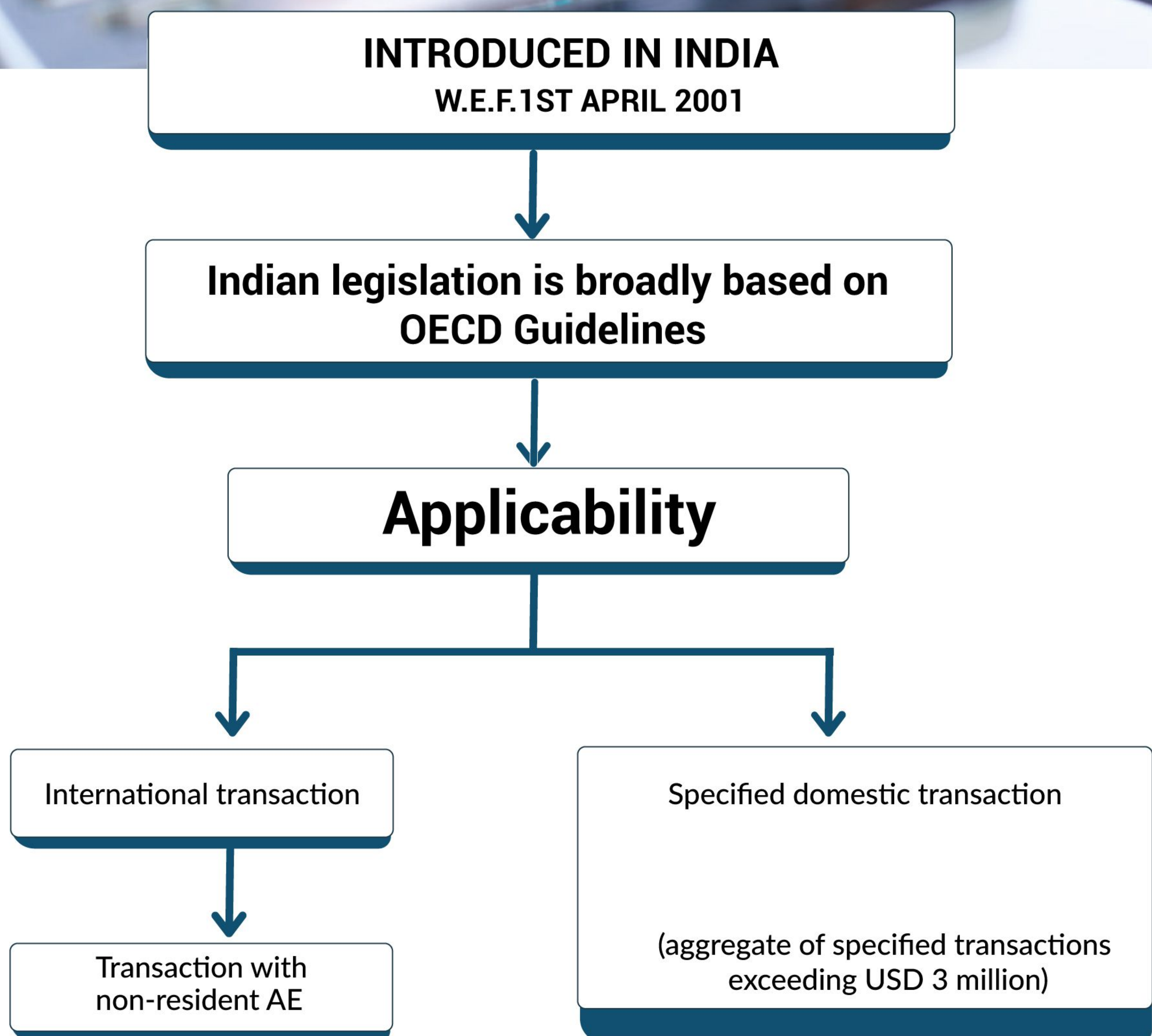


TRANSFER PRICING IN INDIA

2020

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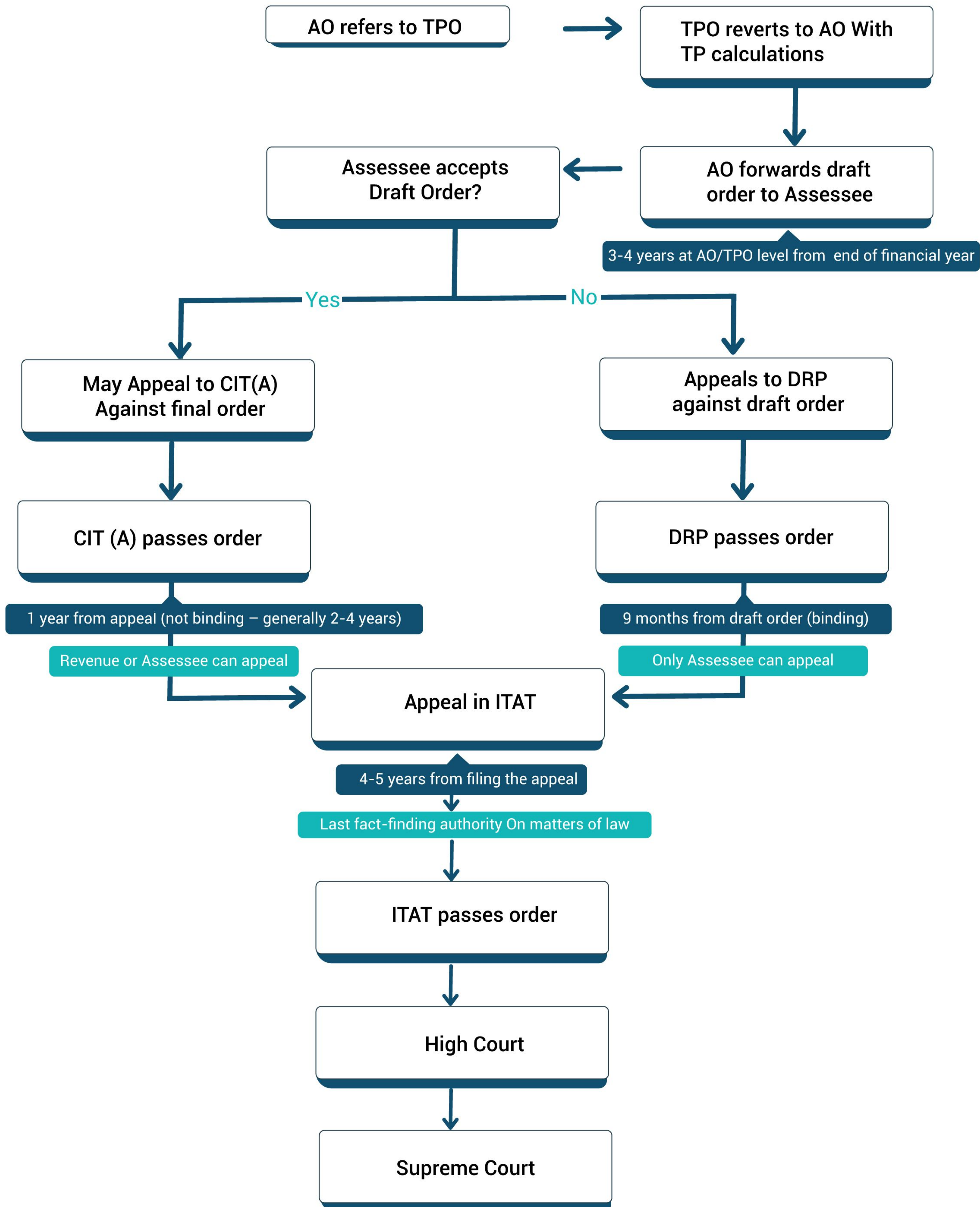


As per **OECD**, glossary of tax terms,

“Generally speaking, enterprises are associated where the same persons participate directly or independently in the management, control