins i.e. for FY 2020-21 or most of the comparables' would not be available at the time of undertaking TP compliances, the recommendation is to align the number of years considered for the tested party with those for the comparable companies. It can be either three years or single year comparison, but the parity must be maintained, especially considering the unprecedented times.

- **Use of Range Concept - 25-75th percentile to be adopted instead of 35-65th percentile**: Based on global experience, the interquartile range (i.e. 25th - 75th percentile) should be considered under the range concept, in order to use the better representative of the sample population of the comparables considered and align with the global standards.

- **Arithmetic mean (AM) – end of long road:** With AM not being the best measure of central tendency as it shows distorted results that are easily influenced by extreme values or with more dispersed (volatile) data sets, it's time to end its use. Further, even if AM is to be continued, then it may be worthwhile to restore the +/-5% tolerance band than using the +/-3% or +/-1%.

- **Section 94B of the Income-Tax Act, 1961 (the Act) - Limitation on interest deduction:** Given the liquidity crunch faced by taxpayers due to the pandemic resulting in increased intra-group financing transactions, it may be worthwhile to contemplate enhancing the applicability limit of Section 94B of the Act from existing INR 1 crore to provide adequate relief to the taxpayers in the admission of deductible interest expense on such intra-group loan availed and keep the loan backed by guarantee (both implicit and explicit) outside the purview of Section 94B of the Act.

- **Section 92CE of the Act - Secondary adjustment:** Considering the current pandemic situation, the authorities should contemplate for upward revision of the said existing threshold of INR 1 crore provided in Section 92CE of the Act. Furthermore, it is recommended that the secondary adjustment provisions should not be applicable in the first place on the dispute resolution programs, i.e., Advance Pricing Arrangement (APA), MAP and Safe Harbour as settlement has already been provided by the Department then there should be no further grievance or demands on their part.

- **Due date of filing of Accountant Report (AR) in Form 3CEB:** The due date of filing of the AR should be made along with the Income Tax Return (ITR) instead of the recent change of filing it one month prior to the ITR due to inter-dependence of the two compliances.

Recommendations for the policy-level change concerning Indian TP legislation:

- **One-time Settlement/ Amnesty scheme for past years:** For the TP cases, say wherein a MAP application could not be filed in the past years since India's position on acceptance of MAP cases in absence of Article 9(2) [correlative adjustment] in Double Tax Avoidance Agreements (DTAA) a one-time settlement scheme could be announced for such Taxpayers.

- **Dispute resolution mechanisms such as Safe Harbor Rules (SHR), APA, MAP, Dispute Resolution Panel (DRP) and Commissioner Income Tax (Appeals) [CIT(A)] should be made more attractive:** The Central Board of Direct Taxes (CBDT) could make plugging the issues at these forums to make them more effective such as consider commissioning of Settlement Commission or equivalent specifically to address TP disputes or enhance the powers of DRP/ CIT(A) to waive penalties and settle disputes with appropriate approvals from CBDT. At the CIT(A) level, there are two main grievances to be addressed – (1) payment of demand of atleast 20%, and (2) no time limit for passing of order by CIT(A). Addressing the two could inflict much confidence in the sentiments of the industry. As regards to the SHR, it could become a safe bet for future. However, it suffers from some deficiencies, such as, the rates in the provision are not closer to the ground reality, has limited applicability, and are announced post the end of the year, to name a few.

- **Block assessment to be considered:** In line with the global best practices followed by many developed countries such as US, Germany, Australia, and many other European countries (as we witness in their specific jurisdictional TP case laws as well), it is suggested that block assessment of 3-5 years should be considered for TP issues.

- **Section 92E of the Act - AR/ TP Certification in Form 3CEB:** Even though the said AR is duly signed by an independent Chartered Accountant (CA), the onus for justifying the information provided therein is still on the taxpayer. The authentication by the CA renders no value addition in the existing form, as it has no practical relevance later once the TP documentation is submitted by the Taxpayer. Therefore, it may be prudent to either, incorporate the required field in the tax return itself to ease compliance burden, or Form 3CEB is self-attested by the Company similar to ITR, as well as Master File (MF) and Country-by-Country (CbC) Report compliances.

- **Associated enterprise under Section 92A of the Act:** According to Section 92A(2)(c) of the Act, two enterprises shall be deemed to be Associated Enterprises (AEs) if, at any time during the previous year a loan advanced by one enterprise to the other enterprise constitutes not less than fifty-one percent of the book value of the total assets of the other enterprise. An exception needs to be carved out for loans advanced by banks/ Non-Banking Financial Corporations (NBFCs) since such enterprises are into the business of lending funds and this creates undue issues/ challenges for small and medium enterprises not having sizable assets, particularly during COVID-19 times.

- **Revision of threshold limits for Master File:** The threshold limit for MF should be enhanced to almost double from the existing threshold of Consolidated Group Revenue greater than INR 500 crores, to reduce the compliance burden on small and medium enterprises in India. Additionally, MF requirements should not be made applicable for the non-resident or the foreign entities in order to reduce the unnecessary compliance burden on the non-resident entities as they must already be undertaking similar compliance in their respective jurisdictions.

Our article discussing the above-mentioned point in greater details can be accessed through the below link:

https://bit.ly/2MAGEUg

OECD releases Inclusive Framework's Action Plan 5 peer review report; India recommended to ensure timely exchange of information on future APAs rulings

On 15 December 2020, the OECD released the fourth annual peer review report relating to compliance by members with the BEPS AP 5 minimum standard on the compulsory spontaneous exchange of information on tax rulings. The report assessed the 2019 calendar-year period and covered 124 jurisdictions out of which 30 jurisdictions were not able to legally, or in practice, issue rulings in scope of the transparency framework. Out of the remaining 94 reviewed jurisdictions, 62 jurisdictions did not receive any recommendations, as they have met all the terms of reference and therefore no separate peer review report is included for these jurisdictions.

With respect to India, the report highlighted that India had met all aspects of the terms of reference for the calendar year 2019 except for ensuring that information on future APAs rulings is exchanged as soon as possible. This recommendation remains unchanged since the 2017 and 2018 peer review reports and was mostly due to the fact that India had to use the “best efforts approach” to identify potential exchange jurisdictions, for APAs issued before 16 June 2017. In addition, India faced difficulties in carrying out exchanges due to the increased number of issued rulings. A number of steps were taken in the year in review to address this, although a significant number of exchanges remained delayed for the year in review. As such, the recommendation remains in place. With regard to statistics, India has exchanged 905 unilateral APAs TP rulings and 6 Permanent Establishments (PE) rulings, which has substantially increased (i.e., around 92%) as compared to previous year 2018 (454 APAs and 21 PE rulings).

The details of Inclusive Framework's Action 5 peer review report can be accessed through the below link:

https://bit.ly/39vffw1

Other happenings

- **CBDT retains the prevailing tolerance range for AY 2020-21 -** On October 19, 2020, CBDT notified that the prevailing tolerance range of 1% for wholesale trading and 3% for other international transaction or specified domestic transaction will continue to apply to all transactions undertaken during the financial year ending March 31, 2020.

- **Extension of compliance due dates in the light of COVID-19** - In view of the challenges faced by taxpayers in meeting the statutory and regulatory compliances due to the outbreak of COVID-19 pandemic and various representations made to the government, CBDT on October 24, 2020 extended various tax compliance deadlines, including Income Tax Returns, tax audit reports and declaration under 'Vivad Se Vishwas Scheme'. Consequently, the date for furnishing of report in respect of international or specified domestic transaction i.e., Form 3CEB was extended to December 31, 2020. Considering the continued hardships faced by the taxpayers, this was further extended to January 15, 2021.

  The notification notifying the further extension for compliance due dates can be accessed through the link stated below:

  https://bit.ly/3oC5y3f

▪ Ruling on different economic adjustments in TP

a. Ruling on Depreciation adjustment

1. Vishay Components India Private Limited VS ACIT Circle-13 Pune – ITA Nos. 1198 and 1501/PUN/2018

Pune Income Tax Appellate Tribunal (ITAT or the Tribunal) in the second round of proceedings rejected the Assessee's adoption of cash Profit Level Indicator (PLI) and concluded that the depreciation adjustment can be allowed only if the depreciation rate applied by the assesse and the comparables are different and not only on the basis of difference in the ratio of depreciation to W.D.V of the assets in the case of Taxpayer (engaged in the manufacturing of Resistors, Capacitors) for AY 2007-08 and AY 2008-09 vis-à-vis comparables. The co-ordinate bench in the first round of proceedings rejected the Profit Before Depreciation, Interest and Tax (PBDIT) as a PLI espoused by the Assessee, however directed to allow for adjustment if the Assessee able to establish material difference in the claim of depreciation by the Assessee vis-à-vis the comparables. Pune ITAT in the second round of proceedings, relied on Rule 10B(1)(e) of the Income Tax Rules, 1962 (the Rule), which require determination of operating profit rate of the Assessee and the comparables which in turn imbibes the effect of all the operating cost on cumulative basis thus equating operating profit and accordingly the variation in the amount of expense on an individual item determined by the Assessee and the comparables will nullify. Further, the Tribunal notes that sub clause (iii) of Rule 10B(1)(e) of the Rules warrants for adjustment when there is a difference in recording a certain expense, however Pune ITAT held it will be applicable only if there is contradiction in the application of depreciation rate by the Assessee and the comparable on a particular item. Thus, the Tribunal rejected the argument of the Assessee and observed that acceptance of plea of such adjustment will lead to distortive comparison result between the Assessee and the comparables.

