VERENDRA KALRA & CO
CHARTERED ACCOUNTANTS

Communiqué

International Tax

November 2022

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ITAT Affirms DRP's Opinion: Transactions with Related and Unrelated Parties Cannot be Clubbed Together for Benchmarking

Facts

The assessee is a resident corporate entity and a wholly owned subsidiary of Marubeni Corporation, Japan and is primarily engaged in providing agency support services and marketing support services to various group entities. In the course of its services, the assessee in certain international transaction with AE's such as provision of agency support services, Cost allocation of software usage and usage services provided by AE's and Reimbursement of expenses by MIPL to AE's. The assessee had benchmarked the transaction relating to agency support services by using the Transaction Net Margin Method (TNMM) and noted a margin of 23.53% on operating cost. For comparative analysis, the assessee shortlisted 13 comparables with arithmetic mean of 10.71%. Thus, the transaction with AEs were claimed to be at arm's length. However, the Transfer Pricing Officer (TPO) rejected the same. He, instead computed the ALP at Rs. 73, 01,27, 442 and post comparing it with the companywide revenue proposed an adjustment of Rs. 8, 40,19,097, to the ALP. Further, the TPO considered the total revenue earned by the assessee from both the segments i.e., agency support services segment and trading segment as against actual operating income from agency support services of Rs.20,40,05,606. The TPO arrived at the conclusion that the Profit Level Indicator (PLI) of operating profit to operating cost used by the assessee was inappropriate. He rejected two of the comparables selected by the assessee viz. Besant Raj International & Capital Trust Ltd. While proposing the draft assessment order, the Assessing Officer (AO) added back the transfer pricing adjustment suggested by the TPO. Consequently, the matter went to the Dispute Resolution Panel (DRP), who listed certain directions for the TPO to follow. Subsequently, the matter reached the Tribunal.

Ruling

The Tribunal ruled in favor of the assessee. It noted that the assessee operates in two different segments. In one of the segments the assessee undertakes international transactions relating to provision of agency support services to AEs, in the other segment, the assessee is engaged in trading of goods to customers in India. The Tribunal observed that while agency services are concerned with related parties the trading of goods is concerned with unrelated parties. Moreover, it was noted that the TPO had undoubtedly aggregated the two transactions while rejecting the assessee's ALP. The Tribunal held that, "*This approach of the TPO is fundamentally wrong and against the statutory provisions. While benchmarking international transactions with AEs, the transactions relating to unrelated parties cannot be clubbed. Therefore, the benchmarking done by the TPO is flawed, hence, unacceptable.*" The tribunal further held that, *"the tinkering of PLI by substituting the denominator with total cost is unacceptable considering that the TPO has included the cost of traded goods with unrelated parties in the total cost. Therefore, we do not find any infirmity in the decision of learned DRP in directing the TPO to recompute the ALP by strictly restricting himself to the international transaction with the AEs."*

Source: Tribunal, Delhi in Deputy CIT vs. M/s. Marubeni India Pvt. Ltd. vide ITA No. 1059/Del/2016 dated 9th November 2022.

Treatment of Interest on Deferred Receivables Is an Independent International Transaction: ITAT Directs LABOR Interest Rate to be Adopted

Facts

The assessee is a company which was started in 2010 as a 50:50 joint venture between Rolls Royce and Hindustan Aeronautics Ltd. for the manufacture of high precision aero engine compressor, gas turbine parts. The assessee filed a return of income for the A.Y. 2018-19 declaring a total income of Rs. 4,71,09,140 under normal provisions of the Act and Rs. 8,64, 84,560 under section 115JB. During scrutiny proceedings, a reference was made to the TPO for determination of ALP of the international transaction the assessee is involved in with its AE. The TPO made an adjustment of Rs. 2,75,38,549 towards interest on delayed receivables by applying the rate of 6.57%. The DRP further affirmed the TPO's adjustment. Consequently, the assessee preferred an appeal before the Tribunal.

