NEWS CRUNCH

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NANGIA & CO LLP
CHARTERED ACCOUNTANTS

What's inside . . .

DIRECT TAX

1. AAR denies Article 13 benefit on capital gains, holds Mauritian entity - mere name lender

Brief Facts of the Case:

- The Applicant (AB Mauritius[1]) is a company incorporated in Mauritius in 2003, having its registered office at Mauritius, holding a Tax Residency Certificate (TRC)
- The Applicant is a part of "C" Equity Portfolio and "C" Affiliates Fund LP ("C" Group), which cumulatively hold 79.62% shares of the Applicant
- It's business activities are carried on from Mauritius and managed by its Board of Directors (BOD). The sole purpose of its incorporation was to invest in the "S" sector in India and other Asian markets
- It acquired 99% of shares in "AB" India, after obtaining regulatory approvals from FSC in Mauritius and FIPB in India, from "AB" Inc. and "US" Inc. USA (Sellers) vide Stock Purchase Agreement (SPA) in November 2003. Since then, it has been holding the shares legally and beneficially and has been enjoying shareholder rights
- The SPA was executed by Mr. "S", as an authorized signatory, representing the promoter group and being authorized by the BOD of the Applicant

[1] [TS-635-AAR-2017]

- The applicant agreed to repay the loan owed by the Sellers to "C" Group, which represents compensation for the shares acquired.

- Pursuant to filing the application, "AB" Singapore, a subsidiary of the Applicant and a regional headquarter, was incorporated in August 2011 as part of the corporate strategy of the Group, to support its business in the Asia and to obtain operational and cost benefits from centralizing the ownership of investments and operations in Asia.

- In order to achieve the above objective, the Applicant proposed to transfer the shares held in "AB" India to "AB" Singapore

- The Applicant filed an application requesting an advance ruling on taxability of capital gains arising on transfer of shares held in "AB" India to "AB" Singapore, claiming India- Mauritius Treaty benefit.

Contentions of the Applicant

- Prior to the transfer of shares to its subsidiary, the Applicant has held the shares of "AB" India for a period of 9 years, and thereafter, through "AB" Singapore for a further period of 3 years.

- By virtue of transferring the shares to "AB" Singapore, the objective was not to earn any gains or earn immediate financial gains.

- The restructuring was solely motivated by business and commercial reasons. Furthermore, post the restructuring, "AB" India continued to carry on its business activities in India.

- Being eligible to avail benefits under the India- Mauritius DTAA, capital gains earned by the Applicant from transfer of shares of "AB" India would not be liable to tax in India

Contentions of the Revenue

- The shares were transferred by two US entities to "C" Group (also US Entities). It was thus a transaction between two sets of US entities

- Applicant had no role in the above transaction. Its name was only interposed in the agreement

- The agreement was signed by Mr. S and on the date of the agreement he was only Managing Director and principal investor in "C" Affiliates Fund of companies for the entire loan, and not the Chairman of the applicant company. Mr. S had absolutely no authority to sign on behalf of the applicant company

Ruling of the Advance Ruling Authority

- That BOD of Applicant merely reiterated the decision of holding company and Applicant had no role in decision making process for acquiring shares of AB India from US sellers

- SPA was signed by MD of C Group and not by any director of Applicant even though applicant was mentioned as buyer in SPA

- The applicant is merely the name lender for C Group

- In a case where the parent acts on behalf of its subsidiary and takes all its decisions, corporate veil between the company's subsidiary and its parent stands torn, not at the instance of the revenue, but by the conduct of the group itself

- Merely superimposing Applicant in transaction done by C Group would render the transaction as colourable device and would fall in category of exception being a mere name lender

- That TRC gives a presumptive evidence of beneficial ownership and not conclusive presumption

- The shares belonged to two C Group Companies based in USA and accordingly, capital gains are taxable in India as per India - US treaty on which TDS is required to be deducted u/s 195

- Transaction is required to benchmarked under Chapter X (TP provisions) but provisions of Section 115JB not applicable.

NANGIA'S TAKE

The ruling touches upon the delicate issue of "substance over form" and emphasises on the fact that having a TRC is not sufficient and that the place of decision making and authority of the Board is important to claim treaty benefit. Moreover, it has made it clear that the Tax Treaty benefits shall be denied whenever the taxpayer has structured the transaction with the intention to take unfair advantage.