or capital of both enterprises, i.e. both enterprises are under common control.”

Definitions of AE in all major tax treaties of India including with US, UK, Singapore, Japan, UAE, etc. have been worded similar to OECD.

TRANSFER PRICING LITIGATION HIERARCHY

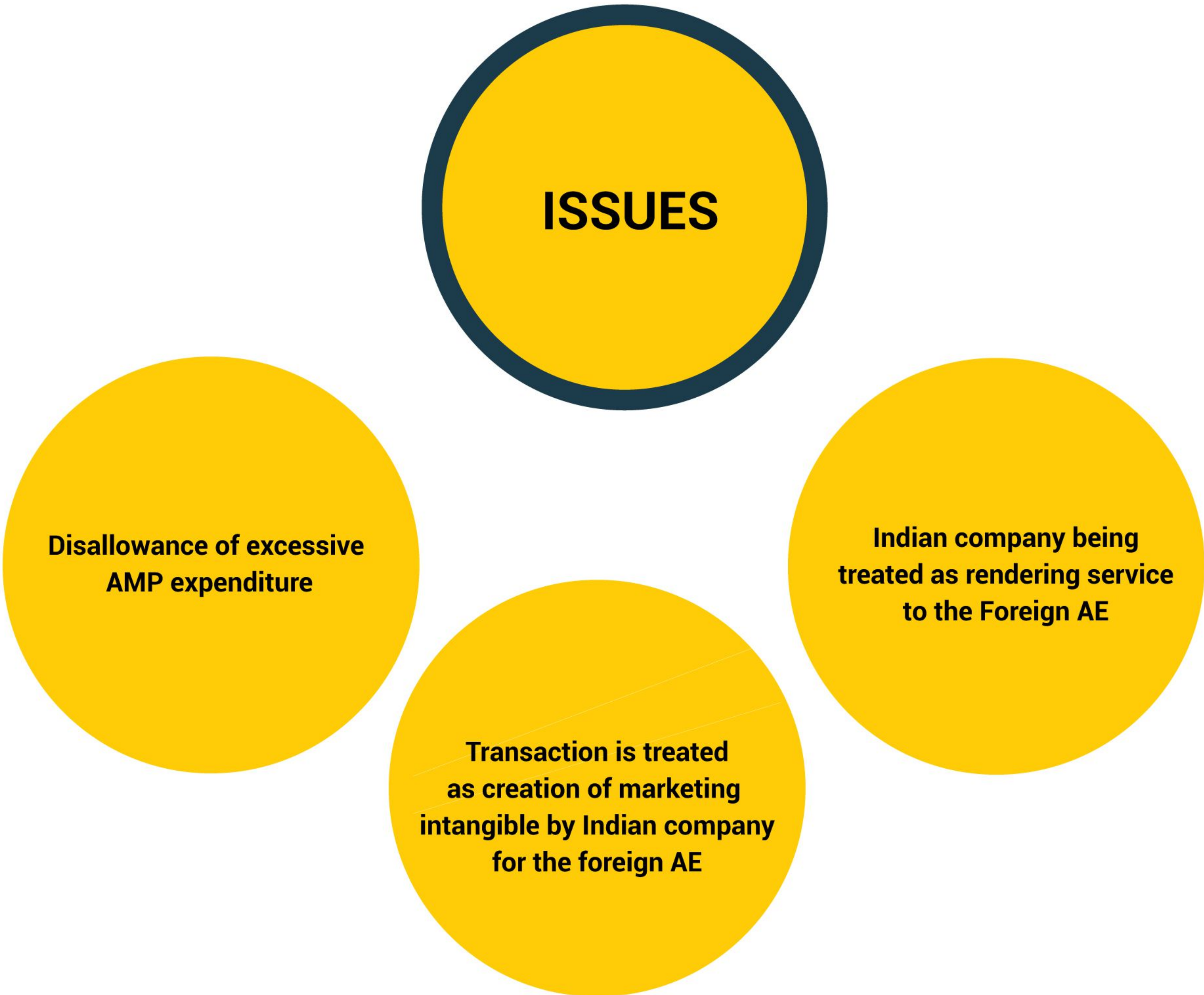
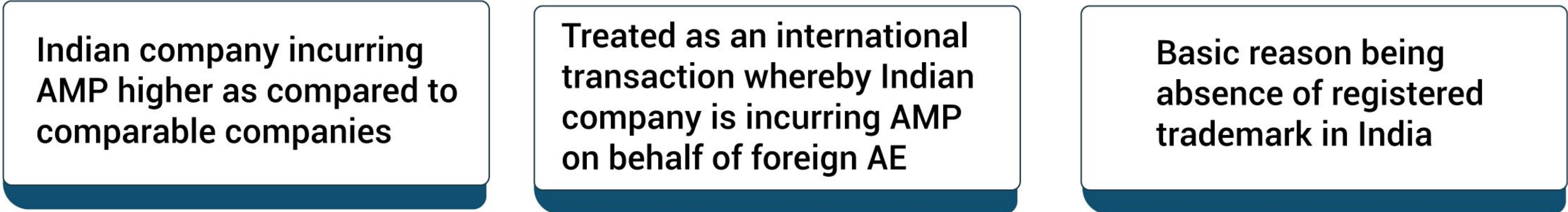


