VERENDRA KALRA & CO
CHARTERED ACCOUNTANTS

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Arm's Length Price Stands at 'Nil': The Onus of Proving Rendition Not Upheld by Assessee'

Facts

The assessee (Yanfeng India Automotive Interior Systems Pvt. Ltd.) a subsidiary of Yanfeng Global Automotive Interior Systems Company Ltd., is a company incorporated in China and was engaged in the business of manufacturing and selling automotive trim components such as door trims, instrumental panels, floor consoles, pillars etc.

During the year under consideration, the assessee was awarded a contract by Ford India Pvt. Ltd. for launching D-562 Line vehicles, a new product for its Indian operation. For the purpose of executing the project, the assessee took the assistance of Yanfeng China and the employees of Yanfeng China visited Germany, Brazil, China etc.

Most activities carried out by the employees Yanfeng China was for the purpose of development of tools for the new product and included understating product design, technical specifications, proto testing and assisting the assessee during the new product launch in India. During the proceedings before the TPO, the assessee submitted that employees of Yanfeng China incurred certain expenditure such as ticket cost, lodging cost, air fare, meal expense, visa application cost etc. These expenses had been reimbursed by the assessee to the AE on cost-to-cost basis without any mark up and were therefore considered to be at arm's length under the India Transfer Pricing Regulation.

Further, this expenditure was with respect to the tools being developed for further re-sale to customer and accordingly the said expenditure was reflected under inventory along with the value of tools as on March 31, 2015.

Since the reimbursement of expenses has been made at actuals, the transaction was considered to be bench marked under Rule 10AB (Any Other Method).

The TPO passed the transfer pricing order by determining the arm's length price of the international transaction pertaining to reimbursement of expenses by the assessee to Yanfeng China as "nil" and as such made a downward adjustment amounting to INR 3,07,69,361 to the transaction value of reimbursement of expenses to the AE.

Aggrieved, the assessee preferred an appeal before the DRP which upheld the TPO's order and consequently, dismissed assessee's appeal. Subsequently, the matter reached the Tribunal.