2. Termination of call options liable to capital gains and transfer pricing aspects

Ahmedabad Income Tax Appellate ITAT ('ITAT') in the case of Vodafone India Services[2] ('Assessee') dealt with the issue of whether termination of call option to buy shares in an Indian company, SMMS Investments (SMMS), which indirectly held shares of an Indian operating company (I Co), results in capital gains.

Background

The Assessee, an Indian company, is an indirect wholly-owned subsidiary of a Netherlands entity (BV Co) and is a part of a global group of companies called Vodafone Group (V Group). Prior to the Assessee becoming a part of V Group, it was held by Hutchinson Group (H Group). It was as a result of transfer of certain intermediary companies holding the Assessee by H Group to BV Co that the Assessee became an indirect subsidiary of BV Co. The taxability of indirect transfer of I Co shares resulting from this transaction was a matter which was decided by the Supreme Court[3](SC). The terms of various agreements entered into by the Assessee and its Associate Enterprises, as relevant to acquisition of shares of SMMS, are as under:

Framework Agreement - The Assessee entered into a framework agreement in June 2007 ('Framework Agreement') with the Investors, with an intent to preserve the priority right of the Assessee to acquire equity interest of the Investors in SMMS in anticipation of the revision in sectoral limits under FDI, as well as to ensure compliance with the FDI Policy.

[2]2018] 89 taxmann.com 299 (Ahmedabad - Trib.)
[3]VIHBV v. UOI [341 ITR 1]

This was done by securing a "call option" for the Assessee and a "put option" for the Investors. The call option entitled the Assessee to buy the entire equity capital of SMMS from the Investors for a consideration of around INR 4 crores in case the fair market value (FMV) of shares of SMMS was less than INR 1500 crores, and a marginally higher consideration was payable if the FMV exceeded INR 1500 crores.

Termination Agreement - Under the Termination Agreement dated Nov 24, 2011, the call and put options granted by Framework Agreement were agreed to be terminated. A termination fee of around INR 21 crores was agreed to be paid by the Assessee to the Investors in lieu of such termination. In addition, as per the terms of Termination Agreement, such termination was agreed to become effective on the date on which the Investors would cease to hold 51% or more of paid-up capital of SMMS.

Shareholder's Agreement - As agreed under shareholder's Agreement dated Nov 24, 2011, post the termination of the call and put options, SMMS issued shares to another Indian company, India Hold Co. and also conferred a right upon the Investors to oblige SMMS to buy back the shares held by the Investors in SMMS within a specified period if such option was exercised by the Investors. **The combination of Framework Agreement, Termination Agreement and Shareholder's Agreement resulted in an increase in equity interest of BVCo in I Co by around 3%.**

Contentions of the Assessee

The option available under Framework Agreement was a contractual right, and not a property right. Pending exercise, options are not property rights and, hence, they do not qualify as capital assets under the Act. The Assessee did not exercise the option, but terminated the same, hence, there is no question of earning capital gains from termination of call options. Reliance was placed on the SC decision in the case of B. C. Srinivasa Setty to contend that even if a call option is accepted to be a capital asset and its termination as a transfer, in the absence of any cost of acquisition, there will be no capital gains. Furthermore, the Assessee did not receive any consideration on termination, instead a compensation was paid by the Assessee to the Investors. Thus, in the absence of a consideration, there cannot be capital gains in the hands of the Assessee.

Contentions of the Revenue

The definition of a capital asset under the Income-tax Act, 1961 ('the Act') has been expanded by clarifying that the term "property" includes all the rights in and in relation to an Indian company. The Assessee had two rights by virtue of the call option viz., the right to exercise the option of purchasing the shares of SMMS and the right to assign the call option. Exercise of an option connotes an active action on the part of the Assessee, which can take numerous forms. For instance, exercise resulting in transfer, exercise resulting in extinguishment or exercise resulting in relinquishment. The right to assign the call option was an absolute right vesting with the Assessee and hence termination of the call option resulted in exercise of the option. Though the SC, in the Assessee's own case for previous years, had held that options are contractual rights and, hence, do not qualify as property, the definition of property under the Act has since been amended to include any rights in relation to an Indian company.

