NANGIA ADVISORS LLP

A collaborating firm with Andersen Global in India

NEWSLETTER

November 16th - 30th , 2018

www.nangia.com

NEWSLETTER
November 16th - 30th , 2018

What's Inside…

DIRECT TAX

INTERNATIONAL TAX

TRANSFER PRICING

NEWSLETTER
November 16th - 30th , 2018

Direct Tax

1. Ahmedabad ITAT holds that there shall be no disallowance for non-deduction of TDS on an expense till the time such expense is not chargeable to tax

Brief Facts of the Case:

- Sophos Technologies Private Limited (the assessee) is engaged in the business of development of network security software.
- The assessee procures anti-virus from Russia and anti-spam software from Israel and bundles them with its own Threat Management software, which is ultimately sold to the end consumers as a bundled product.
- The royalty in respect of the anti-virus and anti-spam software is paid only when the ultimate user of the bundled software activates the license key. However, revenue is recognised at the time of sale of the bundled software to the distributor. The assessee also makes a provision for royalty that it may have to pay upon activation of key.
- The Assessing Officer (AO) did not allow deduction of royalty expense on account of non-deduction of tax at source.
- Sophos Technologies went on to appeal against the said adjustments before the Income Tax Appellate Tribunal, Ahmedabad (ITAT)

Contentions of the Assessee:

- The actual liability to pay royalty crystallized at a much later time when the product was eventually activated by the end customers and tax withholding obligations are discharged at that point only.

Contentions of the Revenue:

- The provision for the liability in respect of royalty payable for the bundled product was not admissible as a deduction because the assessee had failed to deduct the tax at source.
- That the provision for royalty is not a provision per se but an expense payable, which had occurred but was not actually paid as on the year end date.

Judgement:

- Taxability of royalty income in terms of India-Russia DTAA and India-Israel DTAA arises at the time when royalties are paid to the resident of other Contracting State
- The liability to deduct tax at source arises only when the income embedded in the relevant payment is exigible to tax. Clearly the sale of bundled software is not the point of time when the royalty in respect of bundled product becomes payable. It becomes payable when the end product is activated. In these circumstances, the AO's approach of treating the entire provision as income exigible in the hands of the supplier of the anti-virus/ anti-spam product is fallacious.
- Tax withholding liability has been discharged by the assessee as and when the key is activated and royalty becomes payable. This approach is legally correct because activation of the license key is the trigger to royalty accruing to the vendors. The approach of the assessee cannot be faulted with.

NANGIA'S TAKE

The ITAT has ruled rightly on the event of deduction of tax at source. Payments, which are not liable to tax, cannot be disallowed on account of non-deduction of withholding taxes. Thus, it clearly establishes that disallowance of any item for non-deduction of TDS would solely depend on the event at which such item becomes taxable i.e. payment or credit in books. The ITAT has studied all the standpoints of the transactions fastidiously to deliver the judgement to instate the faith of the assesses in the Indian Judiciary.

2. Central Board of Direct Taxes notifies 87 jurisdictions for the purpose of defining a 'passive non-financial entity' under Section 285BA of the Income-tax Act, 1961 read with Rule 114F of the Income-tax Rules, 1962

- The Section 285BA of the Income Tax Act, 1961 (Act) requires certain specified financial institutions (i.e. a custodial institution, a depository institution, an investment entity or a specified insurance company) to furnish a statement of "specified financial transactions/ reportable account" providing the details of relevant information.

- Financial accounts can be identified as a reportable account if it is held by the specified persons which includes passive non-financial entity.

- Whereas, a 'passive non-financial entity' includes an investment entity as specified by the Act, ***which is <u>not</u> located in any of the jurisdictions specified by the Central Board of Direct Taxes ('CBDT') in this behalf***.

- In order to aid classification of an investment entity as a passive non-financial entity, the CBDT has recently, issued a notification no. 78/2018 dated 5 November 2018 to prescribe certain jurisdictions. If an investment entity is located in any of these 87 jurisdictions as specified in the notification, it shall not be treated as a passive non-financial entity and thus, the accounts held shall not be classified as a reportable account.