Ruling

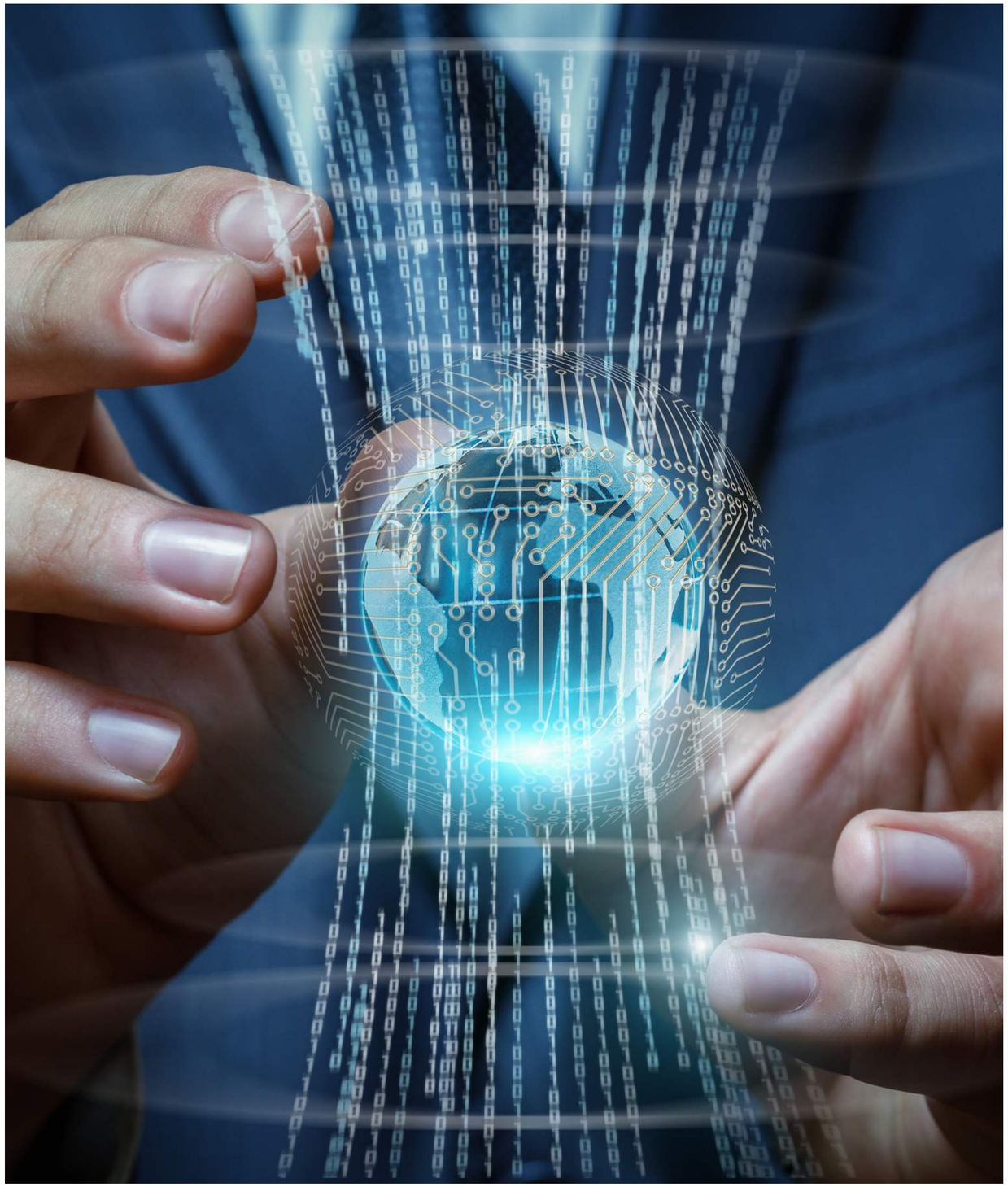
The Tribunal ruled in favor of the Revenue. After perusing the facts and circumstances of the case, the Tribunal observed that the assessee had, many a times, not been able to demonstrate with supporting evidence that the expenses made to the AE were for the actual rendition of services or if they were expenses in relation to services that were co-related with the assessee's business in India. The Tribunal opined that "In a situation the assessee is unable to prove any rendition of services or that the services had any connection with the business of the assessee in India, in our considered view, on such facts, the ld. TPO can determine the arm's length price at "nil".

Furthermore, the Tribunal held that, "The onus of proving the actual rendition of services primarily lies on the assessee in respect of an international transaction."

The Tribunal relied on the cases of Akzonobel India Pvt. Ltd. vs. Addl. CIT 145 taxmann.com 468 (Delhi), Gemplus India Pvt. Ltd. Vs. ACIT (ITA352/Bang/2009), Cisco Systems Capital (India) (P.) Ltd. v. Addl CIT [2014] 52 taxmann.com 17 (Bangalore - Trib.) to support its view.

As such it concluded that as the assessee had failed in providing relevant and necessary agreements and evidence, the TPO was justified in determining the arm's length price as 'nil'.

Source: Tribunal, Ahmedabad in Yanfeng India Automotive Interior Systems Pvt Ltd. Vs. Joint CIT (OSD) vide ITA No. 1429/Ahd/2019 dated January 17, 2023.



Existence of the Term ‘Make Available” in an Agreement Cannot be the Sole Criteria for Affixing Taxability Under FTS

Facts

The assessee M/s TSYS Card Tech Ltd. Ltd is a company and is engaged in the business of providing information technology related services to the financial payments industry. During the relevant AY, the assessee had earned revenue from Indian Customer primarily for rendition of software license (referred to as ‘PRIME’) and provision of software related services including implementation services, enhancement services, annual maintenance services and consultancy services as per the request of the Customers.

During the year the assessee received an amount of INR 5,21,17,082 on account of software (Prime) License fee, fee for provision for other related parties of INR12,01,30,877and receipt in nature of reimbursement of INR 7,24,821. As such the total amounted to INR 17,29,72,780.

The DRP, relying on the judgement made by the Hon’ble Supreme Court in the case of Business Income/Royalty in Engineering Analysis Centre of Excellence Private Ltd. Vs. CIT (Civil Appeal Nos. 8733- 8734 of 2018), held that there was no dispute regarding the fact that the assessee did not have a permanent establishment in India. Accordingly, such receipts would constitute business income under Article 7 of the DTAA alongside the above-mentioned decision of Hon’ble Supreme Court. Therefore, it would not be taxable in India in the absence of PE.