ITAT's ruling

The ITAT noted that under the call option, the Assessee had a right to either exercise the call option or assign the call option in favour of its associated enterprise.

The ITAT further noted that the Assessee did not acquire the shares of SMMS, but exercised the right to nominate the person who could acquire the shares of SMMS. Such right to nominate qualifies as a capital asset under the expanded definition under the Act, which covers within its ambit all rights in or in relation to an Indian company. Post the amendment to the Act, the SC's decision stating that pending exercise, an option does not qualify as a capital asset, is no longer applicable. Furthermore, since the right to nominate comes to an end on exercise, such exercise results in a transfer subject to capital gains tax.

NANGIA'S TAKE

In this landmark ruling, the argument of the Assessee that the right was a no-cost asset and, hence, the charge was not triggered by virtue of the SC decision in the case of B.C. Srinivasa Shetty[4], was rejected by the ITAT. The payments for termination of the call option and acquiring a cashless call option were held to be the cost of acquisition by the ITAT.

The ITAT's ruling deals with peculiar facts and taxpayers will have to evaluate the impact of the principles laid down by the ITAT in light of the facts of their own cases.

[4] (1981) 128 ITR 294 (SC)]

3. CBDT issues instruction for non-recovery of tax demands from "start-up" companies issuing shares at premium value

Income-tax Act, 1961 ('the Act') provides for taxation of premium amount, beyond the Fair Market Value (FMV), received by a closely held company (CHC), on issue of shares to residents in India. Such premium amount received would be taxable as income in the hands of the CHC (Premium taxation).

For the purpose, FMV is considered as the higher of following:

- Value as per the prescribed valuation rules at break up or discounted cash flow (DCF) value as certified by Category I Merchant Banker or CA; or

- Value which company is able to substantiate to the satisfaction of the Tax Authority basis of holding various intellectual property rights (IPRs) like goodwill, know-how, patents, copyrights etc.

Vide Notification dated June 14, 2016, CBDT notified that Premium taxation under the Act will not apply when shares are issued to resident by a qualifying start-up company. However, Indian Tax Authority continued to issue notices to several start-up companies challenging the valuations of share issue.

Pursuant to the above, the CBDT has now issued an administrative instruction[5] to the Tax Authority to relieve start-up companies from coercive measures.

[5] Instruction no F.No. 173/14/2018-ITA.I dated 6 February 2018

CBDT has provided guidelines with regard to recovery of demand from start-up companies for additions made to their taxable income by the Tax Authority, by rejecting/modifying the valuation reports issued by merchant bankers or an accountant (CA) on issue of shares.

The CBDT has instructed the Tax Authority that if additions have been made after modifying/rejecting the valuation reports submitted by a start-up companies, no coercive measures to recover the outstanding tax demand would be taken.

Further, for all such cases which are pending before the First Appellate Authority, necessary administrative steps should be taken for expeditious disposal of appeals, preferably by 31 March 2018.

4. Erection and commissioning charges not taxable as FTS

Chennai bench of the Income-tax Appellate Tribunal ('ITAT') held that payment made to a non-resident entity for erection and commissioning services outside India would not be taxable as fees for technical services ('FTS') in India under the Income-tax Act, 1961 ('the Act').

Background and facts

The Assessee was an Indian company, which purchased machinery and equipment from a Saudi Arabian company. For erection and commissioning it entered into agreement with a tax resident of the UAE. The machinery was purchased and supplied outside India, and the agreement for erection and commissioning was also made outside India. During scrutiny assessment, the assessing officer disallowed payment made towards the erection and commissioning services to the non-resident, on account of not deduction of TDS.

Contentions of the assessee

The Assessee contented that the payment was made towards erection and commissioning activities performed by the non-resident entity. The same amounts to "construction," which falls within the exclusion of FTS, as defined in explanation 2 to section 9(1)(vii) of the Act. Hence, the said payment was not liable to withholding tax.

Contentions of the revenue

The Revenue contended that the amount paid by the Assessee towards erection and commissioning charges was in the nature of FTS under section 9 (1)(vii) of the Act, since the non-resident entity utilised its technical skill and expertise for erection and commissioning of machinery. Therefore, tax was required to be withheld.

