Chapter 4.

Findings
4.1 Findings from TPO Orders:

There were 22 reasons found for the purpose of classification of areas of dispute between the Income Tax Department and the tax payer for acceptance of ALP these were reduced to 19 reasons since a few were found to be very similar. Reason code number 3 with 7, 14 with 17, and 13 with 20 were combined to get final 19 reasons. The original 22 reasons and the merged 19 reasons are as follows:

Table 2: List of original 22 reasons:

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<thead>
<tr>
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<tbody>
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<td>160</td>
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<td>5</td>
<td>Application of Method for ALP</td>
<td>5</td>
<td>121</td>
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<tr>
<td>6</td>
<td>Deliberate mess up by assessee on allocation</td>
<td>6</td>
<td>145</td>
</tr>
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<td>7</td>
<td>Basis of adjustment to ALP</td>
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<td>74</td>
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<tr>
<td>8</td>
<td>Corporate guarantee, its cost &amp; Notional Interest</td>
<td>8</td>
<td>42</td>
</tr>
<tr>
<td>9</td>
<td>Share application money as loan</td>
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<td>Basis of adjustment to expenses/income</td>
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<td>11</td>
<td>Documentation, evidence</td>
<td>11</td>
<td>15</td>
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<tr>
<td>12</td>
<td>Deemed Loan</td>
<td>12</td>
<td>31</td>
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<td>13</td>
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<td>13</td>
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<td>14</td>
<td>Interest free loan</td>
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<td>15</td>
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<td>16</td>
<td>Exclusions / Inclusion from income &amp; Expenses</td>
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<tr>
<td>17</td>
<td>Adjustment for interest free loan</td>
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<tr>
<td>18</td>
<td>Markup Margins</td>
<td>18</td>
<td>166</td>
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<tr>
<td>19</td>
<td>Interest on loan</td>
<td>19</td>
<td>70</td>
</tr>
<tr>
<td>20</td>
<td>Documentation, Royalty Payment</td>
<td>20</td>
<td>9</td>
</tr>
<tr>
<td>21</td>
<td>Multiple year data taken by assessee, rejected by AO</td>
<td>21</td>
<td>86</td>
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<tr>
<td>22</td>
<td>Valuation of Equity Purchased &amp; Sold</td>
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Table 3: List of Final 19 reasons

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These above reasons were further divided into reasons for disputes arising due to taking legislation into incorrect spirit by either tax payer or tax authority, and reasons for disputes arising due to having difference of opinion about the subject matter or facts of case.

Table 4: Reasons for disputes arising due to taking legislation into incorrect spirit

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Table 5: Reasons for disputes arising due to having difference of opinion about the subject matter of case or facts of case

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4.1.1 Findings relating to each reason

Findings relating to each reason stated above are as follows:

1. Product and business differentiation adjustments:
   In 118 cases it is found that the tax payer has sought adjustment to the comparable price to arrive at ALP on account of product differentiation and business differentiation to the comparable. The TPO has rejected claim in all the above cases. The OECD guidelines and Indian legislation allow adjustment in principle to arrive at ALP on this basis. However it is found that the TPO has rejected claims for such adjustments on this account in all the cases.

   The argument put forth by TPO is that, the minor differentiations in the product and business are nullified when you take gross margins. Hence, use TNMM method with gross margins of comparable, is easier and simple to implement, than quantifying the effect of differentiation and adjusting the ALP accordingly.
2. Agreement on comparable:
   In 443 cases, it was found that the dispute about which comparable to be used arose among the TPO and the tax payer. The filter criteria used by the TPO was as follows:
   
a. Companies whose data is not available are excluded.
b. Companies whose sectorial income for business under consideration is less than Rs.1 cr. are excluded.
c. Companies whose revenue from relevant sector is less than 75% of the total operating revenues are excluded.
d. Companies having more than 25% related party transactions (sales as well as expenditure combined) of the sales are excluded.
e. Companies who have export sales less than 25% of the sales for ITES are excluded.
f. Companies who have diminishing revenues/persistent losses for the last three years up to and including the assessment year are excluded.
g. Companies having different financial year ending (i.e. not March 31, of the year) or data of the company does not fall within 12 month period i.e. relevant financial year, are rejected.
h. Companies that are functionally different from the taxpayer are excluded.
i. Companies that are having peculiar economic circumstances are excluded.

The tax payer was never disclosed that this filter criteria will be used for shortlisting the comparable by the TPO’s, making the exercise by the tax payer prone to disputes. The basis for these filter details are not been disclosed by the TPO, though the basis sounds to be logical.

This non-disclosure of the filter details every year by the Income Tax Department creates uncertainty for the tax payer. This uncertainty is not desirable and adds to the disputes arising on account of difference of opinion.

3. Reason for adjustment to ALP:
In 339 cases the TOP has suggested adjustment to the ALP and sighted reasons for the same. The tax payer has argued that the reasons are incorrect. However the TPO has not changed his stance.

On a side by side study of the reasoning given by the tax payer and the TPO, it is found that reasoning of both is logical but still non agreement on the same is prevalent due to the subjectivity prevailing in the legislature, and implementing mechanism.

4. Basis of determination for ALP:
In 160 cases it was found that the basis of determination of ALP was not accepted by the TPO.

In case of financial institutes, service providers and banks, the tax payer has determined ALP on a basis external comparable whereas internal comparable with non AE transactions were available. In such cases the volume of transactions with AE & non AE is significantly comparable. However in cases where the tax payer has claimed that the ALP based on non AE transactions with insignificant comparable business volume, the TPO has rejected such computations.