Ruling

The Tribunal ruled partly in favor of the assessee. It identified the issue in the case as the question of whether the interest on receivable is a separate international transaction and the rate of interest to be considered. The Tribunal relied on the case of PCIT vs. AMD (India) Pl. Ltd. ITA No. 274/2018, and opined that, deferred receivables would constitute an independent international transaction and the same, as such, should be benchmarked independently.
Furthermore, the Tribunal held that,

"Once we have held that the transaction between the assessee and AE was in foreign currency with regard to receivables and transaction was international transaction, then transaction would have to be looked upon by applying the commercial principles with regard to international transactions and accordingly proceeded to take into account interest rate in terms of London Inter Bank Offer Rate [LIBOR] and it would be appropriate to take the LIBOR rate + 2%. For this purpose, we place reliance on the judgment of the Bombay High Court in the case of CIT v. Aurionpro Solutions Ltd., 99 CCH 0070 (Mum HC). It is ordered accordingly…. Once we have held that the transaction between the assessee and AE was in foreign currency with regard to receivables and transaction was international transaction, then transaction would have to be looked upon by applying the commercial principles with regard to international transactions and accordingly proceeded to take into account interest rate in terms of London Inter Bank Offer Rate [LIBOR] and it would be appropriate to take the LIBOR rate + 2%. For this purpose, we place reliance on the judgment of the Bombay High Court in the case of CIT v. Aurionpro Solutions Ltd., 99 CCH 0070 (Mum HC). It is ordered accordingly."

Source: Tribunal, Bangalore in M/s. International Aerospace Manufacturing Private Ltd vs. Deputy Commissioner of Income Tax vide IT(TP)A No. 933/Bang/2022 dated 9th November 2022

ITAT Clarifies Stance on Fixed Place and Dependent Agent PE: Holds Assessee Liable to tax in India

Facts

The assessee, M/s. Redington Distribution Pte. Ltd. (RDPL), is a foreign company and a tax resident of Singapore. It is a subsidiary of M/s. Redington (India) Ltd. (REDIL) The assessee did not file a return of income for the relevant assessment year. The assessment was subsequently reopened under section 147, as per reasons recorded due to which income chargeable to tax had escaped assessment. Notice under section 148 was issued in response to which the assessee filed a return of income disclosing tax and interest payable of Rs. 1,15,01,279. Subsequently, scrutiny proceedings were initiated and during the course of assessment proceedings, the AO on the basis of information gathered during the course of survey coupled with statement recorded from employees of 'Dollar Team' and also on analysis of various evidences including e-mails, correspondence between M/s. REDIL and M/s. RDPL, Singapore, opined that the assessee has a fixed place of PE in India. Additionally, the employees of 'Dollar Team' were looking after complete business model of the assessee, including identification of customers in India, submitting quotes for various equipment's, fixing price and ultimate collection of receivables from the parties. Therefore, there the AO was clear that a PE in India was established and accordingly, the assessee was liable to pay tax in India on its income. Moreover, the AO after considering the total employee cost of M/s. REDIL & M/s. RDPL, Singapore, and also the asset base, come to the conclusion that the assessee has 89.65% profit attributable to Indian operations. Therefore, he computed net profit of the assessee at Rs.19,64,44,881/- and attributed 89.65% profits to Indian operations. The DRP, on appeal dismissed the assessee's contentions.Consequently, the matter reached the Tribunal.

Ruling

The Tribunal ruled party in favor of the assessee. The Tribunal noted that as per the ratio laid down by the Hon'ble Supreme Court on the issue of fixed place PE in India and in order to constitute a fixed place of PE, it is essential that the premise of the Indian subsidiary must be at the disposal of the foreign holding company and the business of the foreign company must be carried on through that place. The Tribunal further observed that there was no dispute with regard to the fact that the premise of the Indian holding company is at the disposal of the assessee, because, the 'Dollar Team' carried out their functions from the premise of Indian holding company and thus, said activities constitutes a fixed place PE in India.