Major Issues/Litigations Open In Transfer Pricing

Enlisted here under are the major issues involved in transfer pricing:

- 1 Advertisement, marketing and Promotion(AMP) and marketing intangibles
- 2 Most Appropriate Method (MAM)
- 3 Selection of Comparables
- 4 Capacity Utilization Adjustment

1. AMP and marketing intangibles



Case	Citation	Quantum(USD)	Facts	AO/TPO	DRP/CIT(A)	ITAT	HC	SC
Sony Ericsson Mobile Communication India	[2015] 55 taxmann.com 240 (Delhi)	10 million	Assessee incurred AMP expenses towards promotion of brand in India, however, no reimbursement of expenses was made from foreign AEs	TPO concluded that Assessee was engaged in brand building development or enhancing market in tangibles. Excess AMP was added back by applying BLT.	DRP accepted the TPO's approach	Case was remanded back to TPO by ITAT	Order passed in favour of Assessee by deleting addition	SLP filed by revenue, accepted by SC but case is still pending
Maruti Suzuki India	[2015] 64 taxmann.com 150 (Delhi)	23 million	A licence agreement was entered between Assessee and its holding company for using the co-branded trademark 'Maruti-Suzuki' on the vehicles. Assessee incurred AMP expenses towards promotion of brand.	TPO benchmarked AMP by applying BLT and concluded that excess must be regarded as having been incurred for promoting the brand 'Suzuki' owned by holding company. Accordingly, he made the adjustment on account of AMP expenses.	DRP upheld the addition made by TPO	ITAT upheld assessment order.	Order passed in favour of Assessee by deleting addition	SLP filed by revenue, accepted by SC but case is still pending
Bausch Lomb Eyecare India	[2016] 65 taxmann.com 141 (Delhi)	3 million	Assessee had entered into an agreement with its AE for distribution of product manufactured by its group companies. Assessee was promoting the B&L brand by incurring expenditure on AMP.	TPO concluded that Assessee was in the process of making the intangible even more valuable by incurring huge AMP expenses, bearing risks and using both its tangible assets and skilled, trained manpower. TPO opined that AMP expenses did not benefit the assessee as it had incurred loss in the subject year and made the addition.	DRP confirmed said addition.	ITAT also confirmed the additions made	Order passed in favour of Assessee	SLP filed by revenue, accepted by SC but case is still pending

Case	Citation	Quantum(USD)	Facts	AO/TPO	DRP/CIT(A)	ITAT	HC	SC
Honda Siel Power Products Ltd	[2015] 64 taxmann.com 328 (Delhi)	1 million	Assessee was engaged in distribution of goods manufactured by its associated enterprises, trademark was owned by its AE. Assessee incurred AMP for promotion of Brand. AMP expenses of the assessee as a percentage of sales were higher than that incurred by the comparable companies	TPO concluded that AMP expenses incurred by assessee, in excess of the Bright line must be regarded as having been incurred for promoting the brand name its AE and further that this was for creating marketing intangibles owned by the AE for which the assessee was required to be suitably compensated by the AE. Accordingly additions	DRP sustained the TP adjustment in respect of AMP expenses proposed by TPO	Case was remanded back to TPO by ITAT	Order passed in favour of Assessee	SLP filed by revenue, accepted by SC but case is still pending
Valvoline Cummins (P.) Ltd.	[2017] 84 taxmann.com 191 (Delhi)	3.5 million	Assessee was engaged in manufacturing and marketing of automotive lubricants, transmission fluids, gear oils, hydraulic lubricants etc. It was subsidiary of US company. It incurred AMP expenses.	TPO held that AMP expenses in excess of BLT were incurred by assessee for enhancing brand name owned by AE and thus, assessee had to be compensated by AE. Accordingly, TPO made the additions.	DRP upheld the said addition	ITAT also confirmed the additions	Order passed in favour of Assessee	SPL has been submitted by the Revenue
Gillette India Ltd.	[2019] 104 taxmann.com 338 (Rajasthan)	27 million	Assessee derives income from manufacturing and trading of razors, blades and other shaving systems, grooming products, torches & dry battery cells etc. It incurred AMP expenses on behalf of AE.	TPO taking a view that assessee had incurred excessive AMP expenses which resulted in brand creation of assessee's AE in India, made addition to assessee's income.	DRP upheld the TP adjustment	Upheld by ITAT	Order passed in favour of Assessee	SLP filed by revenue, accepted by SC but case is still pending