In cases of goods, the tax payer has claimed the difference in market situation in various markets to affect the pricing making the AE & non AE prices non comparable. However on demand of TPO the tax payer is found not to be in a position to disclose the full price determination process and policy. The tax payer has also failed to give reasons as to how different factors, specific to a country affect the pricing.

In all the cases it is found that the stance taken by the TPO is justified in view of lack of explanations given by the tax payer.

5. Application of Method for ALP:
In 121 cases it was found that there was a dispute for the reason of the selection of method applied for arriving at ALP. The reasons cited by tax
payers were rejected by TOP for which he has given his reasons and interpretation. In most of the cases it is found that the TPO is reasonable in his arguments for rejecting the method applied by the tax payer.

6. Deliberate mess up by tax payer on allocation:
In 145 cases it is found that the tax payer has in consecutive years changed the method of determination of ALP. He has also made all the possible adjustments to the ALP. The tax payer is also not consistent over the time period (under different assessment years) in his application of methods and nature of adjustments to the ALP.

It is also found that the tax payer is using multiple ways to arrive at different ALP and justifying the ALP. However tax payer has not justified, why different methods are used or why a particular method is used to arrive at ALP.

The TPO has consistently rejected the claims of tax payer and come out with his own working about the ALP. In certain cases it is found that the TPO is harsh on the tax payer due to the mess up done by them in their ALP computations.

7. Corporate guarantee, its cost & Notional Interest:
In 42 cases it is found that the tax payer has given corporate guarantee to its associate without taking any consideration. The ALP was decided in all of the above cases to be NIL by the tax payer, citing the reason that it is not a transaction. The TPO considered it as incorrect to determine ALP as NIL and stated that, the associate has gained advantage due to the corporate guarantee. The tax payer will not give this guarantee to any other party not related to it and that it was given for the purpose of getting advantage. It is taken as transaction by the TPO and treated as equivalent to a bank guarantee.

In all the cases mentioned, the corporate guarantee has been given for the purpose of acquiring loan by the associate. Thus the corporate guarantee has
done similar function to that of a bank guarantee. Bank guarantee comes at a cost, which the bank takes. It also takes fixed charges for the same. The same equivalent cost the tax payer has to recover under the arm’s length principle.

The corporate guarantee has given advantage to the associate by reducing its interest cost. This is a direct benefit to the associate and for which tax payer should get benefit. Thus guarantee cost plus processing cost or notional interest have to be considered for ALP, which the TPO has done.

The action of TPO is justified considering the Arm’s length principle given under Indian laws as well as OECD guidelines.

8. Share application money as loan:
   In 5 cases it was found that tax payer had given share application money to its associate overseas. This money was pending for allotment of shares for a period more than one year. The TPO treated that the money was deemed loan given to the associate and the interest on the same is to be added to the income of the tax payer which is not received. The basis claimed for the same by TPO is that “the allotment of shares has to be within a reasonable time”, and the reasonable time according to TPO is time allowed for allotment as per laws India. The tax payer has not put forth any argument other than “delay in issue of shares was on account of unforeseen reasons by the associate”.

   The argument of tax payer does not stand any ground, and that the taxpayer had to claim for refund for the share application money or make due diligence before handing over the money.

   The stand of TPO is partially correct, for the reason that the law of the place of associate is also to be considered for the purpose of reasonable time determination. This aspect is not discussed by the TPO; also arguments regarding the same are not made by the tax payer.

9. Basis of adjustment to expenses/income:
In 295 cases it is found that the TPO has not agreed to the basis of adjustment to the ALP as suggested by the tax payer, and the TPO has given his basis. This basis is considered is an average ratio of the expenses of the comparable companies to be compared with the actual ratio and safe harbour margin of 5% is followed.

It is also found that the TPO has audited the expenses of the tax payer in almost all the cases and raised queries about the reasons for the expenses. The reasons and explanations of the tax payer are found not to clarify fully the expenses, compelling the TPO to disallow the same.

In case of commission paid to agents, it is found that the TPO has in all such cases rejected the claim by the tax payer about the amount of such commission and the reasons for paying that amount by the tax payer. In most of the cases the data regarding the competitors is not available to tax payer and the TPO both, thus leaving the decision on arbitrary understanding of the TPO, and explanations of the tax payer. The same is true with differentiable services between associates like technical services & technical fees.

10. Documentation, evidence:
   In 15 cases it was found that the TPO had rejected the working of the tax payer for lack of evidence and documentation based on which the computations for ALP were made. Most of the cases referred in this were based on CUP method & TNMM.

   This act of the TPO is correct for, the onus is on the tax payer to provide the evidence of the basis of his computations. The tax payer cannot claim any ALP without backup computations/evidence.

11. Deemed Loan:
   In 31 cases it is found that the share application money and advance payment for supply given to associate was with the associate for more than reasonable period, in 26 cases the money was with associate for more than one year and
in other cases it was almost one year. The TPO held the transaction to be deemed as loan transaction and ALP interest was imposed as addition to the income of the tax payer.

The argument put forth for advance payment for supplies by the tax payer is that, the supply from AE got delayed and sighting long lasting relation with the supplier the refund or penalty clause was not invoked.

12. Royalty Payment/Brand Fee:
In 106 cases it is found that the TPO has objected to the payment of royalty and brand fee.