- The list of countries is as follows:

NAME OF JURISDICTION				
Andorra	Colombia	Indonesia	The Netherlands	South Africa
Anguilla	Cook Islands	Ireland	New Zealand	Spain
Argentina	Costa Rica	The Isle of Man	Norway	Sweden
Aruba	Croatia	Italy	Pakistan	Switzerland
Australia	Curacao	Japan	Panama	Turks and Caicos Islands
Austria	Cyprus	Jersey	Poland	United Arab Emirates
Azerbaijan	Czech Republic	Korea	Portugal	United Kingdom
Bahamas	Denmark	Kuwait	Romania	Uruguay
Bahrain	Estonia	Latvia	Russian Federation	
Barbados	Faroe Islands	Lebanon	Saint Kitts and Nevis	
Belgium	Finland	Liechtenstein	Saint Lucia	
Belize	France	Lithuania	Saint Vincent and the Grenadines	
Bermuda	Germany	Luxembourg	Samoa	
Brazil	Gibraltar	Malaysia	San Marino	
British Virgin Islands	Greece	Malta	Saudi Arabia	
Bulgaria	Greenland	Mauritius	Seychelles	
Canada	Grenada	Mexico	Singapore	
Cayman Islands	Guernsey	Monaco	Slovak Republic	
Chile	Hungary	Montserrat	Slovenia	
People's Republic of China	Iceland	Nauru	South Africa	

NANGIA'S TAKE

While ascertaining reporting requirements under section 285BA of the Act, financial Institutions shall be required to take into consideration this notification. It is worth noticing that even if an entity qualifies the specified definition of investment entity, it shall not be classified as a passive non-financial entity if the same belongs to one of the specified jurisdictions and thus, will not be under the requirement to report the financial accounts.

3. Delhi ITAT held that reimbursements of the payments made by the foreign company to personal seconded in India shall be treated as salary and not FTS under Indian tax law

Facts of the case

- AT & T Communication Services (India) P. Ltd. (assessee) entered into an agreement with its holding company (AT&T USA) in USA to provide market research, administrative support and liaison services and other support services.
- To facilitate the business operations in India, AWPS, a manpower recruitment firm in USA seconded certain employees having different work profiles and job experience to the assessee in India. The assessee reimbursed the salary and other cost paid by AWPS to the said employees on behalf of the assessee
- The seconded employees were released from all the obligations towards AWPS and had functioned solely under the control, direction and supervision of the assessee
- The assessing officer (AO) relying on the judgement in the case of Centrica India Offshore Pvt. Ltd, Delhi High Court, contended that such payment was taxable as fees for technical services (FTS) under the Income-Tax Act, 1961 (Act) and India-USA tax treaty (tax treaty) and accordingly, tax was required to be deducted under section 195 of the Act. Owing to the aforementioned failure, the AO disallowed the amount reimbursed by the assessee to AWPS
- Aggrieved, the assessee filed an appeal before the Income Tax Appellate Tribunal, Delhi (ITAT)

Assessee's Contentions

- The seconded employees were not working in India to facilitate the business of AWPS and were performing all the business functions in their personal capacity effectively as employee of the assessee
- Thus, the tax was deductible under section 192 of the Act instead of the section 195 of the Act

Department's Contentions

- No employer-employee relationship existed between the assessee and the seconded employees and therefore, provisions of section 195 of the Act were applicable

Judgement

The ITAT held that tax on the reimbursements made by the assessee to AWPS shall be withheld under section 192 of the Act. While holding the same, it held as under:

- The nature of income embedded in related payments is relevant for deciding whether or not section 195 will come into play
- It noted that the seconded personnel were working as the employees of the assessee in India on the basis of the facts of the agreement entered between the assessee and AWPS.
- While holding the same, it distinguished the judgement delivered by the Delhi High Court in the case of Centrica. It noted that the employees were not taking forward the business of AWPS and were effectively working under the control and supervision of the assessee.