As such the Tribunal held that, *"in this case, there is no dispute of whatsoever with regard to existence of fixed place PE in India of the assessee, because of continuous occupation of 'Dollar Team' of Indian holding company premises and further, the business of assessee is continuously carried out from said location. Therefore, we are of the considered view that there is no error in the reasons given by the AO to hold that the activities carried out by a 'Dollar Team' of Indian holding company for the assessee constitute a fixed place PE of assessee in India."*

Furthermore, the Tribunal opined that in light of the evidences gathered during the survey and assessment proceedings, it was evident that all activities had been carried out by 'Dollar Team', except for shipping and export of documents from the Singapore Office. Hence it held that, *"we are of the considered view that the activities undertaken by the 'Dollar Team' of Indian holding company constitutes a dependent agent PE…. we conclude that there exists a fixed place of PE and also dependent agent PE of assessee company in India and hence, income of the assessee is liable to tax in India"*

On the issue of attribution of profits, the Tribunal opined that the correct legal position is that the AO should adopt the margin of the Singapore entity and attribute the same between the Indian PE and the Singapore entity. It held that the AO had erred in considering the unaudited profit before tax when there were audited figures already available.

Source: Tribunal, Chennai in M/s. Redington Distribution Pte. Ltd. vs. the Dy. Commissioner of Income Tax vide IT(TP)A No. 14/Chny/2020 dated 16th November 2022

ITAT Holds: Functionally Different Companies Not to be Considered and Included as Comparables

Facts

TThe assessee, Weatherford Drilling and Production Services (India) Pvt. Ltd., operates two divisions, (i) Manufacturing Division: this division is engaged in manufacturing of gas lift walls and packers (ii) Weatherford Engineered Systems Support Division (WESS): this division supports the maintenance and development of software developed by Weatherford Group. The assessee filed a return for the assessment year 2008-09 and the case of the assessee was referred to the TPO under section 92CA (1) of the Act. A draft order under section 92CA (3) was passed against the assessee after making an upward adjustment of Rs. 80,83,421 to the returned income. Additionally, the TPO did not exclude CTIL as a comparable company even though it was functionally different from WESS. On appeal, the DRP dismissed the contentions of the assessee regarding CTIL and affirmed the order under section 143(3) read with section 144C of the Act, wherein the total income of the assessee was determined as Rs. 2,34,50,561 including the Rs. 80,83,421 amount of TP adjustment. Consequently, the assessee approached the Tribunal for relief.

Ruling

The Tribunal ruled in favor of the assessee. The Tribunal examined the facts of the case in depth. It found that the business model of CTIL was absolutely different from that of the assessee company. It was also noted that since a substantial part of CTIL was outsourced to an outside third party the modus operandi was not compatible with the assessee's and to include it in the comparables would only enhance such dissimilarities.

In order to arrive at its conclusions, the Tribunal analyzed the following case laws, *Ramp Green Solutions vs. CIT (2015) 60taxmann.com355(Delhi), Principal Global Services P. Ltd. (2018) 95 taxmann.com 315 (Bombay), Aptara Technology P. Ltd. (2018) 92taxmann.com 240 (Bombay)and Mercer Consulting India P. Ltd (2016) 76 taxmann.com 153 (Punjab& Haryana)*. After the perusal of the aforementioned rulings, the Tribunal held that,

"In our considered view, in light of the above rulings, it is well established principle that the company which does most of these activities through its own employees is not functionally comparable to a company which outsources majority of its work to third party vendors"

As such, the Tribunal allowed the assessee to exclude CTIL as a comparable company.

Source: Tribunal, Ahmedabad in Weatherford Drilling & Production Services (India) Pvt. Ltd. vs. The ACIT Circle-2(1) (2) vide ITA No. 77/Ahd/2019 dated 21st November 2022

Let's Connect

+91.135.2743283, +91.135.2747084

3rd Floor, MJ Tower, 55, Rajpur Road, Dehradun - 248001

E: info@vkalra.com | W: vkalra.com

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For any further assistance contact our team at kmt@vkalra.com