The argument regarding the brand fee by the TPO is that the brand has no proprietary rights of the brand owner and hence can be used by anybody unless it is registered as patent, trademark or copyright. Thus all the payments for brand fee are being rejected by the TPO. The tax payer has argued in this matter that the brand helps in getting business and for this benefit a fee is paid. The TPO is found correct on law point. But the tax payer is right on the business logic.

It is found in all the cases that the rate of royalty paid by the tax payer has not been accepted by the TPO. The royalty paid by comparable is taken as benchmark and rate of royalty payment adjusted. How much royalty is sufficient and at Arm’s Length is decided arbitrarily. It is found that neither the tax payer nor the TPO has used any of the valuation techniques for intangible assets to arrive at computation of royalty payment. No market assessment is considered for the same.

There is another angle and aspect which is not presented either by an assesse or TPO. If an entity is working as branch, it could not have made Royalty payment/Brand Fee payment as it is accepted Income Tax doctrine that you cannot pay to yourself. Following this doctrine in transfer pricing scenario, it does not sound logical to make these payments to AE.
In cases where the tax payer is using technology from AE and doing business with AE only, and no business is there with non AE, the TPO has considered that the royalty payment is not to be made and has taken ALP to be NIL. The reason given is that the since the tax payer is not involved into commercial utilization of technology, the royalty payment is not warranted. The commercial use is restricted to AE only and hence it is practically captive utilization of technology where in royalty payment is unnecessary. In these cases the TPO seems to be correct in his approach.

13. Interest free loan:
In 26 cases it is found that the interest free loans were given to the associate enterprises. The tax payer has not charged any interest to AE and claimed ALP to be NIL for following reasons:
   a. To shore up the cash-flow of the AE;
   b. To financially strengthen the AE against competition; and
   c. To help the AE in garnering more customers which will boost the business prospects of the group.

All these reasons have not been accepted by the TPO on grounds that the same is against the Arm’s Length Principle. The TPO seems correct in his stand.

14. Comparable not available at time of filing taken by AO:
In 8 cases it was found that the TPO had rejected comparable companies proposed by the tax payer and added comparable whose data was not available at the time of filing the transfer pricing report by the tax payer. This was objected by the tax payer but the objection was not considered by the TPO. This action of the TPO is not correct for the fact that unknown data cannot be considered. For determining ALP for transfer pricing the available information in public domain has to be considered for deciding ALP.

15. Inclusions/Exclusions from incomes & expenses:
   a. Commission paid: Quantum of this is an issue always on agreement as to how much commission is to be paid and why that rate. Justification on quantum is never accepted by department. The quantification and sufficiency proving for the commission is difficult, especially when
there is no competitor for the business in the country of AE, and that the services by the commission agent are not exactly the same.

Finding such a comparable case in public domain is virtually impossible, since segment and country wise data is not available, so as to commission agent wise data for all competitors. This makes things very subjective for tax payer for comparison and adjustment to the ALP.

b. Adjustment to Royalty: quantum paid as royalty, has been an issue of dispute. It is seen that in all cases the TPO has challenged the quantum paid and has made adjustments to it.

c. Purchase price and or Sale price rejected by TNMM: what is the ALP for this is an issue. It starts with the comparable selection and the say the ALP is computed by under TNMM. This has given a lot of disagreement points upon the price determination.

d. Adjustments in the services cost: The value paid for the service has not been agreed by the TPO in most of the cases and there are adjustments to the expenses for payment made to the AE for services.

e. Adjustments to other expenses and incomes: There are instances where in there are other heads of income and expenses where in the TPO has disagreed with tax payer on the amount.

16. Markup Margins:

In 166 cases it was found that the disputes were about the markup margins that were used for the ALP determination under TNMM and cost plus method. There were different variations of dispute under this:

a. Dispute because of selection of comparable companies in the sector for deciding the mark up percentage.
b. Dispute arising about the method of computation in the markup margins.

17. Interest on loan:

In 70 cases the tax payer has given loans to the AE. The rate of interest charged for the same is not being accepted by the TPO. The arguments of the tax payer are that the loans were given for business expediency, and to ensure competitiveness of the AE.

The TPO has argued that the transactions have to be at ALP. In doing so the TPO has considered the risk factor used by the Indian banks and said that the transactions should be marked at LIBOR plus the risk factor of Indian banks.

It is to be noted that the exact comparable are not available for the transactions and the LIBOR is an international benchmark for bank rates. The TPO has explained that, because the tax payer is an Indian entity it will face similar risks that Indian banks face. Hence Indian markups were to be used for ALP determination.

The stand of the TPO seems to be more logical than that of the tax payer considering the principle of Arm’s Length Price.

18. Multiple year data taken by tax payer, rejected by TPO:

In 86 cases it was found that tax payer had considered multiple year data to arrive at TNMM based (margin based) comparable. However the same was rejected by TPO in all the cases. It is found that the TPO was right in his decision.

This finding is based on the legal provision under Income Tax Act 1961, Rule 10B(4) where the rule states that “The data to be used in analyzing the comparability of an uncontrolled transaction with an international transaction shall be the data relating to the financial year in which the international transaction has been entered into: Provided that data relating to a period not being more than two years prior to such financial year may also be considered
if such data reveals facts which could have an influence on the determination of transfer prices in relation to the transactions being compared”.

The tax payer has claimed that OECD provisions give space for multiple year data. The tax payer has failed to consider that the Law of Land in India is different than that of OECD guidelines.