NANGIA'S TAKE

In our opinion, the main factor in ascertaining the taxability of reimbursements made in respect of the payments made by the foreign company to the seconded employees, is the identification of the employer-employee relationship. Judgment highlights that the existence of employer-employee relationship would depend on whether or not the seconded employees were conducting the business of the foreign entity in India. Also, it may be noted that substance of the transaction should be considered before applying any judicial precedent.

4. EPFO introduces online submission of monthly Form IW-1

- The Employees' Provident Fund and Miscellaneous Provisions Act, 1952 (EPF Act) is a legislation enacted to provide social security to the employees in the form of retirement benefits.

- Apart from the employees working in India, the EPF Act includes within its ambit International Workers (IW) too.

- Under the Provident Fund (PF) law, an employer is mandatorily required to file the Form IW-1 for hiring employees qualifying as IWs as per the meaning assigned to the same under Employees' Provident Funds Scheme, 1952. Until now, Form IW-1 was supposed to be filed manually with the PF Office on a monthly basis.

- On 28 November 2018, the Employees' Provident Fund Organisation (EPFO) issued a circular introducing the online submission of monthly Form IW-1 by the employer. The facility of online submission is available from the month of November.

- The following details are required to be mentioned in the new online Form IW-1:

    - Type of IW – whether Indian or Foreigner
    - Name
    - Universal Account Number (UAN) of employee
    - Monthly pay
    - Nationality
    - Details of passport
    - Details of visa
    - Details of Certificate of Coverage
    - Home city of the employee
    - Home country of the employee

Once IW-1 is uploaded, the employer shall be required to verify the same on the IW portal using a one-time password on the registered mobile number.

NANGIA'S TAKE

The initiative is in line with the notion of 'digital India' which the government has been persistently working upon. The environmentally sound move is directed towards making compliance simpler, timely and hassle-free.

5. Delhi ITAT reiterates the importance of disposal test to qualify as a PE in India; ownership not a pre-condition to constitute PE

Brief Facts of the Case:

- GIL Mauritius Holdings Ltd. (the assessee) is a company incorporated under the laws of Mauritius.
- During the year, the assessee rendered the services under two subcontracts entered with HHI and VMGL in connection with prospecting for extraction or production of mineral oil in India.
- The assessee contended that the income earned by rendition of the said services shall be taxed as business profits under India Mauritius tax treaty ('the Tax Treaty') and since there is no permanent establishment ('PE') in India, such income could not be taxed in India.
- During the assessment proceedings, the assessing officer (AO) rejected the contentions of the assessee and noted that the Vessel was at disposal of the assessee and thus, treated it as the PE in India and attributed 25% of total revenue as the income of the assessee.
- The assessee filed an appeal before the Commissioner of Income-tax (Appeals) [CIT(A)] which ruled against the assessee. Aggrieved, the assessee appealed before the Delhi Income Tax Appellate Tribunal ('Delhi ITAT').

Contentions of the Assessee

- Construction and assembly of the pipeline was undertaken in India and both the contracts were for less than 9 months and therefore the assessee did not have a PE in India.
- Date of commencement of work is not available since the details were sought by the department after lapse of considerable time (6 Years) and the employees who had managed the concerned projects have left employment with the assessee and assessee is facing genuine difficulties in collecting the information requested by AO.
- Duration of contracts entered into by GIL does not exceed the threshold of 9 months required for formation of PE as per the Tax Treaty, even if the date of agreement is taken as the 'date of commencement of work'
- Clause 2(i) of Article 5 of the Tax Treaty applies only when the assessee has exploration and mining or an oil/ gas well or any other place of extraction of natural resources as an 'owner'. GIL was merely providing services on such places and therefore did not have a PE.