Nangia Andersen LLP's Take

The Indian TP Rules allows for adjustment to be made, however, there is no standard procedure prescribed in the Indian TP regulation for determining the same though it states that adjustment should be reasonable and accurate. This ruling enforces the fact that even if appropriate comparables are identified, there can still be need to make adjustment to the PLI basis the kind of assets and depreciation thereafter to be considered for computation of PLI. Accordingly, the accounting treatment of the depreciation with respect to depreciation rate becomes critical factor in determining the operating margin. Also, while performing the benchmarking analysis the Taxpayers should try to ensure that both the tested party and the comparable are following a similar accounting standards as it could directly impact in the treatment depreciation in the books of accounts. Having said these there are judgements from Tribunal on acceptance of cash basis PLI and adjustments to account for expenses which have a material impact on comparability and are not related to international transaction.

2. Ruling on Utilization adjustment

The JCIT Noida Range VS Colwell & Salmon Communications[I] Ltd- ITA No. 3054/Del/2011(A.Y 2004-05), ITA No. 1117/Del/2012(A.Y 2005-06)

Delhi ITAT agreeing with the contention of the Assessee (engaged in provision of call center services to its AE) gives confirmation on the capacity utilization adjustment undertaken by the Assessee for the purpose of benchmarking analysis during the first year of its business operation for AY 2004-05. The Transfer pricing Officer (TPO) discounted the Assessee's selection of its AE as a tested party and conducts the fresh economic analysis wherein the TPO arrived at operating margin of 9.52% as against the Assessee's computation of 2.85% and accordingly proposed a the TP adjustment. Before the CIT(A), the Assessee justified the selection of tested party and further submitted an alternate TP study report wherein the Assessee applying the Transactional net Margin Method (TNMM) by considering itself as a tested party undertook capacity utilization adjustment to justify the arm's length nature of its international transaction. Delhi ITAT upheld the decision of the CIT(A) and observed that being the first year of operation Assesse could not achieve the optimum level of capacity utilization as business was in operation for only 9 months and had an unutilized capacity of 47.35%. The Delhi ITAT further noted that the Assessee had to absorb certain start-up and fixed operating costs which resulted in the loss and had no correlation with international tax. Accordingly, the Tribunal granted the capacity utilization adjustment and observed that such adjustment leads to operating margin of 11.20% which is even higher than the margin of the TPO and hence deleted the TP adjustment.

Nangia Andersen LLP's Take

TNMM is more vulnerable on the proportion of fixed and variable cost as the difference in the level of absorption of indirect fixed cost would affect net profit indicator. In the case in hand, Delhi ITAT has rightly allowed for capacity utilization adjustment considering the Assessee's first year of operation as against the comparables who are well established and operating with a healthy utilization capacity. However, in the case Mobis India Limited [TS-235-ITAT-2013(CHNY)-TP], Chennai ITAT had rejected the Assessee's claim of Capacity utilization adjustment being in business operation for two months on the basis that Assessee itself excluded the startup companies having turnover less than INR 1cr. Thus it becomes critical for the Assessee to select the correct filters, accurately bifurcate its Variable and Fixed cost, and prepare a detailed computation showing the effect of capacity underutilization for substantiating its plea before the Tax Authorities. This approach has gain more importance in the current environment because of the pandemic disrupting the business operations for the large portion of the year and the need for undertaking the economic adjustment has risen multi-fold.

3. Ruling on import cost adjustment

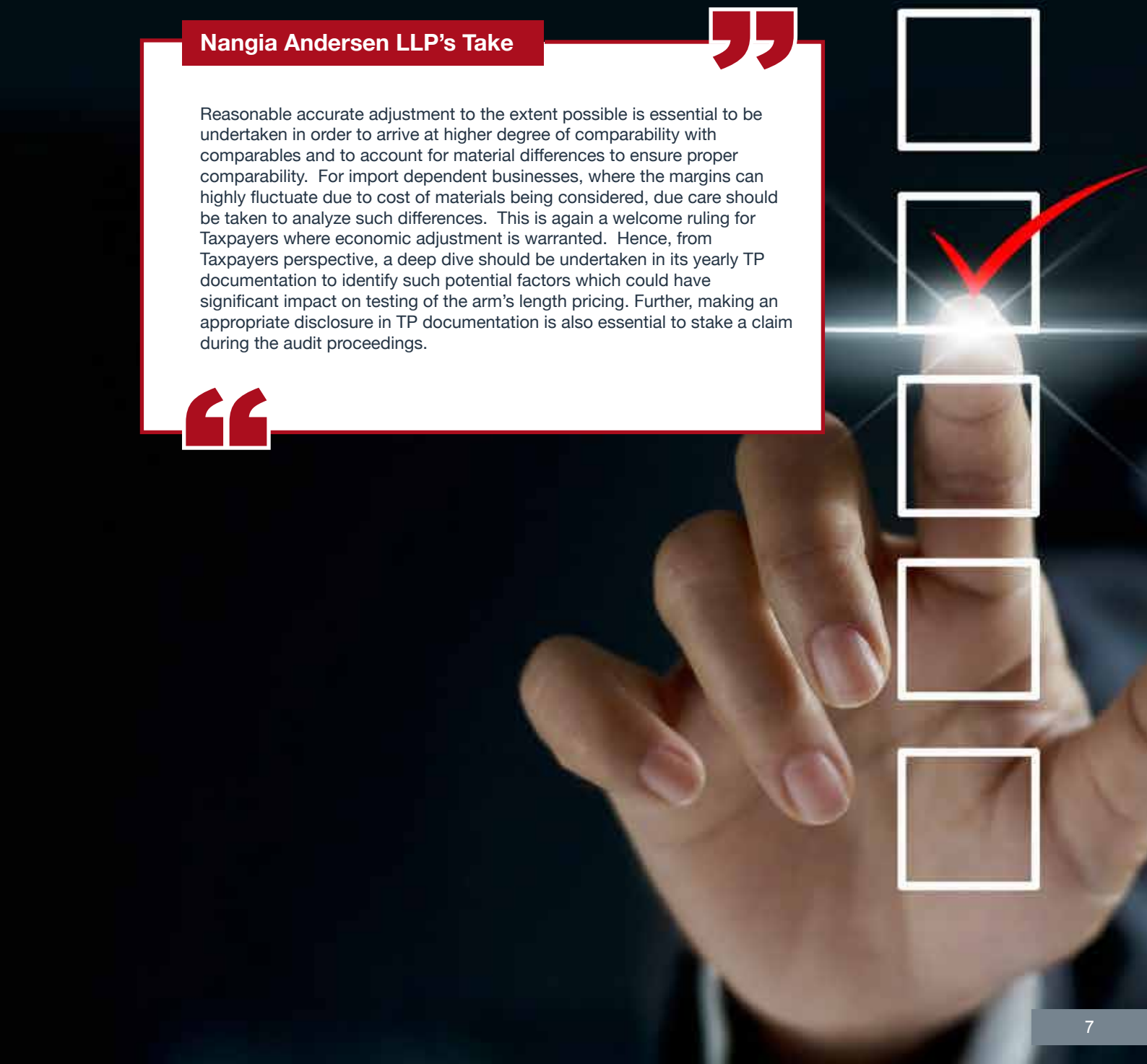
GE India Industrial Pvt Ltd vs Dy. CIT – ITA No. 1684/DEL/2016

Delhi ITAT has adjudicated on various TP adjustment undertaken by the TPO in case of the Assessee engaged in manufacturing, distribution segment for AY 11-12. In the Digital Energy unit (distribution activity), the Tribunal relying on the coordinate bench decision in Assessee's own case for AY 2004-05 [ITA No. 2210/Ahd/2012] agreeing with the contention of the Assessee stated that the Assessee's import to total cost purchase is 67.97% as against

comparables 20.66% accordingly inferring that Assessee is subject to higher import cost at 47.31% thereby allowing the adjustment on account of higher import cost. Further, in the Power control division (engaged in manufacturing of low voltage electrical products for sale to its customers) the Tribunal allowed the adjustment on account of significantly high consumption of raw materials also rejecting the TPO's contention of Assessee being captive center granted adjustment on account of under-utilization of capacity (43% of Assessee as against comparables 53.58%). Also, the Delhi ITAT for the same division, discarded the TPO's treatment of taking SHR into cognizance for considering the item provision no longer required written back as non-operating in nature. The Tribunal following the decision of the jurisdictional HC in the case of Fiserv India Private Limited, held that SHR was introduced on 18 September 2013 being prospective, and hence not applicable for impugned AY. In Transportation Division (selling locomotive parts, turbochargers and railway signaling equipments) the Assessee had claimed the adjustment on account of extraordinary expenses (in the nature of provision for sales tax, rent, gratuity etc.) which was rejected by TPO on the ground that these expenses are in relation to business operation. Delhi ITAT directed the TPO/ Assessing Officer (AO) to decide the issue afresh considering the workings of the adjustment furnished by the Assessee. Further, in respect of Water & Process Technology Division (Manufacturing of Membranes), ITAT allows adjustment on account of scrap of sales. Additionally, the Tribunal has arbitrated on the inclusion/exclusion of 19 comparables in respect of trading segment.