Landmark judgements and principles established

Sony Ericsson Mobile Communication India

- AMP activities are functions performed and not any transaction
- AMP expenditure incurred does not specifically lead to brand building or creation of intangibles

Maruti Suzuki India

- Bright Line test ("BLT") is not permitted under the law
- Onus is on the revenue to demonstrate the existence of International Transactions
- There is lack of statutory guidance on the approach and a machinery provision is absent.
- Benefit to the related party is only incidental
- No adjustment is warranted if transactions are held to be at an Arm's length

Bausch Lomb Eyecare India

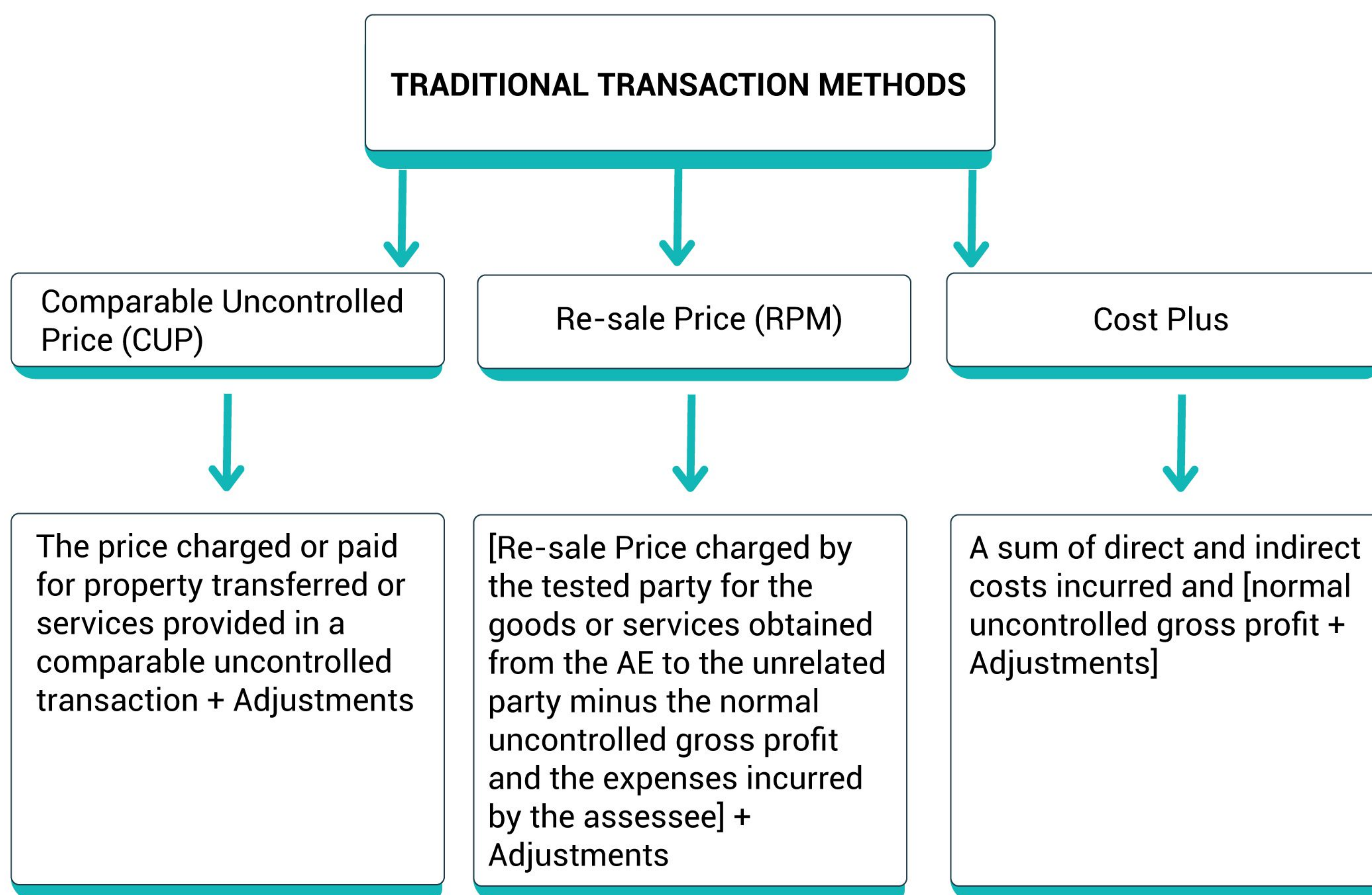
- Benefit to the related party is only incidental
- Advertising and marketing promotion activities are functions performed and not any transaction