19. Valuation of Equity Purchased & Sold:
In 5 cases it was found that the tax payer had purchased equity shares in and from AE. The TPO has doubted the valuation of these purchases & sales. The explanations and submissions by the tax payer are found not to be based on any financial data but on projections about the business benefit about the same. The basis of these projections is not given by the tax payer. Thus the TPO has used his own understanding to make the valuations.

4.2 Other Findings and Observations

1. In TNMM, the net margins from transactions are expected to be compared with similar uncontrolled transactions. It is found that this is practically not possible for non-availability of such detailed data. However for arriving at a logical implementability of the method, in case of non-availability of the internal comparable margins, transactional margins of the tax payer and the margins of the comparable companies are considered. Further to remove the non-operational items to get the correct comparison gross margins are compared.

Such a comparison is against the OECD guidelines and the legislations, though the refuge for the same is taken under the provisions for allowed adjustments for implementation of the method. However such adjustments do not consider the differences in the operational efficiencies. To counter this average of the list of comparable is considered for implementation of the method.
In all the cases using TNMM method this adjustment is found, strongly indicating that the OECD guidelines and the legislation cannot be implemented without adjustments.

2. In case of company number 38, it is found that TPO has made adjustments to the ALP, for payment of commission to AE in AY 2002-2003 till 2004-2005. There was a change in the officer in the next AY, and since then that is from 2005-2006 till 2007-2008, there are no adjustments made to the ALP by the TPO. In all these cases the tax payer had computed the ALP in same manner, indicating lack of consistency in thinking and approach on part of the tax authorities.

3. In case of company no 41 in AY 2007-2008, the tax payer has used statistical tools like mean & median along with normal curve for selection of comparable. Such a method is not prescribed under legislation, and rightly rejected by the tax authorities. In the earlier AY’s the tax payer has not used such a method for comparable selection. This indicates different methods by the tax payer to get comparable, in view of lack of clarity in criteria for selection of comparable.

This is a strong case for lack of clarity and requirement for the same, for the tax payer.

4. In all the cases where in the tax payer has sought adjustment to the ALP for risk, and the risk computation is made using CAPM, the tax authorities have rejected all such claims. The tax authorities have rightly claimed that CAPM does not quantify enterprise risk, but is a tool to manage portfolio risk.

Also cases where tax payer sells his entire product to one AE, the tax payer has claimed for adjustment on account of higher risk for single customer, which is rightly rejected by the tax authorities. The tax authorities have claimed that in fact the customer being AE, there is no risk of business.
The above claims of the tax payer’s are a strong indication about his intentions to manage tax liability, a strong case for undue tax avoidance.

5. In case of company no 99 AY 2005-2006, the agreement with the AE gives the FCD at State Bank of India PLR plus 3%. However the tax payer claimed PLR by RBI. The TPO rightly considered the rate as average PLR of Indian banks.

This is again an indication of the tax payer’s intention to manage the tax liability.

6. Cases where tax payer has paid brand fees, the TPO has rejected the expenses saying that the brand if not registered has no protection under copyright, and hence the fees need not be paid. The contention of the tax authorities in this case is found to be correct in the text of the legislation, however in context of ground realities, factual understanding of the case is very important. This is especially a case where in there is a JV where terms of JV demand such payment to the foreign partner.

Demand by fully owned subsidiary of a foreign company, for payment of brand fee can be a treated as a strategy by the tax payer to shift profits. This is strong case of taking legislature in incorrect spirit by the tax payer.

7. In case of company no 101 AY 2005-2006, the tax payer had used TNMM method while the tax authorities rejecting the same used CUP method. There was no reasonable explanation for the same by TPO. For CUP the TPO compared different transactions with two AE and made adjustments to ALP.

The implementation of CUP adopted by the TPO is against the legislation which says that comparable uncontrolled transactions are to be used for comparison and not two comparable transactions. This adjustment in implementation is violation of the main theme of legislation, giving rise to uncertainty for the tax payer. In this case TPO was right in addition, but gaps in legislature are exposed.
8. In company no 168 AY 2002-2003 and 2003-2004, the tax payer and the tax authorities have dispute for what is ALP royalty and commission. However the determination of the same is found to be very difficult and hence the TPO has accepted the claims by the tax payer.

This case exposes the inability of the legislature and the OECD guidelines to implement the methods given under the same in such unique cases for want of data. With international AE transactions increasing every year, it may be a case that the main theme of legislature may be useless, and only adjustments will be used for implementation of the same. This makes it a strong case for review of legislature for its future implementability.

9. There are procedural flaws found in implementation of the safe harbour rules given under the legislation. The +/-5% of safe harbour allowed in the legislation is been implemented wrongly by the TPO in case of company no 436 AY 2004-2005. Instead of upward revision to the ALP as computed by the tax payer the TPO has revised upwardly the ALP, to ALP less 5%, giving the justification under safe harbour rules.

This is highlighting the lack of clarity on implementation of the rules by the tax authorities. However the question of spirit of legislation is not questioned by this particular act because the addition with ALP less 5% is in favor of tax payer.

10. In company number 498 AY 2005-2006, tax payer has made procedural claims about validity of reference to TPO. However even upon explanation about the validity by tax authorities, the tax payer has not cooperated with tax authorities.