Nangia Andersen LLP's Take

Reasonable accurate adjustment to the extent possible is essential to be undertaken in order to arrive at higher degree of comparability with comparables and to account for material differences to ensure proper comparability. For import dependent businesses, where the margins can highly fluctuate due to cost of materials being considered, due care should be taken to analyze such differences. This is again a welcome ruling for Taxpayers where economic adjustment is warranted. Hence, from Taxpayers perspective, a deep dive should be undertaken in its yearly TP documentation to identify such potential factors which could have significant impact on testing of the arm's length pricing. Further, making an appropriate disclosure in TP documentation is also essential to stake a claim during the audit proceedings.



4. **Ruling on working capital adjustment**

DCIT Vs Transcend MT Services Pvt Ltd- ITA No. 6200/Del/2015 and Transcend MT Services Pvt Ltd Vs DCIT _ ITA No. 6200/Del/2015

Delhi ITAT concurred with the direction of the DRP and upheld the Tax Authorities action of providing the working capital adjustment in the case of Assessee being a captive service provider (engaged in business of medical transcription services to its AE) for the AY 2011-12. For the impugned AY, the TPO rejected the economic analysis undertaken by the Assessee and in the process of conducting a fresh benchmarking, the TPO also carried out working capital adjustment to the set of final comparables. In an appeal, the DRP agreed with the contention of the TPO and upheld the economic adjustment. Delhi ITAT on the perusal of the financial accounts of the Assessee, ITAT noticed that Assessee had a sundry debtors amounting to INR 19.76 crores as against the Revenue of INR 33.36 crores. Accordingly, ITAT held that major portion of Assessee's revenue was locked into sundry debtors and therefore rejected the Assessee's contention of not bearing a working capital risk being a captive service provider.

Nangia Andersen LLP's Take

The sole principle to grant for appropriate working capital adjustment at the enterprise level is to difference out the FAR profile and eliminate the material difference in debtors, creditors, stock holding affecting the net profit margin. Accordingly, as a concept, working capital adjustment should ideally take care of the differences in the price arising out of such outstanding receivables, whether positive or adverse impact on final margins. Thus, it becomes imperative for the Taxpayers to monitor its inter-company receivables to ensure that no independent adjustment to outstanding receivables arises due to high outstanding inter-company balances and also to ensure that no adverse impact arises from working capital adjustment which most often has been accepted by the Indian Tax authorities.

Ruling on issue of Hybrid Financial Instruments

1. **Ruling on treatment of OCD/CCD as "shareholder activity"**

DCIT Vs Kolte Patil Developers ltd –ITA No. 2111/PUN/2017 and Kolte Patil Developers Ltd Vs DCIT- ITA No. 1980/PUN/2017

Pune ITAT acquiesce with the decision of the CIT(A) in rejecting the TPO's action of changing the colour of the transaction undertaken by the Assessee (engaged in business development of real estate) with its AE in respect of treating the issuance of Optionally Convertible Debentures (OCD) and Compulsory Convertible Debenture (CCD) by the Assessee to its AE as equity share capital for AY 2013-14. During the course of TP proceedings, the TPO considering the said international transaction being in the nature of shareholder activity determined the arm's length price (ALP) of interest payment as NIL. Further, to support his contention, the TPO beholding the provision of Thin Capitalization principle, General Anti-Avoidance Rules (GAAR) and comparing Assessee's debt-equity ratio of 1:23 in the light of Reserve Bank of India (RBI's) Master circular stipulating 4:1 on External Commercial Borrowing (ECB) proposed the TP adjustment.

Pune ITAT emphasized on the fact that invocation of GAAR provision to treat a certain transaction as Impermissible Avoidance Agreement (IIA) requires to substantiate that a certain transaction lacks commercial substance in pursuant to the provision specified in Section 97 of the Act. The TPO cannot, on adhoc basis, enroute to GAAR applicability, but should follow the procedure as enshrined in Section 144BA of the Act. Further, the Tribunal held that provision of GAAR and thin capitalization i.e. section 94B of the Act came into effect prospectively from 01 April 2018 and hence not be applicable for the subject AY. Pune ITAT further analysed that Section 94B of the Act even after existence doesn't prescribe any debt-equity ratio as Thin Capitalization rule thereby rendering the TPO's action to be invalid. Also, the Tribunal opined that Chapter X of the Act restricts to determining of ALP of the international transaction and doesn't mandate to re-determine/re-characterize the nature of the transaction. The Tribunal also rejected the TPO's contention of treating the transaction as shareholder activity by taking a reference from OECD Guidelines and held that shareholder activity encompass the nature of the transaction which been undertaken solely on the basis of shareholding interest in other group companies, which is not applicable in the present case. Further, the Tribunal rejected the Revenue's contention of inferring the term investor referred in the Securities Subscription Agreement as investor in shares by holding that the nomenclature used in the agreement cannot be a true decisive element in determining the nature of the transaction.

Nangia Andersen LLP's Take

As mentioned in various judicial rulings, a principle emerges that commercial wisdom of the Taxpayer should not be questioned unless there can be contrary and clear facts behind entering into such an arrangement. The concept for not warranting a charge due to shareholder activity/presence is something which goes beyond the terms of the transaction and re-characterization of any transaction is beyond the capacity of Tax Authorities unless they are in possession of any documents/information to support such a claim.

2. Ruling on characterization of CCD as Equity

Embassy One Developers Pvt Ltd VS DCIT- ITA Nos.2239 and 2240/Bang/2018

Bangalore ITAT deleting the treatment adopted by the TPO in re-characterizing the CCD as equity issued by the Assessee to its AE, remits the matter back to the TPO for determining the correct ALP for AY 2009-10 and 2010-11. During the course of TP proceedings, the TPO treated the CCD's as Foreign Direct Investment (FDI) in the backdrop of RBI policy issued in 2007 which provided for treating a fully and mandatorily convertible instrument as equity under FDI norms. Accordingly, held that interest expense incurred on such CCD should not be treated as expenditure at all. The Assessee contented before the ITAT that the RBI policy should not determine the treatment of interest payment on CCD's in income tax proceedings. Bangalore ITAT holds re-characterization of debt capital into equity in the absence of Thin Capitalization provision as invalid. On the aspect of TPO's reliance on RBI policy, the Tribunal observed that RBI treats CCD instrument as equity as no repayment obligation is present. Further, the Tribunal opines that before the conversion of CCD neither dividend is paid on such CCD nor carries the voting rights. Accordingly, held that CCD should be considered as debt and interest expense should be allowed u/s 36(1)(iii) of the Act. Also, the Tribunal noted that any definition of any term is to be considered in the context in which it is given. The definition of CCD under FDI policy provided by the RBI is in the context to control future repayment obligation and the same cannot be borrowed in the context of Indian tax proceedings. Bangalore ITAT relied on the co-ordinate bench decision in the case of CAE Flight Training (India) Flight Training [IT(TP)A - No.2060/Bang/2016] in arriving at its conclusion.

Nangia Andersen LLP's take

The Indian Judicial system has always drawn inference from the relevant guidance in order to deliver a correct judicial pronouncement. Chapter X of the Act provides only for determination of ALP by TPO and not to re-characterize the transaction itself in absence of any Thin Capitalization Rules or GAAR provisions which also requires a proper procedure to be followed. In the given case, the Tribunal has correctly drawn line towards the application of definition CCD as specified under FDI policy vis-à-vis in the world of Income tax. Also, its pertinent to highlight that the AO/TPO doesn't hold any capacity to re-characterize the complexion of a transaction until a material evidence is placed on record showings the facts presented by a Taxpayer is deviating from the actual transaction.