Contentions of the Revenue

- The assessee has failed to demonstrate the effective 'date of commencement of the work' and duration of project is unascertainable on the basis of the documents provided by it.
- The certificates obtained from HHI, only certified the date of completion of project
- Merely because the vessel entered into India on a particular day, such date cannot be said to be the commencement date
- The assessee has failed to provide any information about the profitability of the contract work, thus most reasonably, 25% of the gross receipt have been attributed as income of the assessee's PE
- The onus to prove that PE exists in India is only when the assessee submits relevant/complete data to the AO

Decision of the Delhi ITAT

- The assessee repeatedly mentioned that the details of 'effective date of commencement of work' were not available. Thus, there is no alternative but to take the date of agreement as the date of commencement of work. Further, since both the contracts are for a period less than the threshold time limit of 9 months, it cannot be said that the assessee has a PE in India under Article 5(2)(i) of the Tax Treaty.

- For determining PE under article 5(2)(g), it is incorrect to say that the assessee should be the owner of the oil/ gas well. The only requirement is that it should be a fixed place, at the disposal of the assessee, from where the business is carried out.

- The entity being a resident of Mauritius, is entitled to claim benefit of the Tax Treaty. Article 5(2) of the Tax Treaty does not provide that the place should be owned by the assessee. Oil well should be under the disposal of the assessee in the sense of having some right to use the premises for the purpose of business and not solely for project undertaken on behalf of the owner of the premises. The assesse has undertaken the project as a sub-contractor and it has not been proved by the CIT(A) that oil well was at the disposal of the assessee.

NANGIA'S TAKE

Delhi ITAT has meticulously analysed the facts and passed a fair judgement. The judgement has made it clear that it is necessary for an entity to pass the disposal test to qualify as a PE in India. It has most appropriately brought to notice that Article 5 (2) does not mandate ownership in order to institute a PE, what is required is that the assessee should have some right over the fixed place of business and it should not be exclusively for the purposes of the project. Sub-contacting is not determinative of such right. Judgements like these smoothen the path for other genuine cases seeking tax benefits in foreign lands.

- No disclosure of the tax deduction account number and method to discharge of the tax liability on the estimated income is required to be made

- Instead of disclosing the date of payment/ deduction/ collection of advance tax/TDS/TCS, now the amount is required to be disclosed for the same

- Exemption certificate, approval is required to be filed for the entities claiming exemption under section 10, 11 and 12 of the Act

- Computation of estimated total income is required to be filed for any of the year in last four years for which the return was not filed

- Income tax return for the last four years filed in the paper form shall be uploaded

- Requirement to file details such as last three years sales/profit chargeable as business income, last three years tax payment, last three years returned/ assessed income, details for return due but not filed, have been removed

- Filing of details in annexure have been simplified in line with the changes made in the point 1 of the Form

NANGIA'S TAKE

One more step has been taken to welcome the digital era by enabling the e-filing of Form 13. Further, the Form has been made much more simplified and precise to capture the relevant information in a more organized way. This would lead to ease in understanding and filing the form both by the tax payer and the assessing officer.

6. Madras high Court holds general clause of the agreement cannot determine character of an income to be Royalty or FTS

Brief Facts of the case

- TVS Motors Co. Ltd (TVS), a representative assessee of AVL List Gmbh in Austria (AVL), entered into an agreement for availing technical assistance from AVL in respect of designing of a new 3-valve cylinder to improve fuel efficiency in India.
- During the assessment proceedings, the assessing officer (AO) held that amount received by the AVL as a consideration for rendering technical services shall be taxed as royalty under India-Austria tax treaty (tax treaty). However, the assessee contended that the consideration received was taxable as fee for technical service (FTS)
- Aggrieved, the appeal was filed before the Commission of Income Tax (Appeal) [CIT(A)] who ruled against the revenue and held that consideration received by the AVL was taxable as FTS and not as royalty. It held that the AVL carried out modification and improvement of the products sent by TVS and thus, no readymade patented product was supplied. The work performed was rendition of specific service instead of any right to use any design or technology
- On further appeal, the Income Tax Appellate Tribunal, Chennai (ITAT) confirmed the order of the CIT(A).
- Thus, the revenue department filed an appeal before the Hon'ble Madras High Court (HC) to adjudicate the matter