However, the DRP held that pertaining to the second set of receipts of INR 12,01,30,877 on account of provision of other related services, it is well settled that such services from a distinct set of receipts which would need to be examined independently in terms of their taxability or otherwise under specific Article 13 (Royalty/FTS). As such they did not stand clubbed as business income under Article 7 of the DTAA. The DRP held that taxable under Article 13 India-UK DTAA under the head ‘FTS’ . The ld. DRP held that the make available clause under Article 13 are also stand satisfied.

Subsequently, the matter reached the Tribunal.

Ruling

The Tribunal ruled in favor of the assessee and observed that the main argument taken before it was that the other related services provided were in connection with utilization of the software (PRIME) which are intricately associated. It was noted that the services were in respect of training programme and updations in connection with utilization of the software PRIME. As such, the Tribunal held that, "when software itself is not taxable, the training and the related activities concerned with utilization and installation cannot be held to be FTS. Further, simply latching on to use of words "Make available" in the agreement, it cannot be said that conditions of Article 13(4)(c) are satisfied. Burden is on the Revenue to demonstrate that make available condition is satisfied. Appeal of the assessee on Ground Nos. 4 and 5 are allowed."

Regarding the issue of the reimbursement of INR 7,24,821 the Tribunal found that the DRP had remanded the matter to the AO to examine the travelling and lodging expenses reimbursed.

However, the Tribunal held that the AO had wrongly taxed the same under FTS. Therefore, the addition so made by the AO was held deleted.

Source: Tribunal, Delhi in TSYS Card Tech Ltd vs. DCIT, Circle 3(1)(1), International Taxation vide ITA No. 2006/Del/2022 dated January 24, 2023.

Benchmarking to be Solely on the Profitability of International Transactions: Cannot be Done on Basis of the Profitability of Whole Company

Facts

The assessee is a private limited company incorporated under the provisions of The Companies Act, 1956, in the state of Karnataka. It was engaged in the business of recruitment, placement, temporary staffing and training services to its group companies outside India and unrelated parties in India.

The assessee filed its return of income for AY 2018-19 declaring a total Income of INR 47,25,17,720. The assessee was assessed u/s 143(3) and a draft order dated July 29, 2021, was issued by the AO proposing a Transfer Pricing adjustment of INR 15,43,89,748. Subsequently, a rectification application was filed on receipt of the TP order.

The TP adjustment was reduced to INR 7,21,651 through an order passed under section 92 CA read with section 154 of the Act, 1961 dated October 1, 2021.

The assessee filed objections to the draft Assessment Order of the AO before the DRP and sought deletion of the proposed transfer pricing adjustment. However, the DRP upheld the order of the TPO.

Aggrieved, the assessee preferred an appeal before the Tribunal for the relief of Transfer Pricing adjustment of INR 6,55,13,030 made by the TPO and adopted by the AO in the final assessment order.

Ruling

The Tribunal adjudicated in favor of the assessee. It observed that the assessee had entered into various transactions with its AEs during the year. It was further observed that the assessee had adopted the MAM applicable for each type of transaction separately as listed out appropriately against the type of transaction. However, the TPO had rejected the ALP determined by the assessee and the MAM adopted by the assessee for each of the transaction and instead opted for TNMM as the MAM for all the transactions entered with AEs by the assessee. The Tribunal found that such step taken by the TPO was "a fundamentally faulty way of assessing the Arms' Length Price ("ALP") of the international transactions undertaken by the assessee with AEs." As the revenue transactions with the AE constituted only 0.75% of the total "Revenue from Operations" earned by the assessee and expenditure transactions with AE constitute only 0.62% of total expenses incurred, it was found that to apply TNMM on the overall basis at such entity level was "against the basic canons of transfer pricing law."

The Tribunal held that the TPO had erroneously made the transfer pricing adjustment with reference to the total costs incurred / revenue earned by the Company. There had been no consideration of the fact that it includes substantial revenue and expenses with non-AEs taken by the TPO, who had then proportionately reduced the adjustment to AE transactions. Moreover, no reasons in the order for not considering the allocation of expenses done by the taxpayer, were given by the TPO.