▪ Ruling on application of domestic TP provision on inter unit transfers

Wipro Limited vs Addl. CIT – IT(TP)A No. 99/ Bang/ 2014

Bangalore ITAT in the case of Wipro Limited for AY 2014-15 has ruled on the eligibility of application of Section 92B(v) of the Act pertaining to SDT provision on inter unit transaction undertaken between two eligible units u/s 10AA of the Rules leading to ALP adjustment. Brief fact of the case is that the Assessee is engaged in providing software and IT services through its various undertaking situated in Special Economic Zone (SEZ)/Software Technology Park (STPI) or other non SEZ/STPI places. The Assessee owned various undertakings eligible for deduction u/s 10AA of the Rules at different rate of 50% and 100% (eligible unit) and also undertakings non eligible for deduction (non-eligible units). During the course of rendering its services to the customer, transactions were undertaken between both eligible units and eligible & non-eligible units (hereinafter referred

as covered transaction). TPO opined that units claiming deduction @ 50% is more than 100% units and provided, huge volume of transaction undertaken across the covered transaction, there is an intent of tax evasion. Contented that such inter-unit transaction between two eligible units is also been covered under Section 92BA(v) of the Act in respect of transaction referred to under Section 10AA of the Rules to which provision of Section 80-IA(8) of the Act applies. Accordingly, TPO performed the TP adjustment on such SDT by deleting the excessive profit margin earned by the various units in the range of 21.02% to 159.36% and restricting it to 15.58% as earned by comparables. Further, the DRP discounted the various contention of the Assessee and upheld the TP adjustment made by the TPO. Bangalore ITAT accepting the contention of the Assessee held that that the inter-unit transaction entered between two eligible units as entered u/s 10AA of the Rules is outside the ambit of Section 92BA of the Act as the provision of Section 80-IA(8) of the Act applicable to Section 10AA of the Rules covers only the transaction between 'eligible & non-eligible units'. Subsequently, the ITAT held that Section 92(3) of the Act (which provides for refraining from application of ALP, having a detrimental effect to the Revenue) shall be inapplicable as the ALP adjustment will be a tax neutral exercise as both units being part of same Assessee. Further, delivered that ALP shall be adopted to both eligible & non-eligible units as provision of Section 92C(4) of the Act requires to compute the 'total income' of the assesse (who owns both the units) with regards to ALP adjustment and unless such is performed, total income of the assesse cannot be computed having regards to ALP. Tribunal observes that, such an adjustment in respect of non-eligible entity is warranted in claiming the overall deduction by the Assessee u/s 10AA of the Rules as it might have an effect of 'reduction' on the quantum of deduction and thereby in turn will have an effect of TP adjustment as envisaged in Section 92 of the Act. Hence, noting that the matter requires the fresh examination, restored the matter back to the file of TPO/AO. Separately, on the issue of liquidated damages paid by the Assessee to its AE, the Tribunal remits the TP adjustment wherein the TPO determined the cost to be Nil and held that TPO failed to cognizance of the fact specified in 'Mutual subcontractor Agreement' where the Assessee was required to pay liquidated damages to its AE and also the TPO didn't furnish any material on record as to why no third party will pay such liquidated damages in respect of dispute. In addition, the Tribunal also ruled on short term loan advances and corporate guarantee.

Nangia Andersen LLP's Take

This ruling by the Tribunal is one of the early judicial pronouncements in relation to SDT introduced in recent times. The Tribunal has appropriately made a cumulative evaluation of deduction provisions and the TP provisions and has laid down important principles for the evaluation of applicability of SDT in case of inter-unit transfers and principles to be applied while determining the SDT adjustments and its impact on the total income and deduction of the Taxpayer. While the Tribunal has gone by strict interpretation of the Act, it has also acknowledged the possibility of "Tax arbitrage" possible even between two EU's where the quantum of deduction is at different rates through rulebook application of the legal provisions.

Detailed analysis of the ruling and our take on the same can be accessed at using the below link.

https://bit.ly/3iVGCIX

Ruling on restructuring under corporate Gift subject to TP

PCIT vs Redington India Limited – T.C.A. Nos. 590 & 591 of 2019

Madras HC in agreement with the contention of the Revenue overruled the decision of the ITAT and declared that the transfer of share of Redington Gulf FZE (RG) 100% held by Redington India (the Assessee or RI) to the newly incorporated step down subsidiary in the name of Redington International (Holdings) Limited in Cayman Islands (RC) [a WOS of Redington International Mauritius Limited (RM)] without consideration not as gift and accordingly upheld the TPO's treatment of such transfer to be an international transaction and thereafter application of Comparable Uncontrolled Price (CUP) method for ALP determination during FY 2008-09. During the course of assessment proceeding, the TPO referred to minutes of the board resolutions and share transfer deed, and wherein the TPO observed that the word gift was absent in the aforementioned documents. Further, the TPO noted that the Board Resolution stated that the transfer of share is towards *restructuring* the concern for which the Board accords its approval *with or without consideration*. Accordingly, held that the impugned transfer of share as gift doesn't cover under the definition of Section 47(iii) of the Act and is to be construed as the transaction, as business restructuring in nature in accordance with Chapter X provisions of the Act. In an appeal, Madras HC resorted to Section 122 of the Transfer Property Act for examining the transaction from the realm of term gift defined therein. HC held that as the Board approved to the transaction with or without consideration, it clearly depicts that the voluntary consent was missing from the part of the Board and was not a gratuitous transfer. Further, the HC observed that within less than a week of transfer of share to RC, a private equity fund, Investcorp GO FRG (IVC) invested USD 65 million in RC for 27% stake. Thus, the HC held that this whole chain of event is self-explanatory that whole intention of the Assessee was corporate restructuring in order to accommodate an investment by IVC in RG and accordingly *voluntariness* in the transfer was share was absent. Madras HC noted that in substance an asset in the form of shares in RG which once owned by the Assessee stood shifted to Cayman Island which is a tax heaven. Accordingly, concludes that the said chain of events is a colorable device and *"undoubtedly a means to avoid taxation in India and the said two companies have been used as conduits to avoid income tax"* and upheld the application of TP provision on such transaction being in the nature of business restructuring. Separately, the Madras HC affirmed with the TP adjustment performed the TPO in computing the trademark/license fee paid by the Assessee to its subsidiary company i.e. Redington Distribution Pte Ltd (RDPL) as Nil. The HC observed that the Assessee is the actual owner of the brand 'Redington' by receiving the 'Certificate of Registration' of the trademark in its name with effect from 29 February 2000. The HC further examine that Assessee has been using the Trademark Redington since 1993 whereas RDPL was established in the year 2006. Hence, the HC noted that the Assessee failed to submit any document to establish that RDPL is the legal owner of the Trademark and therefore, held that there was no genuine rational in the payment of trademark fee which is owned by the Assessee itself. Additionally, the Madras HC on the issue of corporate and bank guarantee confirmed the TP adjustment undertaken by the TPO. Assessee contented that corporate guarantee being in the nature of contingent liability involves no cost to the Assessee and have no bearing on the Assessee's income or loss and accordingly, corporate guarantee is not covered under the definition of International transaction. Madras HC discounted the Assessee's contention and held that the Assessee in turn renders financial service to its AE. Madras HC relied on the ruling of Prolifics Corporation Limited and held that provision of services involve an inherent risk of non-performance of service and indirectly the Guarantor render services to its AE in increasing the credit worthiness for obtaining the loan from the market. Consequently, the Madras HC overturned the decision of the ITAT in deleting the TP adjustment on corporate and bank guarantee conducted the TPO.

Nangia Andersen LLP's Take

From the prism of Indian TP regulation, any transaction which is covered under the definition of international transaction will attract the application of ALP. Accordingly, in the given context once it is established that transfer of share partake the nature of business restructuring then the TP provision application is inevitable. However, on the contrary, there has been a pronouncement where share purchased/ issued in premium from/to its 100% AE subsidiary has been held to be in capital in nature and accordingly no TP adjustment is mandated. Similarly, in the instant case its worth exploring whether the transaction of gift would account as capital and consequently no application of TP provision. It's always advisable to the Taxpayer that in such a scenario, the risk of penalty towards the non- maintenance of TP document and non-filing of Accountant's Report becomes more prone. Thus, it's essential to undertake a detailed analysis of the proposed transaction from the TP implication perspective.

Ruling on Penalty for Non-Resident Assessee not maintaining TP documentation

DCIT vs Convergys Customer Management Group Inc. - I.T.A. No. 3529/DEL/2015 (A.Y 2006-07) & I.T.A. No. 3530/DEL/2015 (A.Y 2008-09)

Delhi ITAT upheld the imposition of levy of penalty u/s 271AA of the Act for non-maintenance of TP documentation prescribed u/s 92D of the Act while disposing off the contention of the Assessee (a non-resident company) for AY 2006-07 and 2008-09. For AY 2006-07, the Assessee had earned income in the form of interest and Fee for technical services from CISL and AEs of the Assessee in India. The AO had held that the Assessee had a fixed place PE, Service PE and Dependent Agent PE in India to which ITAT has confirmed the observation of the AO. The Assessee has preferred an appeal before the High Court (HC). In the meantime, the AO issued show cause notice under section 271(1)(c) and 271AA and levied penalty to the tune of 2% of the value of international transactions. The Tribunal neglecting the CIT(A) decision in favor of the Assessee and rejecting the Assessee's argument of non-requirement of maintenance of TP document in the absence of international transaction uphold the AO's rational of penalty imposition. The Tribunal observed that it is mandatory for all taxpayers without exception, to obtain an independent accountant's report in respect of all international transactions between AEs or Specified Domestic Transactions (SDTs). The Tribunal further held that even if it is submitted that there was no international transaction, the Assessee has to at least obtain independent accountant's report for SDTs. Delhi ITAT in reaching to its conclusion held that Non-maintenance of documents because of the fact that that there is no international transaction and merely relying on documentary evidence of AE shall not be recognized as a 'reasonable cause' (for the purpose of section 273B) for non-maintenance of documents on its own.