Department's contentions

- The main object of the agreement was to exploit the expertise of the AVL and TVS had no right to modify, disclose or sell the project design to any third party
- TVS had only limited right to use the project design for the purpose as mentioned in the agreement
- The amount received by the AVL for designing the cylinder is royalty as per the tax treaty

Representative Assessee's contentions

- The agreement was entered for modifying the engine developed by TVS to make the same fuel efficient
- All the design documentation, engines, components and vehicles required for the project to the AVL were supplied by TVS free of charge
- The work involved in the project was improving an already existing engine developed by TVS
- The payment was treated as FTS in a similar agreement entered with Austrian company in respect of Carburetters and it will apply squarely to the project for improvement of cylinders
- The general terms and conditions of the agreement cannot be assigned specific meaning as the same are general in nature which intended to safeguard AVL from fraud, and such generic clauses could not alter the technical assistance agreement.

Judgment

The High Court confirmed the treatment of consideration received upon rendering technical assistance as FTS and not Royalty. While holding the same, it observed as under:

- The product were developed by TVS and AVL's scope of work included only designing of the cylinder to improve fuel efficiency in India.

- All the work was performed in India with the material supplied by TVS along with all design documentation, engines and components as required for the project

- The general terms and conditions of the agreement were generic in nature applicable to all agreements that AVL may enter into with various third parties.

- The purpose of the general terms and conditions is to protect its rights, know-how, patents ideas and therefore, interpreting clause 7 of the general conditions to state that the agreement between the parties was a license would not be correct

OUR TAKE

The judgment is fact driven wherein facts of the case has been analyzed thoroughly. It establishes the exact nature of the work performed and the purpose of the transaction as key considerations in determination of consideration as royalty or FTS. Further, it narrows down the scope of interpretation of the agreement to specific terms by disregarding the reading of general terms in a specific manner.

7. Dutch to tighten tax rules for multinationals after EU pressure

The Netherlands says it will tighten rules on tax breaks for foreign firms after facing criticism from the EU for offering complicated schemes for multinationals. Dutch authorities said they are cracking down on “letter-box firms” with a Dutch address that allow foreign countries to benefit from lucrative local deals.

https://www.businesslive.co.za/bd/companies/2018-11-27-dutch-to-tighten-tax-rules-for-multinationals-after-eu-pressure/

8. Switzerland to end special tax allocation practices for new principal companies, finance branches

Switzerland’s federal tax administration on 14 November announced that it intends to stop applying special taxpayer-favourable federal allocation rules to new principal companies and Swiss finance branches from 2019.Further, upon the entry into force of expected Swiss tax reform (called TRAF) at the beginning of 2020, the federal practices for existing principal companies and Swiss finance branches will also be abolished.

https://mnetax.com/switzerland-to-end-special-tax-allocation-practices-for-new-principal-companies-finance-branches-31225

9. Google, Facebook Defend Tax Structures To EU Lawmakers

A Facebook tax official denied the company had sought special tax treatment in Europe and a Google executive committed to ending structures in Bermuda as European Union lawmakers sought Tuesday to probe suspected aggressive tax planning within the bloc. At a hearing held in Brussels, a tax executive from luxury clothing firm Kering also said the company's decision to use a Swiss structure was “strategic” rather than tax-motivated.

https://www.law360.com/telecom/articles/1105366

10. U.S. Companies Flee No-Tax Caribbean Havens After EU Crackdown

Many U.S. multinational corporations have packed up or are choosing to open subsidiaries in low tax, rather than no-tax, countries that are seen as more legitimate than the formerly popular island destinations of the Cayman Islands and the Bahamas. They’re fleeing in response to regulations from the European Union that require them to justify the business purpose for their offshore operations.

American corporations have used tax havens for years to avoid higher levies where they actually earn the income. European countries and the U.S. have teamed up in recent years to stop the use of loopholes and collect more of the tax dollars the companies domiciled within their borders owe.

https://www.bloombergquint.com/politics/corporate-america-flees-zero-tax-caribbean-havens-post-crackdown#gs.CDWrTp4

11. ITAT consider Taxpayer as a license manufacturer and not contract manufacturer

Outcome: In favour of the taxpayer
Category: Entity characterization

Facts and Contentions

- Sulzer Pumps India Pvt. Ltd. ("the taxpayer"), is primarily engaged in the business of manufacturing and sale of power driven pumps.