ITAT's ruling

The ITAT noted that the non-resident entity was only a service provider for installation of machinery. The agreement with the non-resident entity was entered outside India, and the installation services were performed outside India. As per the agreement, the equipment, specifications, design drawing, remained the property of the Assessee. In view of specific facts in the agreement, payments made to the non-resident entity could not be construed as FTS within the meaning of section 9(1)(vii) of the Act. Hence, the Assessee was not required to withhold tax on such payments.

NANGIA'S TAKE

This ruling is peculiar to the facts and the terms of the agreements under consideration. Going forward also the facts and terms of assessee's agreements would determine the tax liability of similar payments.

INTERNATIONAL TAX UPDATES

5. Brussels' move on digital taxes raises transatlantic stakes

The Commission takes another aggressive move against Silicon Valley. Tech giants like Google and Facebook may soon face a new tax in the EU that could deliver a major hit to their bottom line — as well as a radical shift in the way their tax bill is calculated. According to a 12-page draft report obtained by POLITICO Pro, the European Commission wants to tax digital companies' gross revenues at rates between 1 and 5 percent, based on where their users are located and how much advertising revenue they bring in. If implemented, this move is bound to further ratchet up tensions between Europe and the United States.

Source: https://www.politico.eu/article/technology-brussels-digital-tax-move-raises-transatlantic-stakes/

6. Australia's tax office will chase down bitcoin investors

The Australian government will use data-matching and identification checks to pursue bitcoin investors for their tax liabilities, according to a report in The Australian. Bilateral tax treaties and anti-money laundering powers will be used by the Australian Tax Office to try to ensure transparency in the crypto market, where the anonymity provided by the underlying blockchain technology is prized among some investors. National Tax Liaison Group member Paul Drum said it was a "watershed moment for the ATO" and would "enabling them to access and thoroughly review cryptocurrency exchange account data for the first time.

"The effectiveness of the anonymity of Bitcoin and other cryptocurrencies is starting to fade. These coming changes mean that people shouldn't assume they can hide forever behind blockchain technology, nor should they assume there are no tax consequences," Drum told The Australian.

Source: https://www.businessinsider.com.au/australia-bitcoin-tax-transparency-2018-2

7. Singapore updates transfer pricing guidelines emphasizing compliance, introducing penalty regime

The Inland Revenue Authority of Singapore (IRAS) issued the 5th edition of its Transfer Pricing Guidelines on 23 February, setting out enhancements to the arm's length principle, adding new transfer pricing documentation requirements, and granting new powers of the Comptroller of Income Tax (Comptroller) to make transfer pricing adjustments and impose surcharges and penalties for non-compliance.
The guidelines update guidance on Singapore's transfer pricing regime and incorporate the new Income Tax (Transfer Pricing Documentation) Rules 2018, which came into effect on 23 February and transfer pricing related amendments to the Income Tax Act (Cap. 34) (ITA).

The guidelines, recent ITA amendments, and the transfer pricing documentation rules are in line with IRAS's objective to increase transfer pricing compliance by taxpayers.

Source: https://mnetax.com/singapore-updates-transfer-pricing-guidelines-emphasizing-compliance-introducing-penalty-regime-26264

8. Google's UK tax could jump seven-fold on plan for revenue levy

Tech giants could see their UK tax bills multiply by hundreds of millions of pounds a year if the Government follows French proposals to introduce a digital levy on revenues. Google paid £36m in tax last year under current rules, with Facebook charged £5.1m. But if the Government follows through on proposals to tax revenues, not just profits, this could hit the companies far harder. Google said it had UK revenues of $7.8bn in 2016, or £5.6bn, so a 5pc tax would take £280m – more than seven-times larger than its current bill. Facebook generated £1.8bn of UK revenue in 2016, according to eMarketer, which would result in a £90m charge, more than 17-times bigger.