Nangia Andersen LLP's Take

Section 92D of the Act explicitly provides that *every person* who enters into an international transaction or specified domestic transaction needs to maintain TP documentation. Therefore, the dependence of TP document maintained by an affiliate entity will not stand valid before TP document maintenance compliance. While placing a reliance on economic analysis is not prohibited, appropriate TP documentation (with suitable justification) needs to be maintained in order to meet the obligations for non-resident company in India, failing which levy of penalty cannot be ruled out. Accordingly, the Assessee should ensure compliance of TP provision in order to circumvent hefty penalty imposition of 2% of the value of international transaction.

Ruling on deemed international transaction in TP

Dy. CIT vs. Gujrat Gas Trading Co. Ltd & Gujrat Gas Trading Co. Ltd vs. DCIT – ITA Nos. 3397, 3069/Ahd/14, 2407, 2340, 2339/Ahd/15, 2028, 1887/Ahd/16, 1974 & 2006/Ahd/2017

Ahmedabad ITAT subscribing to the CIT(A) decision of deleting TP adjustment ruled in the favor of the Assessee (engaged in trading of natural gas) on the issue relating to determination of deemed international transaction for the AY 2010-11. For the impugned AY, BGEH Ltd incorporated in UK, an AE of the Assessee had undertaken negotiation services with the Cairn group for supporting the purchase of gas from Lakshmi filed located in India. The contract for purchase of gas was transferred to another group company i.e. BGIPL located in India. However, subsequently the contract was transferred to the Assessee wherein the Assessee entered into long term contract with Cairn for such purchase. The Assessee paid corporate guarantee commission and commission on purchase of such gas to BEGH Ltd as the Assessee was the beneficiary of the long term contract negotiated by BEGH Ltd and also extended the contract performance guarantee on behalf of the Assessee. The TPO during the TP proceedings invoked the deeming provision prescribed u/s 92B(2) of the Act on the transaction of purchase of gas and held that purchase price of the gas was negotiated by the BEGH Ltd with Cairn and therefore gratify the definition of deemed international transaction and accordingly performed the TP adjustment. Ahmadabad ITAT on the perusal of the copies of agreement observed that BEGH Ltd had no agreement for the purchase of gas with Cairn but only conducted negotiation services. The Tribunal noted that in the said agreement one of the clause specify that the buyer agree to purchase gas from the sellers as per the terms and condition of the contract which includes price calculation, ceiling and floor price etc. Further, the Tribunal also spotted that the besides purchasing gas from Cairn the Assessee also purchased from other operators of Laxmi field on the same price as paid to the Cairn. Hence, the ITAT conclude that it finds no infirmity in the CIT(A) decision and delete the TP adjustment.

Nangia Andersen LLP's Take

Analysis of deemed international transaction u/s 92B(2) of the Act has always been a sensitive, delicate and complex exercise. While contractual agreements are always a starting point, one needs to go beyond the same to determine the actual conduct of the parties to establish that the price has been influenced. While in this ruling the concept of deemed international transaction has been negated by the Hon'ble Tribunal (as there existed other contracts), for entities which are primarily dependent on its foreign AE for undertaking significant business decisions or where the foreign AE has significant control, supervision and decisions in contracts for Indian entity, an in-depth analysis for deemed international transaction is inevitable failing which there exist a significant risk of penalty for non-reporting of such transactions.

Ruling on Most Appropriate Method – CUP for comparison for local vs export sales

Dow Chemical International Pvt Ltd VS DCIT- ITA No. 991/Mum/2016

The Mumbai ITAT finding merit in the contentions of the Assessee (engaged in the business of manufacturing and distribution of Silicon based specialty chemical and lubricants) regarding the selection of Most Appropriate Method (MAM) for benchmarking the export of goods, remitted the matter back to the TPO for AY 2011-12. For the impugned AY, the TPO rejected the Assessee's adoption of TNMM on segmental basis as the MAM for benchmarking the sale of finished products to its AE and considered domestic third party sale as CUP to be the MAM. Mumbai Tribunal noted that application of CUP method requires strict comparability. The Tribunal further held that the price of product sold in domestic market is non comparable to the price fetched in international market due to various factor differences such geography, volume, timing. The Tribunal held that for the application of CUP method it becomes the TPO's responsibility to identify the uncontrolled environment under similar circumstances or otherwise the CUP method cannot be applied. Accordingly, restored the matter back to TPO for fresh adjudication. Separately, the Assessee also entered into Intra Group Service (IGS) transaction with its AE in the nature of marketing, administrative & logistics and Information Technology services. Assessee determined the said IGS to be at ALP by benchmarking them on cost allocation basis to three different segments and performed the segmental TNMM. However, the TPO specified that the Assessee failed to prove the availment of such services besides deriving benefit from it. Accordingly, the TPO re-determine the ALP by applying man hour rate for marketing & logistic services and ad-hoc rate of 30% for IT services. Mumbai Tribunal deleted the TP adjustment by invalidating the benchmarking performed on estimation basis by the TPO and held that benchmarking of an international transaction has to be undertaken only in accordance with the method prescribed under the Act. Also, observed that as TPO allowed the part payment of IGS even though on estimation basis clearly reveal that such IGS were in fact received by the Assessee and it also benefitted from such services.

Nangia Andersen LLP's Take

Rule 10B(2) of the Rules articulates on the due consideration to be given on account of prevailing market condition which include geographical location, size of the market, overall economic development etc. while determining the comparability of an international transaction. Hence, it becomes imperative to consider all the relevant economic circumstances pertaining to a transaction in identifying accurate comparability and more so while applying the CUP method which compare the price at transactional level. Section 92C of the Act read with Rule 10B of the Rules mandate for the compulsory application of the specified methods to be the MAM while benchmarking any international transaction. This ruling is again a reinforcement that in TP, detailed and critical aspects of transactions should be analysed well for comparability purposes. Further, to demonstrate the receipt of IGS received the Taxpayer should ensure to organize a detailed documentary evidence in the form of inter service agreement, invoices, mails etc. to be furnished before the Tax Authorities.

Ruling on choice of PLI – GP/Sales as appropriate

Tata Consultancy Services Ltd Vs ACIT- IT(TP)A No. 3262/Mum/2017 and ACIT Vs Tata Consultancy Services Ltd- IT(TP)A No. 3389/Mum/2017

Mumbai ITAT adjudicated on various TP adjustments proposed by the TPO in the case of Assessee engaged in the business of computer software and management consultancy for AY 2007-08. Firstly, with respect to provision of software and technical services to its AE's, the TPO discarded the GP/Sales PLI adopted by the Assessee in computing the margins of the AE and proposed to apply net cost pus margin as an appropriate PLI on the premise that AE's being low risk bearing entity should be compensated in the form of operating profit to value added expenses. The Tribunal relying on the co-ordinate bench ruling in Assessee's own case for AY 2009-10, observed that AE's performed the role of risk distribution entity. On further perusal of documents, Mumbai ITAT observed that AE's hold manpower base to perform significant marketing functions and bears credit default and marketing risk. Such manpower base are competent to undertake various marketing functions and client co-ordination independently. Hence, the Tribunal held that the GP/sales is a suitable PLI to remunerate the risk endured by the AE. Also, the Tribunal rejected the TPO's treatment of considering the sub-contracting cost as pass through in determining the margins of the AE's stating that similar cost incurred by the comparables were not excluded thereby will result in distorted PLI computation. Secondly, the Tribunal discussed on the issue with respect to various guarantee services in the form of performance and financial guarantee rendered by the Assessee to the third party on behalf of its AE. Mumbai ITAT relying on Assessee's own case for AY 2009-10, rejected the Assessee's contention of guarantee service not covered under the definition of international transaction and further directed to charge 0.5% guarantee commission restricted to the portion of the service performed by the Assessee itself. Separately, with respect to interest free advance to AE, the Tribunal remits the matter back to TPO for fresh examination after considering the nature of such advance was for the purpose of downstream investment, working capital etc.

Nangia Andersen LLP's take

The basic principle in determining the appropriate remuneration pertaining to a specified transaction is to make compensation in commensuration to Functions, Assets and Risks employed by the parties involved to a transaction. No detailed guidance has been stipulated in the Indian TP regulations in determining the PLI and the selection of accurate PLI will depend on the degree of FAR undertaken by each entity to a transaction. Hence it becomes critical on the part of the Assessee to articulate its selection of a particular PLI. Further, sub-contracting a particular function is a very common phenomena in the business operation in order to render a specific services or a product. However, whether such cost will be considered as operating or pass through will depend on the direct linkage to the main contract. Hence, the Assessee should maintain robust documentation to support the transaction undertaken and the business/commercial rationale of the same.

Ruling on AMP adjustment

Bacardi India Private Limited vs ACIT – ITA No. 1970/Del/2017

Delhi ITAT ruling in favor of the Assessee (manufacturing products bearing Bacardi brand) quashed the TP adjustment undertaken by the TPO in respect of Advertisement, Marketing & Promotional (AMP) expenditure incurred by the Assessee for AY 2012-13. During the assessment proceeding, the TPO observed that the Assessee expensed AMP amounting to 26.19% of total sales as against the comparables 2.61%.