- During the year under consideration, the taxpayer has entered into certain international transactions viz. purchase of raw material, sale of finished goods, payment of royalty, payment of technical know-how and payment of commission with its Associated Enterprise ("AE") and followed aggregated approach while benchmarked the same using transactional net margin method ("TNMM") as the most appropriate method ("MAM").

- During the course of Assessment Proceeding, TPO rejected the aggregation approach adopted by the taxpayer and noted that the agreement entered by the taxpayer with its AE gives it no exclusive right to sell manufactured goods without prior approval of its AE. Accordingly, TPO characterized the taxpayer as contract manufacturer instead of license manufacturer and determined the ALP of royalty, technical know-how expenses at Nil.

- Additionally, the AE of the taxpayer had entered into contract with Microsoft for allocating the annual charges of Microsoft licensing fee to the group entities annually. In relation to above the taxpayer has also paid certain amount as annual charges, since the same was not reported by the auditor in form 3CEB, the TPO determined the ALP of the transaction at Nil.

- Aggrieved by the same, the taxpayer filed an appeal before learned commissioner of income tax (Ld. CIT(A)).

- The Ld. CIT(A) upheld the TPO's view and further noted that the payment made by the taxpayer in relation to technical know-how exceeds the limits prescribed by the RBI and accordingly disallowed the same on the above supplementary reason. Aggrieved by the same, the taxpayer filed an appeal before Mumbai Income Tax Appellant Tribunal ("ITAT"/ "the Tribunal").

ITAT's Ruling

ITAT made the following observations:

- ITAT noted that the taxpayer's exports includes exports to AE and non- AE's also. Further, the taxpayer had also demonstrated the purpose of obtaining approval from its AE for sales is to avoid competition in the market. In view of the above the Tribunal considered the taxpayer as the 'License manufacturer'. Subsequently, the disallowance of royalty and technical know-how were abortive.

- Further, ITAT observed that the taxpayer aggregated and benchmarked the transaction using TNMM on the reason that the transaction related to royalty is intrinsically linked to the primary function of manufacturing. Since, the TPO considered the taxpayer as contract manufacturer and did not examine these contentions, hence the ITAT remanded the matter back to TPO for examining them fresh according to the law.

- Further, In relation to disallowance of annual charges of Microsoft licensing fee, the ITAT noted that the tax authorities were under the impression that there is a variation between the transaction reported in Form 3CEB and the agreement submitted by the taxpayer due to appearance of different names. However, based on the document submitted by the taxpayer both the names referred to the same Company. Accordingly, the Tribunal restored the ALP determination of annual charges.

- In view of the aforesaid observations, ITAT rejects TPO's characterization of the taxpayer as 'contract manufacturer' and sets aside TPO's order determining ALP of royalty, technical know-how expenses at nil.

NANGIA'S TAKE

- ***The ruling in the instant case acknowledges the difference between a licensed manufacturer and a contract manufacturer. The characterisation is closely associated with the functions, assets and risks analysis of the relevant manufacturer.***

- ***For determination of arm's length price from transfer pricing purposes it is very important to define an entity based on its characterization. Therefore, first stage of comparability analysis in a Transfer Pricing benchmarking exercise is to gather all the relevant facts and circumstances surrounding the controlled transactions under review. Hence, the characterization cannot be out rightly rejected without any reasonable basis.***

- ***The aforesaid ruling also emphasis on the aggregation approach for determining ALP by aggregating international transactions which are interlinked or inter-related to each other and cannot be evaluated separately. Therefore, if two or more transactions between the same enterprises can be said to be closely linked if the transactions are interlinked and terms and condition as well as prices between the parties are determined based on the totality of the transactions and not on individual and separate transactions.***