Furthermore, the Tribunal held that the observations made by Hon'ble DRP were factually incorrect as the assessee had filed the net operating margin analysis of the AE and non-AE segment in its documentation-maintained u/s 92D of the Income tax Act, 1961.

The Tribunal perused the OECD Transfer Pricing Guidance on Multinational Enterprises and Tax Administrations (2017) as well as the provisions of Rule 10B(1)(e) of the Income Tax Rules, 1962 ('the Rules') which provides for the manner of determination of ALP of an international transaction while applying TNMM, to reach a conclusion. It opined that, *"the guidance from the Indian legislation on transfer pricing as well as the global guidance on transfer pricing, which is followed by several countries, voices out the same principle of benchmarking only the profitability of the international transactions and not the profitability of the whole company."*

As such the Tribunal directed the AO/TPO to consider the margin analysis as provided by the assessee relating to AE segment alone.

Source: Tribunal, Bangalore in M/s. Adecco India Pvt. Ltd. vs. DCIT, Circle 3(1)(1), Bangalore vide IT(TP)A No. 998/Bang/2022 dated January 10, 2023

ITAT Passes Expansive Ruling: Encompasses TP Adjustment Under Software Development Services, ITeS and Interest on Delayed Receivables

Facts

The assessee is engaged in the business of providing business process outsourcing (BPO), software development (SWD) services and human resources outsourcing services. The assessee rendered these services to its Associated Enterprises (AE) located in US, UK, Canada and Singapore.

For the AY 2018-19, the assessee filed the return of income on November 30, 2018, declaring an income of INR 1,75,42,60,930. The case was selected for scrutiny under CASS and a notice under section 143(2) was duly served on the assessee. The case was referred to the TPO for determination of ALP regarding the international transactions the assessee had with the AE. The TPO made the following TP adjustments:

-Software development services –
INR 41,20,89,204

-BPO Services (ITeS Services) –
INR 22,42,68,187

-Interest on delayed receivables –
INR 53,92,838

Aggrieved, the assessee raised its objections before the DRP pursuant to which, the TP adjustments were modified as under: -

-Software development services –
INR 33,47,10,065

-BPO Services (ITeS Services) –
INR 13,83,31,654

-Interest on delayed receivables –
INR 53,92,838

Consequently, the assessee appealed before the Tribunal.

Ruling

The Tribunal partly ruled in favor of the assessee, by allowing its appeal for the TP adjustment of software development services and BPO services (ITeS Services). However, it ruled in favor of revenue regarding interest on delayed receivables.

With respect to the software development services the Tribunal excluded the functionally dissimilar Tally Solutions P. Ltd and Eclrex Services Ltd. Moreover, the Tribunal remitted back the comparability of the following companies to the AO/TPO for fresh consideration:

-Wipro Ltd.

-Infosys Ltd.

-Cybage Software P. Ltd

-Consilient Technologies P. Ltd

With respect to the ITeS service, the Tribunal observed that the margin of the assessee was well within the range and despite the same, the TPO had chosen to make a TP adjustment that was utterly unwarranted.

As such, the Tribunal directed the TPO to consider the submissions made by the assessee in the rectification petition and pass the order accordingly.

With respect to the interest on delayed variables, the Tribunal perused the case of PCIT vs. AMD (India) Pl. Ltd ITA No. 274/2018, wherein it was held that, *"deferred receivables would constitute an independent international transaction and the same is required to be benchmarked independently"*

The Tribunal took the view that, *"the transaction between the assessee and AE was in foreign currency regarding receivables and transaction was international transaction, then transaction would have to be looked upon by applying the commercial principles with regard to international transactions."*

As such, the Tribunal held that, *"the treatment of interest on deferred receivables is rightly considered as an independent international transaction and benchmarked separately by the revenue authorities. With regard to calculation of interest, respectfully following the above decision we hold that 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)."*

Source: Tribunal, Bangalore in Wipro HR Services India Private Limited vs. ACIT Circle 7(1)(1), Bangalore vide ITA(TP)No. 873/Bang/2022 dated January 9, 2023

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