Accordingly, TPO held that Assessee is promoting the brand of the Assessee in India and applied the Bright Line Test (BLT) method to conduct the TP adjustment. Delhi ITAT acknowledged the fact that the Assessee is not a distributor but rather a manufacturer selling its own manufactured goods to the extent of 95% and also paying royalty to the Assessee which indicate that the AMP expense has not done any favor to the parent company. Accordingly, the Tribunal relying on the ruling in case of Sony Ericsson Mobile Communications India Pvt. Ltd. [ITA No. 638/2015] held that BLT could not be applied for either determining existence of an international transaction involving AMP expenses or for determining ALP of such transaction. The ITAT further held that the purpose of Chapter X provision is to prevent the tax evasion between Indian entity and its overseas AE and therefore, perceived indirect benefit accruing to the AE due to incurring AMP expense is not covered under TP provision. Also, the Tribunal following jurisdictional HC ruling in the case of Bausch & Lomb Eye care (India) Pvt. Ltd. [ITA No. 643/2014] held that it's the Revenue's obligation to establish the existence of international transaction between the Assessee and its AE as in the present case AMP expenditure was made to third parties which were located in India. Separately, the ITAT also adjudicated on the payment of royalty and interest on Foreign Convertible Debentures to its AE.

Nangia Andersen LLP's Take

The issue pertaining to marketing intangibles has been doing rounds for more than half a dozen years now in India where BLT has been beaten down by every judicial forum. Marketing intangibles is always a fact sensitive exercise and one size fits all approach does not work the way Indian Tax authorities have been conducting the analysis. With plethora of ruling in Assessee's favour, Taxpayers should anyways ensure to undertake a comprehensive and detailed analysis of the supply chain, functional profile of the transacting entities in terms of DEMPE (Development, Enhancement, Maintenance, Protection and Exploitation) related to marketing intangibles, legal contract, economic substance, etc. to substantiate arm's length nature of their business models.

However, with the matter pending before the Hon'ble Supreme Court it would be interesting to ascertain as to what extent the larger issue (such as whether AMP expenses should be construe as international transaction, how to determine ALP, quantification of enhancement of brand value etc.) around the marketing intangibles will be addressed by the Apex Court given that it may render justice only with respect to issue presented before itself.

Ruling on TP aspects of Fixed asset purchase

Roki Minda Co. Pvt Ltd VS ACIT- ITA No. 6555/Del/2016

Delhi ITAT in consonance with the contention of the Assessee (engaged in manufacturing and sale of automobile parts) deleted the TP adjustment with respect to the international transaction of purchase of fixed asset from AE for AY 2012-13, however held that adjustment would impact the actual cost for the purpose of claiming depreciation. In the phase of proceedings, the TPO rejected the Assessee's adoption of Resale Price Method (RPM) as the MAM wherein the Assessee has declared 8% mark-up on the purchased of fixed assets at ALP. The TPO held that the Assessee failed to furnish any supporting evidence regarding the markup charged by the AE. TPO observed that the markup charged by the AE is over and above cost on profit charged by the third party. Further, the TPO stated that the Assessee doesn't provide any cogent reason for importing the goods from its AE. Accordingly, TPO determined the ALP of the import of such fixed assets at NIL. The DRP upheld the decision of the TPO and continued with the proposed adjustment. Delhi ITAT in pronouncing its decision relied in the case of Honda Motorcycle and Scooter India Private Limited (56 taxmann.com 237) wherein it was held that any international transaction being in the capital nature will not be called for TP adjustment even if the value of such transaction deviate from the ALP principle as it will not disturb the income statement of the Assessee. However, also noted that actual cost will be adjusted with ALP determined for claiming depreciation being a revenue offshoot item. Delhi ITAT respectfully following the coordinate decision deleted the TP adjustment.

Nangia Andersen LLP's take

Explanation to sub Section (1) of Section 92B of the Act elucidate the meaning of international transaction which inter alia include purchase of tangible property in the nature of machinery, equipments etc. However, the main substantive provision of Chapter X specify that any income or expense arising from international transaction has to be computed in accordance with ALP. Accordingly, as observed by the Tribunal, though the purchase of fixed Assets is covered under the definition of international transaction the same need not be adjusted to ALP as it does not have a direct and complete impact on the income statement of the Assessee. However, depreciation being an expense item which is claimed as business expenditure u/s 37 of the Act, will also have an impact in case the ALP of fixed assets determined differently.

Ruling on re-assessment proceedings for PE existence

PT.LP Display Indonesia vs DDIT – ITA Nos. 1845 to 1847/Del/2014 and DDIT vs PT.LP Display Indonesia – ITA Nos. 1887 & 1888/Del/2014

Delhi ITAT suppressed the reassessment proceedings initiated u/s 147 of the Act by the Revenue on the ground of existence of business connection and PE in the case of Assessee (a non-resident company) through its Indian AE i.e. L.G. Electronics India Private Limited (LGEIL) expressing that once the international transaction has been established to be at ALP then the question of PE becomes academic.

From the course of TDS survey conducted at the premise of LGEIL, the Revenue concluded that L.G. Korea and its AE's including the Assessee had a business connection with LGEIL in accordance with Section 9(1)(i) of the Act and also had a fixed place PE in the form of LGEIL as per the Article 5(1) of India Indonesia DTAA. Further, the revenue observed that expatriate workers of L.G. Korea were working not only in the interest of Korea but also its other affiliates and subsidiaries and held that the non-resident business were doing business in India through the employees of the parent company. Delhi ITAT relying on Hon'ble SC decision in the case of Honda Motors Co. Ltd. [92 taxmann.com 353 (SC)] held that once the arm's length principle has been satisfied then there could be no further profit attributable to a person even if it had a PE in India. Accordingly, the Tribunal held that notice issued for reassessment becomes redundant even if the PE has been established in pursuant Article (5)(1)(i) of the DTAA.

Nangia Andersen LLP's Take

The whole intention of the introduction of concept PE is to ensure that revenue generated in India through the business connection of a foreign company is taxable in India and there is no loss in tax revenue to the Government. However, with the satisfaction of arm's length procedure in respect of international transaction which in itself is based on the principle of prevention of profit shifting from India then the entire process of following the PE theory stands irrelevant.

OECD released blueprint for Pillars 1 and 2

On 12 October 2020, OECD released public consultation document on the reports on Pillar One and Pillar Two blueprints to address the tax challenges of the digitalisation of the economy by 14 December 2020. The released blueprint of Pillar One would help market jurisdiction in expanding their taxing right. OECD targets to obtain global consensus by mid-2021. Detailed reports and public consultation document can be accessed at:

https://bit.ly/36qe670

OECD released new methodology for peer review of BEPS AP 13

On 29 October 2020, OECD released new methodology for the CbC reporting peer review under BEPS AP 13 as against 2017 methodology. In the document procedural mechanism for completing peer review process has been laid down, providing scope, the information that will be used to conduct the reviews, the timelines and procedures, outline of the peer review reports, the process for discussion and approval of reviews, amendments and interpretation, and the confidentiality of peer review documents. The released document can be accessed at: **https://bit.ly/3r39USA**

BEPS AP 14 Update: OECD released 2019 MAP statistics, MAP awards and invited public comments on 2020 review of BEPS AP 14

Under BEPS AP 14 (Making Dispute Resolution Mechanisms More Effective), all Inclusive Framework (IF) members have committed to the implementation of the minimum standard i.e. timely and complete reporting of MAP statistics pursuant to an agreed reporting framework. The 2019 MAP statistics providing details of the total MAP caseload and MAP outcomes (i.e., cases closed) can be accessed at: **https://bit.ly/3af399h**

OECD released MAP 2019 awards under 4 categories namely average time to close MAP cases, age of inventory, caseload management and co-operation; wherein India-Japan bagged MAP award for highest agreement ratio of ~64% in 2019 for TP cases. MAP 2019 Awards can be accessed at: **https://bit.ly/2MhoOpt**

In November 2020, OECD invited public comments on 2020 review of BEPS AP 14 as a part of ongoing work of OECD/G20 Inclusive Framework on BEPS, on which virtual meeting will be held on 1 February 2021. There is increased focus on improving the MAP process. Public consultation document can be accessed at: **https://bit.ly/39t9PS3** and our detailed analysis of the said document can be accessed at: **https://bit.ly/3pwvfDk**

OECD releases stage-2 MAP peer reviews for Singapore, Spain, Korea and 5 other jurisdictions