Source: Sulzer Pumps India Pvt Ltd [TS-1156-ITAT-2018(Mum)-TP]

12. AMP Expense incurred by the manufacturer - not an international transaction, does not warrant separate determination of ALP

Outcome: In favour of taxpayer
Category: Marketing intangible/ AMP adjustment

Facts of the Case

- Organon (India) Pvt. Ltd ("the taxpayer") is engaged in the business of performing value added distribution segment akin to secondary manufacturing i.e. Converts the raw materials imported from Associated Enterprises ("AEs") into pharmaceutical formulations. The taxpayer does not possess any manufacturing facilities of its own. It outsources its entire production requirements to toll manufacturers / contract manufacturers on a licence basis.

- During the Assessment Year ("the year under consideration") 2012-13 and 2013-14, the taxpayer has entered into various international transactions with its AEs which was accepted at arm's length by the Transfer Pricing Officer ("TPO"). The TPO, however, during the course of assessment proceedings, observed that Advertisement, Marketing and Promotion ("AMP") expenses incurred by the taxpayer were attributed towards creation of marketing intangibles for the AE for which taxpayer is not compensated. Accordingly, the TPO made an upward AMP adjustment, to the tune of INR 7.07 Crores (post adding 5% mark-up) for AY 2012-13.

- Aggrieved by the same, the taxpayer filed an appeal before Dispute Resolution Panel ("DRP"). The Ld. DRP upheld the action of TPO in determining the arm's length price ("ALP") of AMP expenditure treating the same as a separate international transaction.

Aggrieved, the taxpayer filed an appeal before the Kolkata Income Tax Appellant Tribunal ("ITAT").

ITAT Ruling

- At the outset, the Ld. ITAT found that the preliminary objection of the taxpayer was against treating the AMP expenses as an international transaction. Over this it was observed that, the taxpayer, by procuring the raw materials from its AEs and getting it converted into finished goods from toll-manufacturers, is acting as a manufacturer.

- The ITAT, accordingly, relied on the ruling in **Philips India Ltd** case to adjudicate that AMP expenditure is not an international transaction and hence shall not warrant determination of ALP of the same.

- Further, concerning revenue's objection over marketing the brand name of AE by the taxpayer by using its name "**Organon**" for Indian operation, the ITAT held that "*it is the products manufactured by the Organon India that really matters and not the company which manufactures*". The ITAT opined that the name by which a product is sold in market is more relevant then the name of manufacturer. Accordingly, ITAT held that AMP expenses, in the taxpayer case, cannot be attributed towards brand promotion of AE.

- Separately, ITAT noted that the selling expenses are purely related to products of the taxpayer and not for any brand and thereby excluded selling expenses for purposes of benchmarking the AMP expenditure.

NANGIA'S TAKE

Transfer pricing aspect of the AMP expenditure incurred by the Indian entities has been a contentious issue with the Indian Tax authorities. The ITAT, while ruling on the aforesaid matter, relies on the verdicts of the Delhi High Court in the cases of Sony Ericsson and Maruti Suzuki. The said conventional approach is also followed by the ITAT Kolkata bench, in the instant case. The Ld. ITAT while deciding on the merits, held that AMP expenditure is not to be considered as an international transaction. Additionally, selling expenses for taxpayer itself cannot be held as AMP expenditure for a brand/AE.

Source: Organon (India) Pvt Ltd [TS-1141-ITAT-2018(Kol)-TP]