Such behavior about the tax payer is found to be against the spirit of law and implies his intentions of undue tax avoidance.
11. OECD guidelines permit earlier period data if it essentially impacts current year figures. However Indian legislation does not do so under Rule 10B(4). It is found that the tax payers are using the prior period data for comparable. The law of land always prevails and innocence cannot be claimed for not following the law citing international guidelines. This incorrect understanding of legislature, taking refuge under OECD guidelines is found to be an act of avoidance of tax in India.

12. In case of company number 530, through AY 2005-2006 to AY 2007-2008, the tax payer has changed the nature of payments to AE as per earlier year TPO orders. Two probable reasons are found for such an act:
   - There is a desperate attempt to avoid tax in India by all ways possible, trying very hard every year for TPO acceptability.
   - The tax payer has certain committed payments to AE and due to uncertainty about its allowability is changing heads of payments to get an acceptable solution for the same.

13. Many ITES companies have considered comparable with different accounting period than theirs, for comparison. This is done without adjustment for to match the accounting periods with theirs, as mandated by Law. Such an act of the tax payer is found to be with sole intention of tax avoidance.

Very few cases where in such adjustments to accounting period are made by the tax payer, no logic or rational behind implementation of the adjustment is clarified, highlighting such selection as intention to avoid tax.

14. In case of company number 600 in AY 2008-09 reliance was placed on Philip Software Pvt. Ltd. Vs. ACIT (119-TTJ-721)(Bangalore). On which following was argued by TPO:
   “In this regard, it is pointed out that the decision of the Honorable Bangalore ITAT relied upon by the tax payer has been stayed by the Karnataka High Court. The multinational enterprises and their ability to allocate profits to sister concern (associated enterprises) outside Indian jurisdiction by controlling prices in group transactions has become a matter of great concern.
The purposes of Transfer Pricing regulations have been aptly clarified in Circular Nos.12 and 14 of the CBDT, issued after enactment of regulation. The provisions are intended to ensure that profits taxable in India are not understood (or losses are not overstated) by declaring lower receipts or higher outgoings than those which would have been declared by persons entering into similar transaction with unrelated parties in the same or similar circumstances. The basic intention underlying the transfer pricing regulation is to prevent shifting out of profits by manipulating prices charged or paid in international transactions, thereby eroding the country’s tax base."

The above explanation makes clear the stand of the tax authorities that their intention is to collect rightful tax and that there is a big concern of profit shifting by the tax payer out of India.

15. In company number 635, AY 2008-2009, it is found that as the tax payer’s taxability of the Indian operations increased, the GP margins of 15.55% above cost was reduced to 4.46% in AY 2008-2009. On rationalization by the TPO, and reworking the ALP, the TPO arrived at figures close to 15.55%. From the examination of the order it is found that the TPO has not taken reference for the previous year orders as bench mark for arriving at the figures. This is a clear case of undue tax avoidance by the tax payer.

16. There are cases where in the tax payer has sought adjustments for WC because prompt payment by AE reduces cost of capital locked in WC. Since net WC requirement is reduced, the burden of proof for the quantification of reduction in cost is on the tax payer.

It is found that the tax payer has failed in all cases to prove and quantify. In fact no attempt is made by the tax payer to justify the claim. All such claims of the tax payer are turned down by the tax authorities. Such claims of tax payer are found to be attempts to avoid tax and as a strategy to divert the tax authorities on matter of no importance.
4.3 Findings from Reported Cases

The High Courts and the Supreme Court only handle the cases where in, the point in question is about interpretation of law. All the fact finding for any dispute ends at Income Tax Appellate Tribunal (ITAT) which is the highest fact finding body so far as disputes relating to the Income Tax matters are concerned.

As highlighted in the Delhi High Court case (Maruti Suzuki India Ltd. vs. Additional Commissioner of Income Tax/Transfer Pricing Officer, 2010) in no place did the amount of payment of royalty has been taken into consideration by the Transfer Pricing Officer (TPO), though the TPO has made addition based on the royalty issue. The Concept of advertising expense for a commercial product sale in India by a Indian company, as a brand building exercise for a AE not operating in India through any other ways in farfetched. It does not have any logical significance for deriving commercial value outside India. This was done by the TPO. The tax payer on the other hand never thought that use of co-branding would tantamount to interpretation as deemed sale of the brand.

The High Court of Punjab & Haryana, held in that there was no need to give a chance to hear to the tax payer before referring the matter to the TPO. The assessing Officer can within his rights do the same without intimating the tax payer. Further the court continues saying that the TPO has the freedom of selecting any other method than that selected by the tax payer for determining the Arm’s Length Price (ALP), which he may feel more appropriate. (Coca Cola India Inc. VS. Assistant Commissioner of Income Tax & Ors., 2008)

The High Court of Delhi in Writ Petn. No 9594 of 2005 held that AO is not bound to accept the arm’s length price as determined by the TPO and he can consider not only the report of the TPO but any other material that may be placed before him; CBDT Instruction No. 3 of 2003, dt. 20th May, 2003, is consistent with the statutory objective underlying s. 92CA and it is neither violative of Art. 14 of the Constitution nor ultra-varies the Act (Sony India (P) Ltd vs. Central Board of Direct Taxes & Anr., 2006).
It is found that the ITAT is dealing with the decisions with remand and asking the AO to redo the calculation for ALP computations. Places where in the CIT has changed the comparable than that used by the AO, the ITAT has put the cases back to the AO asking to rework with reasons which comparable are to be worked with and why. ITAT has also directed the Dispute Settlement Panel (DRP) to give speaking orders on the matters decided by them, meaning to give orders which explain reasons behind their decisions and not just decisions.