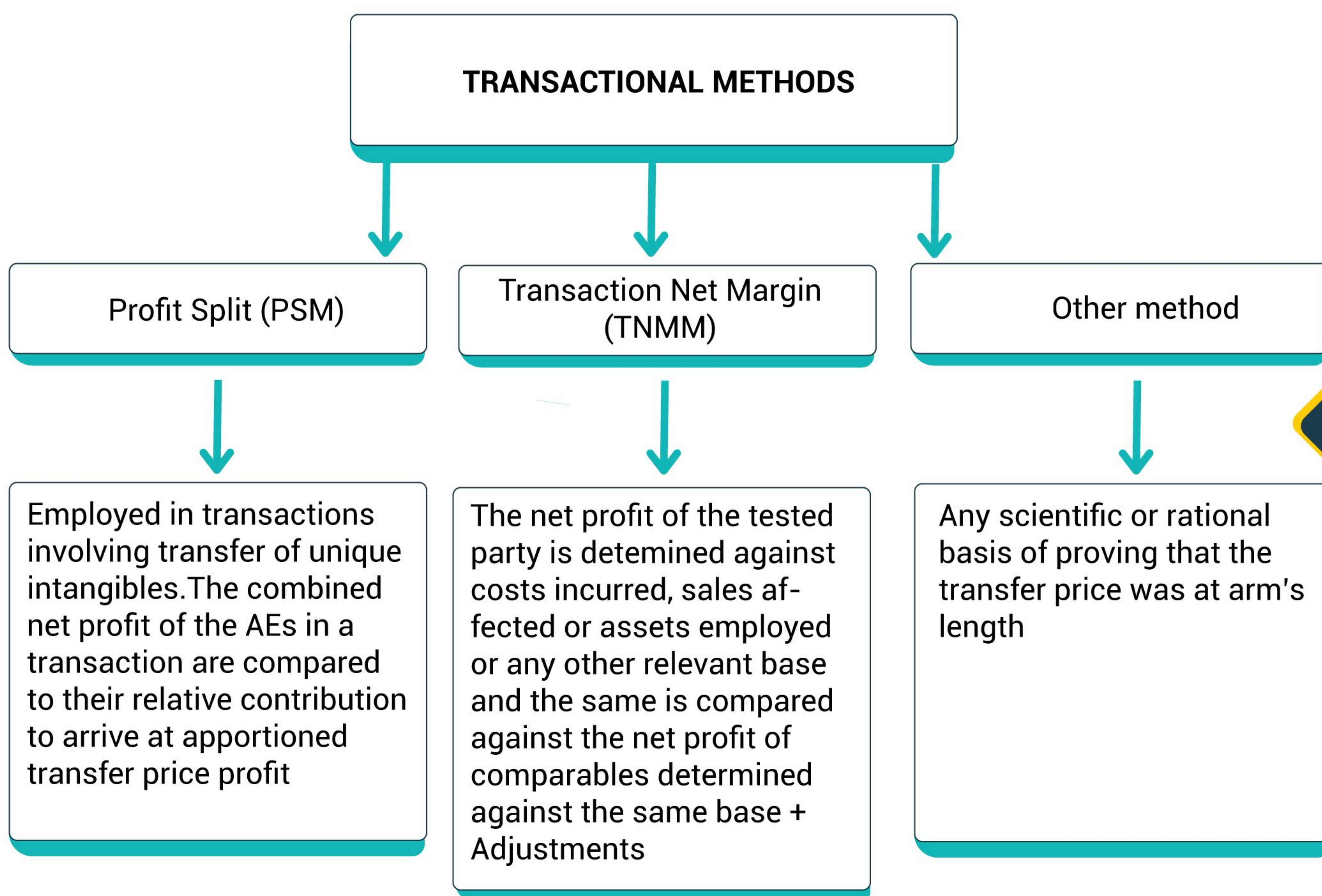
As a result of the numerous favourable judgements by different High Courts, the tax officers are currently doing **protective assessments**, since the matter will attain finality upon receiving decision of the Honourable Supreme Court

Matter pending for final adjudication at Supreme Court level

2. Most Appropriate Method

- Indian Income Tax Act does not provide any specific hierarchy of methods
- It insists on applying the 'Most Appropriate Method' (MAM)
- Rules specify factors for determining MAM, which are similar to factors stated in OECD guidelines:
 - Functional analysis
 - Availability of reliable information (in particular, on uncontrolled comparables)
 - Degree of comparability between the controlled and uncontrolled transactions
 - Reliability of comparability adjustments that may be needed to eliminate material differences between them
- Traditional / direct methods more preferred over transactional / indirect methods
- Other method is also a direct method - [Toll Global Forwarding India \(P.\) Ltd. v. DCIT– \[2015\] 167 TTJ 57 \(Del-Tri\)](#)





Case	Citation	Quantum(USD)	Facts	AO/TPO	DRP/CIT(A)	ITAT	HC	SC
Toll Global Forwarding India (P.) Ltd.	[2014] 51 taxmann.com 342(Delhi - Trib.)	298,573	Assessee offered multimodal transportation services to business shippers through global freight forwarding services. Assessee adopted industry-wide business model. In the industrywide business model, residual profit (after deduction of related transportation cost) is shared equally between the associated parties. Therefore in absence of any uncontrolled price for the similar transaction undertaken by the Assessee, 50:50 ratio model was adopted by the Assessee as CUP method.	TPO having rejected CUP method, proceeded to adopt TNMM and thereby made certain additions to assessee's ALP	The DRP set aside objections raised by assessee.	ITAT held that the business model of 50:50 was admittedly prevalent in the line of business activity of the assessee and as is followed by the assessee, thus indeed satisfies the test for determination of arm's length price. Assessee's contention to the effect that the arm's length price of services rendered to, or received from, the associated enterprises, which was computed on the basis of the same 50:50 model as is the industry norm and as has been employed by the assessee for computing similar services to the independent enterprises, was at arm's length. Accordingly, the impugned arm's length price adjustment stands deleted.	HC upheld order of ITAT	NA

Case	Citation	Quantum(USD)	Facts	AO/TPO	DRP/CIT(A)	ITAT	HC	SC
Gujarat Glass Ltd.	[2019] 106 taxmann.com 402 (Mumbai - Trib.)	4,59,762	Assessee benchmarked purchase of moulds using CUP method which was rejected by TPO	TPO concluded that the price paid by the assessee towards purchase of moulds is not at arm's length. Therefore an ad hoc adjustment was made in income of the Assessee	CIT(A) upheld order of TPO	Remanded back	NA	NA
Glenmark Pharmaceuticals Ltd.	[2019] 102 taxmann. com 438 (Mumbai - Trib.)	167,306	Assessee manufactures and exports pharmaceutical products to its various AE's and benchmark the same using TNMM.	TPO rejected TNMM method and used CUP method instead on the basis that Assessee is a manufacturer of pharmaceutical formulations and it is exporting the same product to various geographies including the local market.	CIT(A) rejected adjustment made by TPO	ITAT upheld the order of CIT(A)	NA	NA
Sodexo Food Solutions India (P.) Ltd.	[2019] 103 taxmann.com 437 (Mumbai - Trib.)	14,99,628	Assessee applied TNMM while determining ALP, same was changed by TPO by making few adjustments.	The Ld. AO rejected the three years data used in TP report by the Assessee and opined that only the data of relevant FY was to be considered for comparability analysis. However revised margin so calculated by TPO was implied on all the transactions of the assessee at an entity level instead of international transactions	CIT(A) held that volume of international transactions with AEs constituted only 2.19% of the total payments and the adjustments, could not be extended to all transactions of assessee at an entity level, which had third party transactions as well. Therefore impugned additions were deleted.	ITAT upheld the order of CIT(A)	NA	NA