13. Determination of Most Appropriate Method as per Section 92C(2) of Income Tax Act, 1961

Outcome – In favour of taxpayer
Category – Selection of Most Appropriate Method

Facts and Contentions

- Mitsubishi Electric Automotive [I] Pvt Ltd ("the taxpayer"), a part of Mitsubishi Electric Corporation, Japan is engaged in the business of assembly of automated electrical components and distribution of automotive components.
- During the year under consideration, the taxpayer entered into international transaction of import of automotive components from its Associated Enterprises ("AEs") and benchmarked the same by adopting Transactional Net Margin Method ("TNMM").
- During the course of assessment proceeding, the Transfer Pricing Officer ("TPO") analyse the subject transaction and found that it purchases made by the taxpayer from its AE were directly sold to unrelated parties without any value addition to products and accordingly, rejected the method applied by the taxpayer and held that Resale Price Method ("RPM") shall be the Most Appropriate Method ("MAM").
- While doing the benchmarking analysis, the TPO rejected two of six comparables taken by the taxpayer and computed margin at gross basis by using RPM and proposed an upward adjustment.
- Aggrieved by the same, the taxpayer filed an appeal before Dispute Resolution Panel ("DRP"). Furthermore, DRP also upheld the order of the TPO. Consequently, taxpayer filed an appeal Income Tax Appellate Tribunal ("ITAT").

Proceedings before ITAT ("the Tribunal")

ITAT made the following observations:

- ITAT referred to the functional, asset and risk analysis furnished in the TP documentation and found that the taxpayer has categorized itself as a limited risk distributor. Further, on the basis of a close scrutiny of the methodology given under RPM in rule 10B of Income Tax Rules ITAT held that RPM is best suited for benchmarking an international transaction in the nature of purchase of goods from an AE and which are resold as such to unrelated parties without making any insignificant value addition to the goods.
- Further, ITAT also rejected the comparables taken by the TPO as he overlooked huge differences in the low risk function performed by the taxpayer vis-a-vis high intensity functions performed by the comparables which is not acceptable and directed TPO to admit the fresh comparables filed by the taxpayer before DRP.
- In view of the aforesaid observations and facts, ITAT directed to adopt RPM as the MAM and directed DRP to decide issue as per law by giving proper opportunity to the taxpayer.

NANGIA'S TAKE

The instant ruling reiterates the fact that as Rule 10B(1) of Income Tax Rules, 1962, says that for purposes of Section 92C(2), ALP shall be determined by any one of the five methods, which is found to be the most appropriate method, and goes on to lay down the manner of determination of ALP under each method. Rule 10B(1)(b) recognizes Resale Price Method(RPM), as the method for determining ALP in relation to an international transaction where the price at which the property is purchased is resold to a customer, without there being any value addition in the product resold.

Source: Mitsubishi Electric Automotive [I] Pvt Ltd [TS – 1147- 2018(DEL)- TP]

ABOUT US

Nangia Advisors LLP is a premier professional services organization offering a diverse range of Taxation, Transaction Advisory and Business Consulting services. Nangia Advisors LLP has presence currently in Noida, Delhi, Gurgoan, Mumbai, Dehradun and Singapore.

Quality of our people is the cornerstone of our ability to serve our clients. For this reason, we invest tremendous resources in identifying exceptional people, developing their skills, and creating an environment that fosters their growth as leaders. From our newest staff members through senior partners, exceptional client service represents a dedication to going above and beyond expectations in every working relationship.

We strive to develop a detailed understanding of our clients' business and industry sector to offer insights on market developments and assist our clients develop effective strategies and business models. We have the resources and experience necessary to anticipate and competently serve our clients on issues pertaining to all facets of Tax and Transaction Advisory. We take pride in our ability to provide definite advice to our clients with the shortest turnaround time. The business and tax landscapes have changed dramatically, and the pace and complexity of change continues to increase. We can assist you navigate this shifting landscape.

OUR OFFICES

NOIDA
A-109,Sector-136,
Noida (Delhi- NCR)
201304,
INDIA

DELHI
B-27, Soami Nagar,
New Delhi – 110017,
INDIA

GURGOAN
812-814, Tower B,
Emaar Digital Greens
Sector 61, Gurgaon,
Haryana- 122102

MUMBAI
11th Floor, B Wing, Peninsula Business Park, Ganpatrao Kadam Marg, Lower Parel, Mumbai – 400 013. INDIA

DEHRADUN
First Floor, "IDA"
46 E. C. Road,
Dehradun – 248001,
Uttarakhand.
INDIA

SINGAPORE
24 Raffles Place,
#25-04A, Clifford Centre,
Singapore - 048621