Specific Findings from the ITAT orders are as follows:

1. In case a seconded person is transported to the AE for performing the duties, expenses of such a person expenses are to be borne by the tax payer and not the AE. The tax payer has an agreement for technical knowhow and the person from AE is going for training. It makes business sense and logic that such expenses are to be borne by the AE. (MASTEK LIMITED vs. DCIT, 2012).

2. If the TPO gives proper reasoning for rejecting the method used by the tax payer, the TPO may change to any other method that he feels is most appropriate method for the case. However the TPO has to give reasons for rejecting the method and reasons for using different methods. (COASTAL ENERGY (P) LTD. vs. ASSISTANT COMMISSIONER OF INCOME TAX, 2011), (ACIT vs. VISTAAR SYSTEMS PVT. LTD., 2012). In case of (TRANSWITCH INDIA PVT. LTD. vs. DCIT, 2012). ITAT has decided in favor of the tax payer since the TPO had not given reasoning for rejecting the method used by the tax payer. In case of TRANSWITCH INDIA PVT. LTD. vs. DCIT, there were abnormal expenses by the tax payer. Hence operating margin comparison was not the right way to apply TNMM. A logical way was to use cost relating to AE. Further in case of (SERDIA PHARMACEUTICALS (INDIA) (P) LTD. vs. ASSISTANT COMMISSIONER OF INCOME TAX, 2010), the ITAT has ruled that the power to decide on the method to be used for ALP determination as most appropriate method vests with the AO/TPO. This is however with a rider that the AO/TPO must give proper reasoning for rejecting the method used by the tax payer.
3. Use of operating margins for application of TNMM has been rejected by the ITAT saying that the AE related costs have to be considered for the comparison where available. (ADDITIONAL COMMISSIONER OF INCOME TAX vs. TEJ DIAM, 2010). Further in case of (FOUR SOFT LTD. vs. DEPUTY COMMISSIONER OF INCOME TAX, 2011), (DEPUTY COMMISSIONER OF INCOME TAX vs. STARLITE, 2010) ITAT has ruled that so far as possible the cost of AE transactions only have to be considered and not the enterprise profits for computation of ALP under TNMM. This is so because enterprise level profits may give a distorted picture.

4. In case of (MARUBENI INDIA (P) LTD. vs. ADDITIONAL COMMISSIONER OF INCOME TAX, 2011), the ITAT has detailed the procedure to compute adjustment. ITAT has said that the unique features of each case have to be understood before going into computation of the adjustments.

5. In case of (ARICENT TECHNOLOGIES (HOLDING) LTD. vs. DEPUTY COMMISSIONER OF INCOME TAX, 2011), the TPO has not considered other legislatures and but has only looked to the provisions of Income Tax Act 1961 relating to international transfer pricing. According to ITAT, this is incorrect and due consideration is to be given to the other legislations when coming to the decision of the ALP determination in each case.

6. The ITAT has ruled that the comparable companies used in one year may not remain the same. They may change or the list may change. This is for the reason that the case to case circumstances in each year may be different in case of tax payer and/or in case of the comparable company. (DHL EXPRESS (INDIA) (P) LTD. vs. ASSISTANT COMMISSIONER OF INCOME TAX, 2011), blindly following the comparable for the reason that it was used in previous years is incorrect as the circumstances may change (HOSLEY INDIA PVT. LTD. vs. DCIT, 2012). ITAT has further in case of (TEVA INDIA (P) LTD. vs. DEPUTY COMMISSIONER OF INCOME TAX, 2011), ruled that exact comparable may not be there, however the company may be selected as comparable if there is functional similarity between the operations.
and business of the tax payer and the comparable company. Further the ITAT has said that there should be explanation given for selecting particular company as comparable. In absence of the same the selection of the comparable is incorrect. There should also be risk assessment and application of mind by the TPO when making selection of the comparable. Risk, functional similarity and are required and for the same application of mind is required on case to case basis. (ADOBE SYSTEMS INDIA (P) LTD. vs. ADDITIONAL COMMISSIONER OF INCOME TAX, 2011), (MENTOR GRAPHICS (NOIDA) (P) LTD. vs. DEPUTY COMMISSIONER OF INCOME TAX, 2007), (DEPUTY COMMISSIONER OF INCOME TAX vs. INDO AMERICAN JEWELLERY LTD., 2010), (BECHTEL INDIA (P) LTD. vs. DEPUTY COMMISSIONER OF INCOME TAX, 2010).

7. Royalty @ 3% vide RBI letter and @ 8% for on export and 3% on domestic sales are allowable as per Government of India Ministry of Commerce and Industry & DIPP, press note in 2003. This is allowable unless the TPO gives evidence to the contrary. (DCIT vs. SONA OKEGAWA PRECISION FORGINGS LTD., 2011). Further the ITAT has ruled that when part of the produce is sold to AE and rest to non AE, than it cannot be said that the tax payer is a contract manufacturer. The disallowance or royalty expense in such a case is not justified by the TPO.

8. ITAT has ruled in case of (INTERVET INDIA (P) LTD. vs. ASSISTANT COMMISSIONER OF INCOME TAX, 2010) that use of internal comparable in different markets is incorrect by the TPO since the two markets that is countries will have different economic factors which are unique. Such a comparison is not correct as per law.