Principles held by the Honourable ITAT in the above judgements:

➤ **Gujarat Glass Ltd.**

- Issue to be restored to Assessing Officer for determining ALP by applying any one of prescribed methods, where assessee was unable to justify its claim of CUP method as MAM and that TPO had not followed any prescribed method, but had determined ALP on purely estimation basis

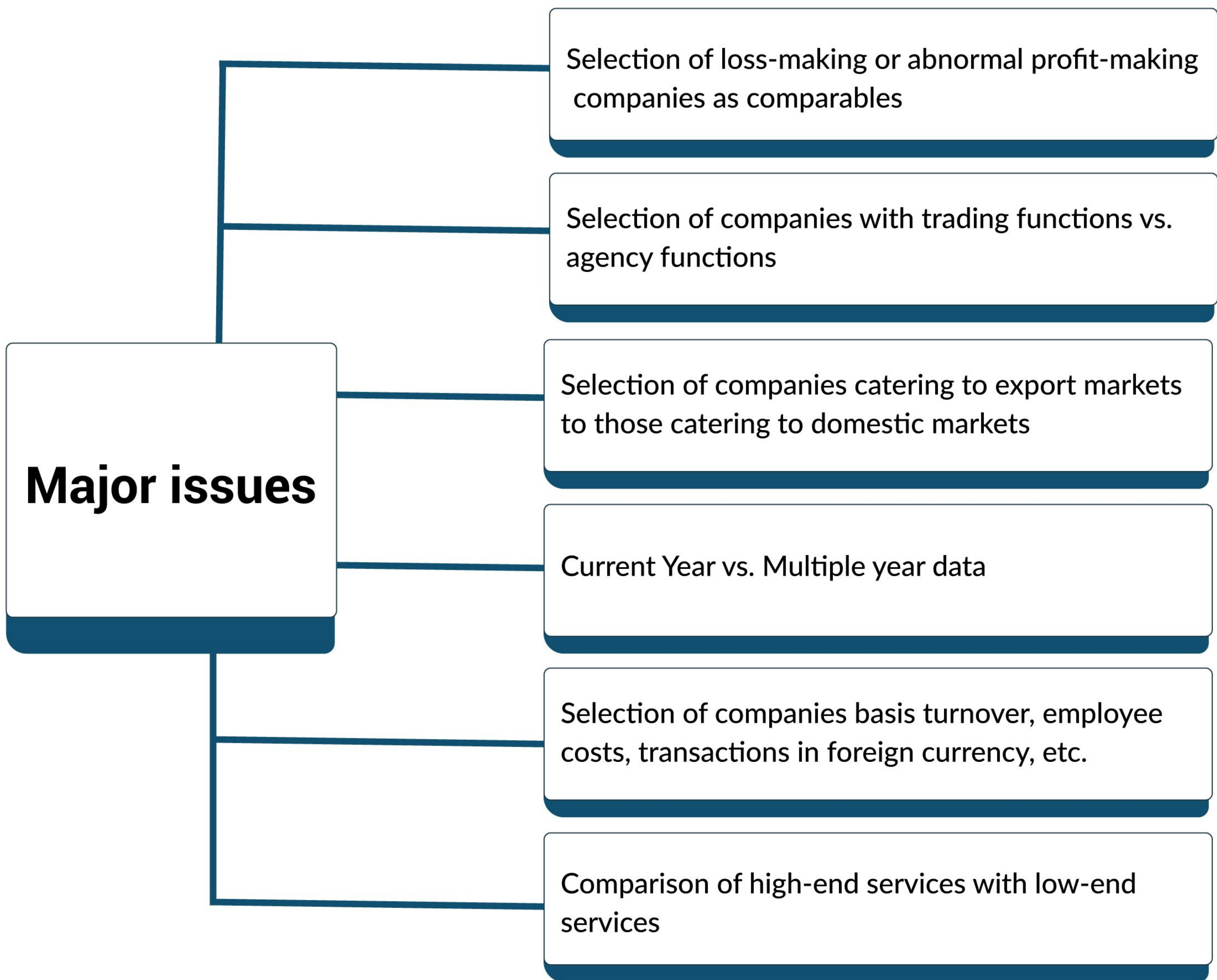
➤ **Glenmark Pharmaceuticals Ltd.**

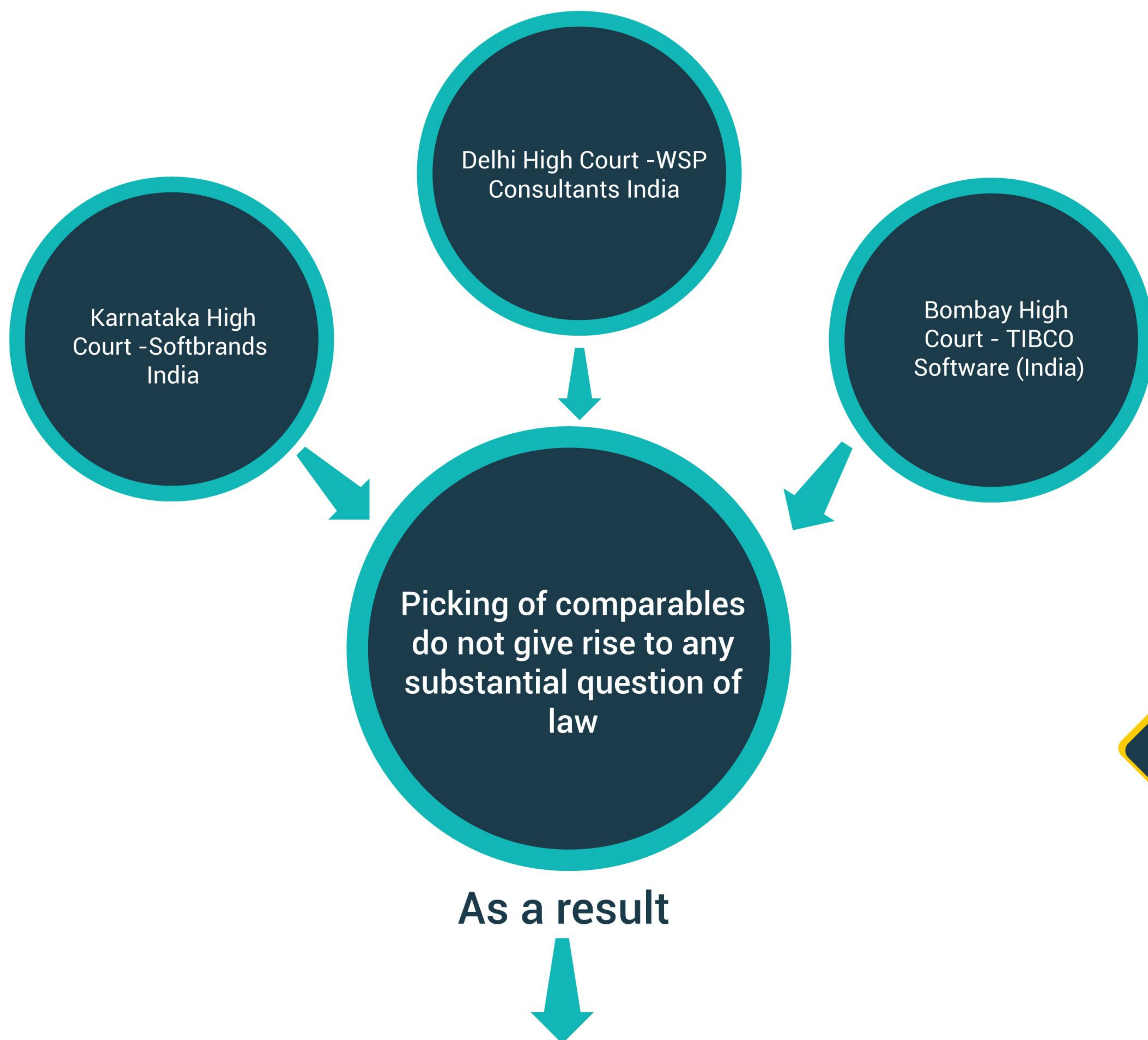
- Where TPO had changed over to CUP method as MAM by rejecting TNMM consistently being applied by assessee without any change in facts and law, adjustment made by TPO was to be set aside

➤ **Sodexo Food Solutions India (P.) Ltd.**

- Entity level TNMM cannot be applied to all transactions/cost base on gross basis as a whole and same has to be applied on proportionate basis to international transactions which are subjected to determination of ALP

3. Selection Of Comparable





Case	Citation	Quantum(USD)	Facts	AO/TPO	DRP/CIT(A)	ITAT	HC	SC
Softbrands India (P.) Ltd.	[2018] 94 taxmann. com 426 (Karnataka)	363,894	Comparables as selected by the Assessee rejected by TPO on the basis of wrong filters applied.	TPO found that the turnover of one of the comparables was more than twice the turnover of the assessee company and, thus, rejected.	CIT(A) upheld the order of TPO	On Appeal to ITAT grounds as raised by Assessee were upheld and appeal was allowed.	HC held that present appeals filed by the Revenue do not give rise to any substantial question of law as comparables had been rightly picked or not, filters for arriving at correct list of comparables had been rightly picked or not do not give rise to any substantial question of law. Therefore held in favour of the Assessee.	NA

Case	Citation	Quantum(USD)	Facts	AO/TPO	DRP/CIT(A)	ITAT	HC	SC