In October 2020, OECD released stage 2 peer review reports for eight jurisdictions including Singapore, Spain and Korea. The reports assess the progress made by countries in implementing the BEPS AP 14 (minimum standard) in improving their tax dispute resolution processes. The report highlights positive changes across all jurisdictions such as signing of Multilateral Instrument, expansion in Competent Authority to handle MAP,

decreased time to handle AMP cases, updation of MAP guidance, etc. Jurisdiction-wise stage 2 peer review monitoring reports can be accessed at:

https://bit.ly/2MBfz30

OECD to finalize Programme for TP risk assessment of MNE groups

On 8 December 2020, the OECD's Forum on Tax Administration (FTA) agreed to move the ICAP (International Compliance Assurance Programme) from the pilot phase to an established programme, in order to focus on tax certainty and enhancing mechanisms for dispute prevention and resolution. They aim to agree global actions to meet the current economic and administrative challenges through identifying improvements in APAs and MAPs, enhance the use of standardized benchmarking in common areas of TP dispute, and support tax administrations in risk assessments through TREAT (Tax Risk Evaluation and Assessment Tool) for analysing CbC Reportings filed by Multi National Enterprises (MNEs). Details can be accessed at:

https://bit.ly/3cjyiLl

OECD released TP Guidance on COVID-19 implications

On 18 December 2020, OECD released a guidance for tackling the issues that may arise due to the disruptions in the supply chain caused by COVID-19. The TP guidance focuses on focusing on comparability analysis, APAs, losses and the allocation of COVID-19 specific costs, and government assistance programmes. Detailed TP guidance released by the OECD can be accessed at:

https://bit.ly/3otxru7

OECD released jurisdiction-specific information on 'hard-to-value intangibles' approach

Under BEPS AP 8 outcome, OECD released jurisdiction-specific information on implementation of the hard-to-value intangibles (HTVI) approach, wherein as part of monitoring process, participating jurisdictions report their legislation and administrative practices relevant to the application of the HTVI approach. More details can be accessed at:

https://bit.ly/39pEgIN

Global TP News

Australia

On 10 November 2020, the Australian Taxation Office (ATO) released updated information addressing the treatment of JobKeeper payments in TP arrangements by an Australian entity. Details of amendment can be accessed at: **https://bit.ly/36myzJS**

On 3 December 2020, ATO released an updated guidance on APAs to provide instructions to ATO staff on APAs and insights to taxpayers on ATO's internal review and approval processes for APAs. Detailed APAs guidance can be accessed at: **https://bit.ly/3ckupWH**

Russia

On 23 November 2020, Russian Tax authority notified allowable interest rates on controlled debt obligations. Loan interest paid during the specified period (i.e. from 1 January 2020 to 31 December 2021) and within the notified range of interest does not require TP analysis.

Italy

On 23 November 2020, the Italian Tax authority issued new regulations effective for TP compliance requirements from fiscal year 2020 onwards, completely replacing the former TP guidelines applicable covering important aspects such as new rules on eligibility for the penalty protection regime, new electronic signing requirements, and new TP documentation requirements for low-value-added services.

On 16 December 2020, the Italian Tax authority (vide Legislative Decree no. 49/2020) issued regulations to implement new tax dispute resolution mechanisms and MAP processes that includes measures on providing access to taxpayers to discuss their case before filing the MAP request, electronic/ paper submission rules for MAP requests, list of documents to be submitted along with MAP request and procedures as well as the timeframe to be followed by the taxpayer and the tax authorities to name a few.

United States

On 16 November 2020, IRS announced that the authorities of the US and Mexico have agreed to renew the Qualified Maquiladora Approach (QMA) agreement for maquiladoras in Mexico engaged in contract manufacturing and assembly operations for US taxpayers, with unilateral APAs in Mexico under terms negotiated in advance between the CAs. Details can be accessed at: **https://bit.ly/3pwXP7D**

On 2 December 2020, IRS published joint declaration of the competent authority (CA) of the US with the CA of the Germany on the Implementation of the Spontaneous Exchange of CbC Reports for Fiscal Years of MNE group in fiscal year 2019. Detailed US-Germany joint declaration can be accessed at: **https://bit.ly/2YrpIrq**

Vietnam

On 5 December 2020, Vietnamese Tax Authority updated TP rules replacing former TP guidance. The revised rules are applicable on income tax paying taxpayers with related party transactions, which may mean that foreign entities in Vietnam could also be subject to the application of TP provision. Further, the arm's length range in case of at least five independent comparables has been revised to 35th (from 25th) to 75th percentile value, with TP adjustment in case of non-arm's length transaction made at the median. Other revision in the existing statute can be accessed at: **https://bit.ly/3pp66KR**

China

On 29 October 2020, the State Taxation Administration (STA) published the China APA annual report-2019 that provides statistics on concluded APAs from 2005 to 2019.

2019 China APA Annual Report published by STA can be accessed at: **https://bit.ly/39qSysO**

Singapore

On 27 October 2020, The Inland Revenue Authority of Singapore (IRAS) published "frequently asked questions" (FAQs) to address TP considerations of those taxpayers whose businesses have been affected by the COVID-19 pandemic, which can be accessed at: **https://bit.ly/3cmGU3S**

On 9 November 2020, IRAS released a new e-Tax Guide named "GST: Transfer Pricing Adjustments" explaining the goods and services tax (GST) treatment for TP adjustments in case of the transactions with related parties. Detailed guidance can be accessed at: **https://bit.ly/3adql83**

Lithuania

On 19 October 2020, in alignment with OECD BEPS AP 8-10, Lithuania updated its TP documentation requirements w.e.f 1 January 2021. Some of the key points in the revised regulation are: (i) a simplified approach for low-value adding intra-group services, (ii) simplified tax administration processes for controlled transactions pertaining to hard-to-value intangibles, (iii) simplified documentation procedures, (iv) clarification for applying profit-split method. Complete Legislation text can be accessed at: **https://bit.ly/3r36Fu8**

UAE

In November 2020, revenue authorities of UAE launched its CbC reporting platform for MNEs, complying with BEPS AP 13. Details can be accessed at: **https://bit.ly/3cipK7H**

Egypt

On 3 December 2020, Egyptian Tax Authority amended its penalty law prospectively w.e.f. 4 December 2020, introducing stringent penalties on taxpayers failing to comply with TP documentation and tax return filing deadlines, capped at 3% of the taxpayer's total domestic and international related party transactions during the taxable year.

Ukraine

On 17 December 2020, the Ukrainian parliament adopted tax reform bill, making important TP related amendments around the BEPS tax legislation, scope of PEs with stricter rules for agency PEs and requirement for taxability of PEs in line with arm's length principle, limiting the scope of thin capitalization rules to only loans received from nonresidents (both related and unrelated, excluding international finance institutions and foreign banks).

Austria

On 22 October 2020, the Austrian Federal Ministry issued guidance note complying with the EU directive on mandatory automatic exchange of information (AEOI) for reportable cross-border arrangements. Some points addressed in the guidance are: (i) reporting timelines, (ii) primary reporting obligations for intermediaries, (iii) reporting exemptions., (iv) corporate structures capable of exploiting favourable tax policies and jurisdictions, (v) hybrid arrangements, (vi) cross-border leasing of assets, (vii) transactions exempting income in both contracting states, (viii) transactions falling under safe harbour regulations, (viii) payments made to persons not tax resident of any jurisdiction or resident of a non-cooperative territory.

Turkey

On 1 October 2020, the revenue authorities of Turkey published declaration regarding the multilateral competent authority agreement (MCAA) on the exchange of CbC reports. With its implementation, Turkey enabled exchange of CbC reports with CAs of the contracting countries.

Further, as a relief to the taxpayers of Turkey, Tax authorities vide circular no. TF-2 / 2020-1 has extended the due date for CbC report filing for reporting year 2019 from 31 December 2020 to 26 February 2021.

Key TP Rulings around the Globe

US Tax Court judgement in Coca Cola's royalty computation for intangible properties

The Coca-Cola Co. (TCCC or the company), the ultimate flagship company headquartered in US, is the legal owner of all the IP which includes trademarks, logos, patents, brand, secret formula etc. necessary to manufacture, distribute and sell some of the best beverages (Coca-Cola, Sprite, Fanta etc.) around the world. The company licenses its IP to its manufacturing affiliates (referred as Supply Points or SP) in the region of Ireland, Mexico, Brazil, Chile, Costa Rica, Egypt and Swaziland to manufacture 'concentrate' required in the production of beverages and later sales it to hundreds of Coca-Cola 'Bottlers' across the globe. The Bottlers thereafter use this concentrate to produce the finished beverages by exploiting TCCC's IP and sale to millions of retailers throughout the world. Further, TCCC contracted affiliated Service company (ServCos) regionally located being owned by TCCC to undertake local marketing campaigns of the beverages, promotion, business development etc. For the purpose of determining the appropriate amount of royalty payment by SP to TCCC, for years 2007-2009, TCCC adopted 10-50-50 formulary apportionment method (where, 10% of gross sale earned by SP is being retained by SP and balance being equally split between TCCC and SP) arising out of 'closing agreement' being agreed between TCCC and the Internal Revenue Service (IRS) in 1996.