Source: https://www.telegraph.co.uk/business/2018/02/25/googles-uk-tax-could-jump-seven-fold-plan-revenue-levy/

9. Tax Law Gives Buffett's Berkshire Hathaway a Big Boost in Value

Warren Buffett's Berkshire Hathaway Inc. was a big winner from the recent tax overhaul. Book value, a metric he's called a "crude, but useful" way to track the conglomerate's worth, climbed 13 percent to $211,750 per Class A share at the end of 2017 compared to three months earlier, the company said Saturday in a statement. Analysts at Barclays Plc last month predicted that the measure of assets minus liabilities would rise as Berkshire lowered its tax liability on some appreciated investments. Buffett got a $29 billion boost to net earnings in the fourth quarter from the tax code changes. Buffett had a mixed reaction to the tax overhaul passed by Congress last year. In January, he praised how the changes mean business owners will get a bigger share of profits and said he would have voted for it as a representative of Berkshire's investors.

Still, when asked if he would have encouraged legislators to support or fight it, Buffett said he would have gone with a different bill. The billionaire investor has long advocated for higher taxes on the wealthy, while the new law reduced the top income-tax rate.

Source: https://www.bloomberg.com/news/articles/2018-02-24/tax-law-gives-buffett-s-berkshire-hathaway-a-big-boost-in-value

TRANSFER PRICING

10. ITAT rejects ALP of intra-group services (i.e. license, management fees) as NIL and holds non-monetary aspects important for judging benefit test

Facts of the case

Adcock Ingram Limited ("the taxpayer"), incorporated in India and established as a joint venture company between Medreich SA and Adcock Ingram Health Care (Pty) Ltd, South Africa ("AIHPL"), is engaged in the manufacture of pharmaceutical formulations for AIHPL. The taxpayer entered into business agreement for technical knowhow manufacture of pharmaceutical formulations with its Associated Enterprises ("AE") viz. AIHPL and management agreement with Medreich SA for the purposes of liaisoning and coordinating the services and also to manage its supply arrangement to AIHPL more efficiently. As per the terms of agreements, the taxpayer was required to pay license fee to AIHPL and management fee to Medreich SA at a rate of 8% and 3% of the net sales respectively.

The taxpayer adopted Transactional Net Margin Method ("TNMM") as the Most Appropriate Method ("MAM") and computed operating profit/operating cost at the entity level at 25.49% as against the non-AE at 5.26%. However, TPO was of the view that no benefit has been obtained by the taxpayer from such intra-group service payments. Accordingly, the TPO determined the ALP of the transactions as NIL, thereby rejecting the TNMM approach adopted by the taxpayer and instead applied Comparable Uncontrolled Price ("CUP") Method.
In appeal, the Commissioner of Income Tax (Appeal) ["CIT(A)"] deleted the addition proposed by the AO/TPO.

Aggrieved by the order passed by CIT(A), the Revenue filed an appeal before Bangalore Income Tax Appellate Tribunal ("ITAT").

Proceedings before ITAT
ITAT's Ruling

Aggregation of Transaction

At the outset, ITAT noted that the payment of license fees and management fees were interlinked with the main transaction of manufacture and export of drug formulations. Therefore, the aggregation approach adopted by the taxpayer and as upheld by CIT(A) were in accordance with law as the Revenue has not put forward any specific challenge regarding the same. ITAT opined that *"aggregation of transaction is permissible under income tax Act and rules framed there under"* and referred to Delhi High Court ("HC") judgement in the case of ***Sony Ericsson Mobile Communications India Pvt Ltd & Ors [TS-96-HC-2015(DEL)-TP]*** wherein it was held that "*the aggregation of such transactions was permissible*".

License Fees

ITAT stated that **benefit test** is a necessary part of determining ALP of any intra-group service. However, ITAT clarified that benefit cannot have qualifications such as "substantial", "direct" and "tangible" as these qualifications are not given under section 92(2) of the Income-tax Act, further there are several non-monetary terms other than profitability which are required to be seen while judging the benefit test. Further, ITAT observed that the license was required for long term manufacturing of drugs and formulation with know-how of the AE and hence, ITAT opines that "TPO cannot lose sight of various benefit which may flow to Indian partner in the absence of provision for making the payment for the use of license.