WSP Consultants India (P.) Ltd	[2017] 87 taxmann. com 266 (Delhi)	553,636	Some of the Comparables taken by the Assessee while determination of ALP were rejected and new comparables were added by income tax authorities.	TPO took into consideration 16 comparables and derived the ALP while considering the report filed by the assessee for ALP determination	DRP to which the assessee appealed, deleted 7 comparables and at the same time included 7 more.	On appeal to ITAT, 3 comparables were rejected	HC held that any inclusion or exclusion of comparables cannot be treated as a question of law unless it is demonstrated to the Court that the Tribunal or any other lower authority took into account irrelevant consideration or excluded relevant factors in the ALP determination that impact significantly and no such error was there in the present case. Therefore, in favour of Assessee.	NA
TIBCO Software (India) (P.) Ltd.	[2019] 101 taxmann.com 296 (Bombay)	517,095	Comparables selected by Assessee rejected by TPO on account of non functional business	TPO in this case did not accept the benchmarking done by the Assessee and made an upward adjustment.	DRP upheld the order of TPO	Held that same issue has been dealt with for preceding year, which was in favour of the Assessee and followed the same	HC held that the present appeal doesn't raises any substantial questions of law. In fact, in our limited jurisdiction, we cannot re-appreciate and reappraise the same factual findings to arrive at a different conclusion. Resultantly, the Appeal of revenue is fails and it is dismissed	NA

4. Capacity utilization adjustment

Applicability

- Allowed for early years of operation where comparables had on average higher utilization
- Where sizes of entities and level of activities differ

Principles

At present there is no authoritative guidance relating to capacity utilization adjustments but the decision of the Delhi Bench of the ITAT in the case of **Claas India Private Limited** [ITA No. 1783/Del/2011], has put forth useful observations and guidelines on capacity utilization adjustment, which are as under:

- It is essential to ascertain the percentage of capacity utilization by the taxpayer and the comparables when applying the TNMM.
- The difference in the percentage of capacity utilization of the taxpayer vis-à-vis comparables should be given effect to in the operating profit of comparables by adjusting their respective operating costs.