For the year 2007-09, the IRS proposed a TP adjustment by increasing the aggregate taxable income of TCCC by $9 billion against the royalty payment received form its SPs by rejecting the 10-50-50 formulary apportionment method and employed Comparable Profit Method (or TNMM in Indian context) as the MAM with 'Bottlers' as the comparable and Return on Operating Asset as the PLI. Copy of the judgement can be accessed at: **http://bit.ly/3t0t90O**

Detailed analysis of the ruling can be accessed at: **https://bit.ly/3taultg**

Italian Court upholds taxpayer's TP assessment, rejects tax authority's comparables

BI Srl (Assessee), an Italian based distributor of single supplier, made intra-group purchases from its German parent entity (AE). This transaction was benchmarked using CUP method by comparing the prices charged by the AE to the Assessee vis-à-vis the prices charged by the AE for the sale of same/ similar goods to unrelated third parties. Further, as a corroborative analysis, TNMM was considered to compute the ALP. Assessee shared these two analyses and also provided the Master file during the cross-examination and Country file for the years under examination (i.e. FY 2013, 2014 and 2015) to the Italian Tax Authorities. Assessee contended that CUP method was the most direct and reliable in identifying the arm's length value since the AE applied discount of 33% on intra-group transaction vis-à-vis sales made to independent third parties. However, the Italian Tax Authorities considered TNMM using return on sales as the MAM and challenged Assessee's margins using their own set of comparables. The Italian Court upheld that Assessee's pricing conformed to the arm's length principle and rejected Revenue's comparables selected via TNMM highlighting their dissimilarity with Assessee's business in terms of product sector, market, level of risk, distribution channel and type of products sold. Further, the Court also upheld partial assessment by the Tax Authorities based on fact that the Assessee had inadequate TP documentation, which is violations of the TP legislature in force. Copy of the translated judgement can be accessed at: **https://bit.ly/3t4TkDv**

Danish HC holds TP documentation sufficient to determine ALP, rejects claims of AE purchases on non-ALP basis

ECCO A/S (Assessee) is the Danish parent entity of an MNE group, engaged in the design, development, production and sale of shoes, with goods purchased from both internal and external producers. Issue at hand was whether the controlled transactions were undertaken on arm's length basis.

Assessee had prepared two sets of TP documentation, both of which were available when the tax authorities issued its assessment. TP documentation contained a review of the parent company's pricing (i.e. using standard costing approach based on the total budgeted production costs plus profit margin that may vary for each shoe model) and terms in relation to both internal and external production companies, along with comparability analysis.

The High Court issued decision in favor of the Assessee, upholding that there was no justification for the assessment of additional income. The Court observed that the TP documentation was not deficient to such an extent that it could be equated with lack of documentation, and that the tax authorities did not prove that the pricing of the Assessee's transactions with its foreign subsidiaries were not conducted on arm's length basis. Copy of the translated judgement can be accessed at: **https://bit.ly/3cmYs00**

Danish Tax Tribunal order on ALP and deficiency in TP documentation in a restructuring transaction

Denmark based Assessee, pursuant to a group restructuring, transformed from a distribution company into a commission agent and accordingly new commission agent agreement replaced the existing distributor agreement. During the assessment review of the Assessee, Danish Tax Authority (SKAT) alleged that during restructuring, the intangible assets in the form of know-how and customer relations were transferred by the Assessee to its group company. Further, SKAT observed that the TP documentation furnished by the Assessee did not reflect the transfer of such intangibles by the Assessee and accordingly, increased the taxable income by conducting discretionary assessment. Assessee aggrieved by the adjustment preferred an appeal to the Tribunal. The Tribunal held that non-disclosure of the said transaction was not sufficient in itself to establish any deficiency in the TP documentation prepared and furnished by the Assessee and SKAT was not correct in making a different assessment on discretionary basis. The Tribunal, ruling in favor of the Revenue Department, further observed that the TP documentation covers relevant circumstances for the restructuring, analyzed functions and risks, and made comparability analysis for before and after the restructuring transaction took place. Tribunal also held that SKAT is allowed to re-examine the transactions as per arms' length principle under Danish TP legislature. Tribunal observed that certain intangible assets of the Assessee had been transferred which were not under the ALP, as established by the SKAT. In this regard, the Tribunal referred to the OECD Guidelines, highlighting that an independent distributor with a potential to earn a high future profit will not be willing to give up its potential profit for a stable lower earnings without receiving compensation against it. Accordingly, the Tribunal finds that SKAT rightly concluded that the reorganization was not carried out on arm's length basis and that during the group restructuring, the intangibles developed by the Assessee have been transferred to its group entity. However, the Tribunal disregarded the ad-hoc adjustment made by the SKAT, giving direction for re-examination of the transaction involving restructuring in accordance with the Danish Tax Legislature. Copy of the translated judgement can be accessed at: **https://bit.ly/36pvSHn**

Polish Court holds TP provisions apply only to proven 'tax-evasion' which differs from economic optimization

Poland based Assessee acts as a limited risk distributor of metal packaging products in Poland for its Swiss AE. Assessee concluded the arm's length nature of its international transaction with its AE under TNMM by bench-marking its operating margins (OM) against the arm's length range of weighted average OM earned by comparables engaged in distribution activity. The Polish tax authorities issued tax assessment for FY 2009-2012, rejected the comparables selected by the Assessee and conducted fresh assessment based on the market price of the products, concluding that the Assessee's cross border transaction was not at arm's length.

The Court of first instance held in favor of the tax authorities against which Assessee further preferred an appeal before the Administrative Court of Appeal. The Court opined that it is necessary to distinguish between the activity of entrepreneurs, which is intended to reduce financing costs of day-to-day activities (economic optimization) from measures aimed at transferring funds leading solely to a favorable tax result.

The Court stated that the tax authorities did not subject the case to thorough verification in accordance with the legal standards provided in the TP regulations. The Court explained that to determine a deviation from ALP, the authority must undertake *an analysis of economic aspect of each operation, nature of existing relationship between parties to the agreement and must establish a comparable point of reference. Court directed that the tax authority to "consider that the mere difference in prices between related entities, as compared to the prices accepted towards unrelated entities, does not constitute a premise for applying the provision in question and including potential and not actual income of the taxpayer".*

The Court, ruling in favour of the Assessee, further stressed the importance of functional and comparability analysis, with due regard to the regulations, and concluded that rules on comparability criteria of transactions precedes the rules on estimations methods. The Court opined that the tax authority did not conduct thorough verification of the transactions as per legal standards and failed to prove that conditions of cooperation between parties deviated from those that would have been present between independent entities. More succinctly, the Court held that since the Tax Authorities did not prove that difference in pricing was aimed at tax evasion and did not result from economic conditions; TP provisions could not be applied. Copy of the translated judgement can be accessed at: **https://bit.ly/36oZaG1**

Australian Court judgement on TP adjustment of Glencore

Cobar Management Pty Ltd (Assessee), an Australian group entity, supplied copper concentrate to its Swiss AE during the period 2007-2009. The pricing agreement between the AE and the Assessee was amended resulting in reduced profits in the hand of the Assessee pursuant to which the ATO recalculated the taxable income while contending that the transaction price is different from what would have been charged by the unrelated parties. Assessee aggrieved by the ATO's adjustment challenged the order in the Court.

The Court ruling in favour of the Assessee duly observed that under Australia TP regulations, the ATO has the powers to change the methodology or reassess the taxable income; however the authority cannot substitute different terms of a contract where those terms are not seen as defining the consideration received for supply of goods. The Court acknowledged that more than one ALP price is possible and that a taxpayer is under no obligation to choose a pricing method which pursues profitability at the expense of prudence. The Court opined that ATO's reliance on OECD Guidelines is incorrect, since it provides guidance in application of the arms' length principle to the Revenue Authorities/ Taxpayers in general or how the OECD member state might enact it in their domestic law. Having said so, the enacted domestic TP rules and regulations need to be followed for determining whether an entity adheres to TP legislature. Copy of the judgement can be accessed at: **http://bit.ly/3iOyle6**

UK Tribunal accepts Blackrock's inter-company loan to be at arm's length

Blackrock Holdco LLC (Assessee) in UK availed loan of USD 4 billion from its US-based parent company to fund its acquisition of Barclay Global Investment, US (BGI). UK's Her Majesty Revenue and Customs (HMRC) challenged the interest deduction claimed by the Assessee, citing tax advantage to be main purpose of the said transaction and accordingly disallowed the entire deduction of the interest expense claimed. The Tribunal rejected the HMRC's contention that *"the group 'as a whole' must be considered and the borrowing costs would have been lower had lending taken place higher up the group". UK Tribunal stating that "it is clear from paragraph 1.6 of the (OECD) Guidelines... that a "separate entity approach" should be adopted as this is the "heart of the application of the arm's length principle"*, held that an independent entity would have entered into a loan transaction on the similar terms as of the impugned transaction; however, subject to certain additional covenants. UK Tribunal accepted the Assessee's contention that purpose of loan was purely commercial and not to obtain a tax advantage. Tribunal further observed that "it is necessary to look beyond the *conscious motives…securing of a tax advantage is an inevitable and inextricable consequence of the Loan"*. In addition, the Tribunal referring to OECD guidelines clarifies that "for TP purposes it does not matter whether or not the arrangement was motivated by a purpose of obtaining a tax advantage." UK Tribunal upheld the decision in favour of the Assessee while rejecting the revenue's contentions. Copy of the judgement can be accessed at: **http://bit.ly/3t0s218**

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