9. In case of (DEPUTY COMMISSIONER OF INCOME TAX vs. BP INDIA SERVICES (P) LTD., 2011) the ITAT has clarified its stand on the filter criteria that the same has to be in line with the business of the tax payer. Blanket criteria are incorrect. The filters used to adopt and shortlist the comparable hence to be done on a case to case basis.
10. In case of (SHANKER EXPORTERS vs. ADDITIONAL COMMISSIONER OF INCOME TAX, 2010) the TPO has rejected the accounts since the customers of the tax payer did not give verification. In this case the TPO had accepted the sales to these parties but rejected the purchases from them claiming non verification. This is held to be inconsistent in law by ITAT.

11. The ITAT has upheld the TPO ruling in case of (LOGIX MICRO SYSTEMS LTD. vs. ASSISTANT COMMISSIONER OF INCOME TAX, 2010) that the deemed loan as considered by the TPO is correct, however the rate has to be reasonable. The TPO considered the rate to be PLR of SBI, the CIT(A) had given directions to adopt LIBOR/US-FED rate. The ITAT has given opinion that it is correct to use Indian interest rates but SBI PLR is too harsh and the ITAT fixed the ALP interest at 5% and has reverted back for recompilation. However the ITAT has not given justification for 5% except that it has considered the circumstances of the case. ITAT has ruled in case of (NIMBUS COMMUNICATIONS LTD. vs. ASSISTANT COMMISSIONER OF INCOME TAX, 2011) that if the practice of the tax payer is not of charging interest on over dues from any party and that the tax payer is consistent in doing so with AE and the non AE parties, than the interest on the overdue amount may not be required addition, considering it as a deemed loan. So far as the tax payer is consistent in his acts with the AE and non AE aspects, the ITAT has given the benefit to the tax payer. As is case of (DEPUTY COMMISSIONER OF INCOME TAX vs. INDO AMERICAN JEWELLERY LTD., 2010) the tax payer had outstanding debtors for a long time and the same was true with AE & non AE. In this case ITAT reversed the ruling in favor of the tax payer about addition of interest on outstanding AE dues claiming as deemed loan by the TPO.

12. ITAT ruled in case of (CUSHMAN & WAKEFIELD INDIA (P) LTD. vs. ASSISTANT COMMISSIONER OF INCOME TAX, 2011) that evidence that overseas service to the AE was given is sufficient. Such evidence may be even emails sent and received by such an employee.
13. In case of (ASSISTANT COMMISSIONER OF INCOME TAX vs. UE TRADE CORPORATION (INDIA) (P) LTD., 2010) ITAT has ruled that the TPO is there to expedite the matters for the AO, and that the report of the TPO is not binding on the AO. The AO has to be convinced that the ALP computed is correct and that he can partially or completely reject the TPO report.

14. ITAT in case of (ASSISTANT COMMISSIONER OF INCOME TAX vs. NIT LTD, 2011) has held that if the comparable which were not available to the taxpayer at the time of filing by the taxpayer but are essential for computation of ALP may be taken by the TPO provided sufficient opportunity is given to the taxpayer to be heard.

15. In case of Alp determination under CUP, comparison of different markets is difficult since the situations in different markets are different. Comparison may not give correct ALP. Hence such comparison is not sustainable as found by ITAT in case of (ARVIVA INDUSTRIES LTD. vs. ASSISTANT COMMISSIONER OF INCOME TAX, 2011).

16. ITAT has ruled that in case of (VIPIN ENTERPRISES vs. ACIT, 2012) where there were comparable uncontrolled transactions to determine ALP the LME rates need not be referred. Such comparable transactions are sufficient for determination of the ALP provided that they follow all other filter criteria for considering comparable. In this case it was relating to copper and hence the uncontrolled transactions had to be within the similar time period.

17. ITAT has ruled in case of (ABHISHEK AUTO INDUSTRIES LTD. vs. DEPUTY COMMISSIONER OF INCOME TAX, 2010) that the AO cannot determine if the business arrangement by the taxpayer with the AE is required. His job is to determine ALP and not comment on how the business needs to be done by the taxpayer.

18. In case of (LIBERTY AGRI PRODUCTS (P) LTD. vs. INCOME TAX OFFICER, 2011) the ITAT has ruled that the AO and TPO should understand
the logic about the incidence of transaction. In this case it was wrongly done by the AO and hence ITAT reversed the addition by the AO.

19. ITAT has ruled in case of (DEPUTY COMMISSIONER OF INCOME TAX vs. FIRST RAIN SOFTWARE CENTRE, 2011) that for rejecting any expense by the AO or TPO they have to give proper and detailed explanation. Rejecting the expenses without proper reasoning is not sustainable under the law.

20. The ITAT in (CA COMPUTER ASSOCIATES (P) LTD. vs. DEPUTY COMMISSIONER OF INCOME TAX, 2010) has held that the bad debts of the AE that are written off cannot be the criteria for determination of ALP for royalty. However it is observed that in case under consideration bad debts are received from 100% subsidiary, which is strange and unusual.

It is found that majorly the ITAT rulings are about cases where in there are issues relating to selection of comparable and issues relating to procedures of computations of ALP that relates to particular fact. They refer to how adjustments are made and are mostly referred back to the AO for re-computation as per directions of the ITAT. ITAT has not considered intentions of the tax payer or that of the AO as suggested by the Supreme Court ruling in case of (M.CT.M. Chidambaram Chettiar & Ors. vs. Commissioner Of Income Tax, 1965), where in the Supreme Court has said that the most important factor in such related party international transactions is the intention of the tax payer. If the intention is not to avoid tax and that the tax avoidance is incidental the tax payer is not guilty of tax evasion. However if the intention behind the transaction is to avoid tax than the tax payer is guilty of tax evasion.