The ITAT explained that operating costs can be either fixed, variable or semi-variable:

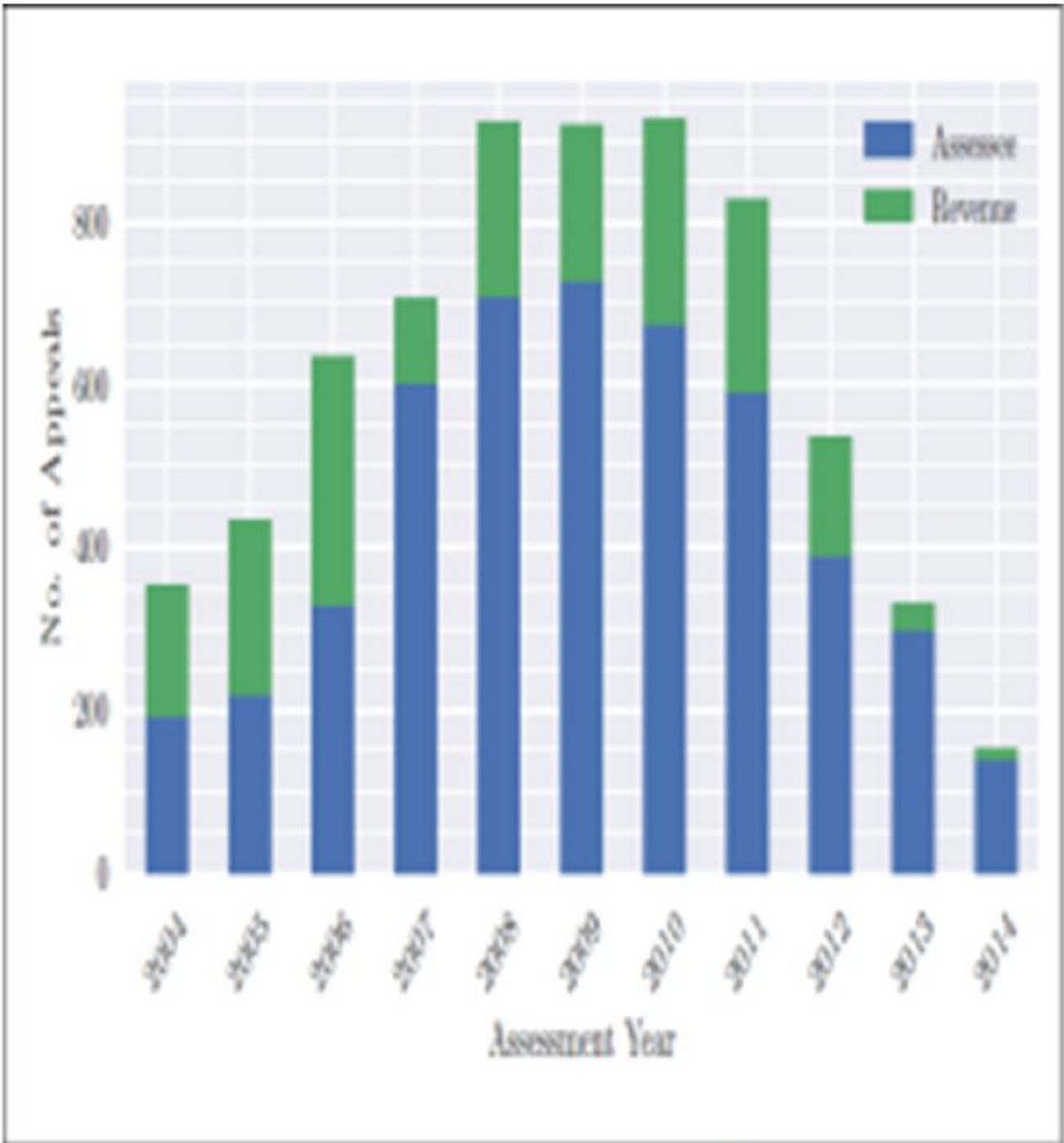
- **Semi-variable costs** need to be split into fixed and variable part.
- The **variable costs** and the variable portion of the semi-variable costs remain unaffected due to any under or overutilization of capacity.
- The **fixed operating costs** and the fixed part of the semi-variable costs are scaled up or down by considering the percentage of capacity utilization by the taxpayer and such comparable.

Litigation Trends & Resolution Measures:

Litigation trends



Appellant	Result of appeal				Total
	Allowed	Dismissed	Partly Allowed	N/A	
Assessee	1852	412	2151	463	4878
Revenue	178	1137	391	147	1853
Total	2030	1549	2542	610	6731



Measures to reduce litigation

Dispute Resolution
Mechanism

Advance Pricing
Agreement

Safe Harbour Rules

Mutual Agreement
Procedure

Glossary :







AE	Associated Enterprises
ALP	Arms Length Price
AMP	Advertisement, Marketing and Promotion
AO	Assessing Officer
CIT(A)	Commissioner of Income Tax (Appeals)
DRP	Dispute Resolution Panel
HC	High Court
HUF	Hindu Undivided Family
INR	Indian Rupee
ITAT	Income Tax Appellate Tribunal
MAM	Most Appropriate Method
OECD	Organization for Economic Cooperation and Development
SC	Supreme Court
SLP	Special Leave Petition
TP	Transfer Pricing
TPO	Transfer Pricing Officer
USD	United States Dollar



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