ITAT noted TPO's conclusion that "*no license fee should have been charged by AIHPL as all the manufactured drugs formulations were exported to AIHPL and TPO's recordings that there was a huge difference in profit margin of a related party sales and the contract manufacture"* and cited that the approach of TPO was contrary to law & relied upon judgements in the case of ***EKL Appliances Ltd [TS-206-HC-2012(DEL)-TP]*** *and* ***Dresser Rand India P. Ltd [TS-545-ITAT-2011(Mum)-TP]*** in which Tribunal had held that *while evaluating the ALP of a service, it is wholly irrelevant as to whether the taxpayer benefits from it or not. The real question is whether the price of this service is what an independent enterprise would have paid for the same.* In the present case, ITAT stated that it is important for the taxpayer to obtain license for exporting pharmaceutical drugs. ITAT opined that *"the prices charged by the taxpayer and the amount of licence fees paid to AE cannot be examined on stand-alone basis, because it will have effect of determination the net prizes received by the taxpayer"*. Therefore, ITAT rejected the approach of *TPO to compute NIL charges for the license fees under CUP method.*

However, ITAT observed that the taxpayer's comparability analysis has not been examined by the authorities. Thus, ITAT remanded the issue to the file of the CIT(A) for inspecting the correctness of the ALP.

ITAT also noted that the pre-condition for CUP Method is the availability of the price of the product and service in uncontrolled conditions and the availability of the real value which in the present case is absent.

Management Fees

ITAT observed that TPO's claim of duplication of services and lack of evidence of rendering services for the management is irrelevant because the burden of maintenance of documents/evidences cannot be increased merely on the fact that taxpayer is receiving services from its AEs. ITAT stated that *"Just because these services are worthless in the eyes of the revenue authorities, the arm's length price of these services cannot be held to be NIL"* and referred to the judgement in case of ***Merck Ltd [TS-143-ITAT-2016(MUM)-TP]*** wherein it was held that *"Just because these services were too general, in the perception of the authorities below, or just because the taxpayer did not need these services from the outside agencies, cannot be reason enough to hold that the services were not rendered at all".* ITAT further stated that though *"TPO had rejected taxpayer's TNMM, he also did not adopt any other permissible method for determination of arm's length price. Thus, ITAT held "Such a course of action…is not permissible in law".*

Lastly by relying on **Dresser-Rand India (supra)** ruling the ITAT dismissed the Revenue's contention regarding deletion of adjustment by CIT(A).

NANGIA'S TAKE

The verdict in the instant case echoes the fact that the objective of Transfer pricing provisions under the section 92C is to ensure that the price of international transactions should be at arm's length and the department cannot validate / confirm the tangible benefits in regard to payment of intra-group services.

Source: Adcock Ingram Ltd [TS-57-ITAT-2018(BANG)-TP]

The Assessing Officer was of the view that since the taxpayer was entitled to receive know how under the royalty agreement, no separate payment for production planning in manufacturing process was warranted.

On the basis of above, the Assessing Officer concluded that "it was legal duty of the licensor to provide such services for which he was already paid as royalty charges, and therefore, technical fees to its own AE is nothing but a diversion of income and hence, is required to be disallowed" under provisions of section 37(1) of Income-tax Act, 1961 ["the Act"]. Aggrieved, the taxpayer filed an appeal before Commissioner of Appeals ["CIT(A)"] wherein the disallowance made by the AO was partly confirmed.

In view of the above, the taxpayer filed appeal before Income Tax Appellate Tribunal ["the ITAT"/ "the Tribunal"].

The Tribunal's ruling: On determining the arm's length price by the Transfer Pricing Officer

In this regard, the ITAT made following observations:

- The payments made by the taxpayer to its AE were covered by the international transactions reported by the taxpayer and the TPO had accepted the same to be at arm's length.

- It cannot be open to the AO to assume the powers of the TPO and hold that these are not arm's length payments. Such a parallel analysis of transactions by the AO and the TPO is not at all contemplated under the Indian TP legislation.

- AO is not entitled to deal with the matter once he has referred the same for determination of arm's length price to the TPO.

Section 92CA(4) of the Act, provides that "***On receipt of the order under sub-section (3), the Assessing Officer shall proceed to compute the total income of the assessee under sub-section (4) of section 92C having regard to the arm's length price determined under subsection (3) by the Transfer Pricing Officer.***" Thus, it cannot be open to the AO to disregard the arm's length price determined by the TPO.