It is found that ITAT though is a top fact finding body for the income tax matters, its role has been till now restricted to decisions and disputes on procedural matters. It has so far not given any directional ruling so far as the intentions of the tax payer or the AO/TPO are revealed. In spite of old rulings of the Supreme Court regarding the intention behind the pricing of the international related party transaction, so far it is still a wait for such rulings from ITAT.
Of the above reasons for dispute found, ITAT has addressed most of the reasons except reason code No. 1, 6, 8, 9, 14, 18 and 22. Even after covering 11 reasons of the total found above, ITAT has not put light on the intentions behind transactions. Intentions being very important part, when it comes to the subjective legislation are yet not commented by the ITAT. This is after the fact that the Supreme Court has very long back clarified in (M.CT.M. Chidambaram Chettiar & Ors. vs. Commissioner Of Income Tax, 1965) that the intentions are very important. Orders of ITAT considered so far relate to cases reported till August 2012.

4.4 Findings from Interviews:

4.4.1 Interviews of MNC Officials & Tax Practitioners:

1. The official was not aware about what is the mechanism used for pricing by the AE. He said, pricings come from AE and are different for different countries; and these are followed. It is based on strategies, competition and global plans.

In most cases the price determination is found to be out of control of the tax payer. They are imposed upon them. This indicates that the assumptions that MNC’s work on perfect principles of profit center is void. Profit center in its fullest meaning is not implemented by the MNC’s.

After the decision on price, which is not known if it is at ALP; justification is prepared to fit it into ALP as per legislation. This is a very clear case of purposeful and undue tax avoidance by the tax payer. Or for that matter disregard to the tax system of the country.

Through the interview it was found that the respondent was consistently emphasizing on the global strategies and pricing being dictated by the same. The legislation is not playing any role in price determination.
2. The respondents were very open in criticizing the treatment of corporate guarantee as bank guarantee for ALP determination. The claim was that the corporate guarantee does not involve any blockage of funds. It does not carry any cost, hence when there is no cost how can any income be claimed upon the same. However upon enquiry if similar guarantee would have been given to any unrelated party for no cost, the respondents were unwilling to give any reply, but they were negative to an idea of giving corporate guarantee to unrelated parties.

It is found that the arm’s length principle is not clear with the tax payer or they do not intend to follow it in its spirit. The same is also found in the cases analyzed. In case of corporate guarantee, the AE is drawing advantage from corporate guarantee. Such advantage has to earn some reward for the tax payer. Such arguments are found to be made because of non-acceptance of the spirit of the legislature by the tax payer.

3. The respondents were very loud about the cost of compliance and baseless additions (according to them) for ALP for TP. The fact that the stakes are very high makes them fight to the end for the dispute, they are also found to be concerned about the uncertainty of tax liability. Through the study of cases and the interviews it is found that the uncertainty is created due to following:
   a. Not following of arm’s length principle by the tax payer during pricing.
   b. Justifying the same as an after exercise for tax compliance is adding to their woos.
   c. Tax authorities perceiving the non-compliance to ALP as purposeful and willfully planned act of tax avoidance by the tax payer, and hence using all possible points in the case to increase the tax liability.

4. It was very openly told that TP legislation is not considered when deciding on the transfer price. The pricing decision is based on the strategy and global requirements. Risk plays an important role in decision making, and since TP is the cheapest route of fund movement, it is looked as a very important part of
strategy. Final global PAT and risk management play the most important role in pricing decision.

The tax compliance is incidental to the pricing decision. Tax practitioners and the tax payer officials are told post pricing decision to do the compliance. The pricing process does not consider the legislation. That’s the reason the tax practitioners are not aware about the intention behind the pricing decision. They are not revealed the intention. They just do the tax compliance.

4.4.2 Interviews of tax authorities

1. It is found that the tax authorities are starting to understand the strategies of MNC’s better, day by day. They are getting knowledge about the nature and functioning of the MNC’s businesses and are using that for pointing undue tax avoidance.

2. It is found that the tax payers are not willing to accept any via media as settlement to dispute. They want full ALP as they have worked out. During interviews of the DRP officials it was revealed that, irrespective of the order for resolution of dispute, the tax payer is continuing with his appeal to higher authorities. This is a waste of time of dispute settlement mechanism, highlighting the intentions of the tax payer that, he is not interested in settling the dispute.

3. The tax authorities have annual and biannual meets wherein they discuss the criteria used for comparable selection. This is done to maintain uniformity through the country in implementation of legislation. It is found that the filter criteria are not being changed by the authorities. With experiences they have updated the same. The tax authorities have been taking all steps to collect due tax and stop undue tax avoidance.

4. In interviews of DRP member, indications were found that the tax practitioners get paid on man hour of work and hence they are interested in the dispute to linger around. The appeal in spite of appearing before the DRP is a
result of the same. The submissions made are not significant and in most cases repetitive. Indications have been found about the vested interests of the practitioners in non-settlement of disputes.

5. Tax practitioners have claimed that the authorities are relentless in making additions and they are not willing to accept any arguments. Indications are given that the tax authorities fear audit query and vigilance, and to avoid the same are doing baseless additions. When such indications were analyzed in the TPO orders studied, it was found that in some instances, justification to additions was inadequate and the same is upheld in ITAT in other cases. However it is found that such a claim against the tax authorities is found to be not valid.