It cannot, therefore, be open for the AO to say that even though transaction value is held to be at arm's length by the TPO, the arm's length price can be reduced on account of actual rendition, or non-rendition, of services.

In view of the above, the Tribunal allowed the taxpayer's appeal and set aside the additions made by AO.

NANGIA'S TAKE

The Indian TP provisions empower the TPO to determine arm's length price of a transaction once the matter has been referred to him by the AO. Such determination involves a detailed factual analysis and is not just a theoretical exercise. Thereafter, while computing the total income, the AO cannot disregard the arm's length price determined by the TPO on the basis of any random assumptions.

Source: Deputy Commissioner Of Income Tax vs YKK India Pvt Ltd (ITA No. 238/Del/16)

11. ITAT holds that Advance Pricing Agreement (APA) terms can be applied to year outside APA Period and relies on Abicor

Facts of the case

Tieto IT Services India Private Limited ("the taxpayer") is a wholly owned subsidiary of TietoEnator Deutschland GmbH, Germany ("Associated Enterprise"/ "AE"). The taxpayer is a captive service provider, providing software development services to Tieto group of companies and entered into various international transactions with the AE during the AY 2010-11 ("year under consideration").

For the purpose of Allocation of management support services cost ("MSS"), the group has set up a centralized mechanism for provision of MSS to all the group entities. Therefore, the costs incurred in providing the support are allocated to the group entities. Accordingly, the taxpayer follows an aggregation approach and such MSS transactions are integrated with provision of software development services.

During the course of assessment proceedings, all the transactions were accepted by the Transfer Pricing Officer ("TPO") to be at Arm's Length Price ("ALP") except payment for MSS and determined the ALP of MSS to be NIL. Based on the TPO findings, the Assessing Officer ("AO") confirmed Transfer Pricing ("TP") adjustment on account of international transaction adjustments.

Further, Commissioner of Income Tax (Appeals) ["CIT(A)"] also confirmed the addition proposed by AO/TPO. Aggrieved by the order passed by CIT(A), the taxpayer filed an appeal before Pune Income Tax Appellate Tribunal ("ITAT").

Proceedings before ITAT

Taxpayer's Submissions

The taxpayer submitted that in the Previous Assessment years, MSS fees paid to its AE were accepted by the TPO to be at arm's length price. The taxpayer also submitted that he had entered into Advance Pricing Agreement ("APA") with CBDT for the Assessment Year ("AY") 2015-16 and APA also applied to four rollback years starting from AYs 2011- 2015. Further, the taxpayer submitted that the nature of transactions covered under APA were identical to the transactions entered by the taxpayer during the year under consideration. Therefore, TP adjustment in respect of MSS should be made in accordance with the said APA. To support his submission, the taxpayer placed reliance on various judgments i.e. ***AXA Technologies Shared Services Private Limited Vs. Dy. Commissioner of Income Tax*** **and** ***Ranbaxy Laboratories Limited Vs. ACIT***.

ITAT'S Ruling

ITAT noted that the international transactions carried out by the taxpayer in year under consideration were similar to the one covered under APA. Further, ITAT noted that the taxpayer's submission in past as well as in subsequent AY's in regard to payment of MSS fees to its AE had been accepted by TPO/DRP to be at ALP. Accordingly, ITAT opined that it was appropriate to remit the file back to CIT(A) for re-examination of the issue in the light of terms and conditions of the APA, subject to verify that the international transactions in dispute were similar to the transactions covered by APA.

Thus, ITAT reckons that *"there is no impediment on department in applying the terms and conditions of APA while considering the transactions in the AY not covered by the APA, but subject to the condition that the nature of transactions should be identical in both the situations"* and remitted the issue back to the CIT(A) for re- adjudication. Consequently, the appeal of the taxpayer was allowed for statistical purpose.

NANGIA'S TAKE

The verdict in the instant case reiterates the fact that unless there is a significant change in the business or international transactions undertaken by the taxpayer, the results of the transfer pricing assessments should be consistent and should not be unnecessarily varied by the tax authorities.

Source: Tieto IT Services India Private Limited [TS-69-ITAT-2018(PUN)-TP]

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