

Mumbai Tribunal: Assessing Officer cannot make a reference to the TPO mechanically without applying his mind

7 December 2015



Recently, the Mumbai Bench of the Income-tax Appellate Tribunal ('the Tribunal') in the case of *DCIT v. Tata Consultancy Services Ltd.*¹ held that the Assessing Officer ('AO') cannot make a reference to the Transfer Pricing Officer ('TPO') mechanically without applying his mind to the TP report or to other material or information. A summary of the decision along with our comments has been provided below.

Decision SummaryFacts

- Under Section 92CA of the Income-tax Act, 1961 ('the Act'), the AO may, if he considers necessary or expedient so to do, refer the computation of ALP in relation to international transactions to the TPO.
- In this regard, the CBDT had issued an Instruction No. 3 dated 20 May 2003, which provided that a compulsory reference should be made to the TPO to determine the arm's length price, where the aggregate value of the international transactions exceeded Rs. 5 crores (later enhanced to 15 years).
- Based upon the above Instruction, the AO referred the case of the assessee to the TPO for determination of ALP. The TPO made adjustments to the ALP, which were incorporated in the assessment order by the AO..
- On appeal, the above additions were deleted by the Commissioner of Income-tax (Appeals) ('CIT(A)').

¹ TS-521-ITAT-2015(Mum)-TP

- Aggrieved by the order of the CIT(A), the department preferred an appeal before the Tribunal.

Issues before the Tribunal

- Whether under section 92CA of the Act, it was the duty of the AO to independently decide whether the determination of ALP by the assessee should be accepted or whether a reference to the TPO is required?
- Can a TP adjustment be made in the case of assessee which enjoys tax holiday under the Act or where the tax rate in the country of the assessee's AE is higher than that in India.

Assessee's Arguments

- Before the Tribunal, the assessee argued that under 92C or 92CA of the Act, it was the statutory duty of the AO to independently decide whether the determination of ALP by the assessee should be accepted, before referring the matter to the TPO. It was submitted that the CBDT Instruction No. 3 of 2003 dated 20.05.2003 detracts the AO and the Id. CIT from the above statutory obligation and are hence bad in law.
- The assessee also relied upon the decision of the Bombay High Court in the case of *Vodafone India Services Pvt. Ltd. v. Union of India*², where it was held that the CBDT Instruction No. 3 was not binding on the AO
- On the second issue, the assessee placed reliance on the following decisions wherein it has been held that the Revenue authorities cannot contend that the taxpayer had a motive or intention to shift profits outside India, where the income derived from international transactions is exempt from tax in India or where the tax rates in the country of the AE were higher than the tax rates in India:

² 361 ITR 531

³ ITA No. 3043/Ahd/2010

⁴ 22 ITR(T) 320 (Delhi Tribunal)

⁵ 41 SOT 1 (Mumbai Tribunal)

⁶ 309 ITR 194 (Punjab & Haryana High Court)

1. ACIT v. Motif Infotech Pvt. Ltd.³
2. Cotton Naturals (I) Pvt. Ltd. v. DCIT⁴
3. DCIT v. Indo-American Jewellery⁵

Department's Arguments

- The Department placed reliance on the following decisions supporting the action of the AO.
 1. Coca Cola India Inc v. ACIT⁶
 2. Sony India P Ltd. v. CBDT⁷
 3. Aztec Software and Technology Services Ltd. v. ACIT⁸

Tribunals' Observations

- The Tribunal accepted the assessee's reliance on the decision of the Jurisdictional Bombay High Court in the case of *Vodafone* and held that the decision in the case of *Aztec Software & Technology Services* had no application in view of the judgement in *Vodafone*. The decision of Coca Cola India which was appealed before the Supreme Court⁹ was found inapplicable since the Supreme Court directed that the authorities below should decide the matter afresh, uninfluenced by any of the observations made in the High Court judgement.
- The Tribunal held that the AO did not examine the question whether he should accept the transfer pricing report of the assessee or whether he should himself determine the arm's length price.
- Referring to the decision of the Johari Lal vs. CIT¹⁰, it was observed by the Tribunal that the approval of the CIT for the reference to the TPO on a proper application of mind relevant to the facts and circumstances is a condition precedent and a necessary safeguard for the statutory right of the assessee and this cannot be performed in a mechanical manner.

⁷ 288 ITR 52 (Delhi High Court)

⁸ 294 ITR(AT) 32 (Bangalore Tribunal) (SB)

⁹ 336 ITR 1

¹⁰ 88 ITR 439 (SC)

-
- Based upon the above observations the Tribunal held that the AO erred in not himself examining the issue of TP and with the approval of the CIT, made a reference to the TPO u/s 92CA(1) of the Act. It was further held that the AO as well as the CIT (A) failed to apply their mind to the TP report filed by the assessee, or to any other material or information or document furnished and accordingly did not discharge their necessary respective quasi-judicial functions conferred on them under section 92CA of the Act.
 - Further, the Tribunal also accepted the assessee's contention that no TP adjustment could be made in case where the taxpayer enjoyed the benefit of a tax holiday, or where the tax rate in the country of the AE was higher than the rate of tax in India and where the establishment of tax avoidance or manipulation of prices or shifting of profits out of India was not possible.

Our Comments

This decision is undoubtedly one of the most far reaching decisions in the field of transfer pricing in recent years. On the jurisdictional question, its conclusion that the AO should specifically apply his mind before making a reference to the TPO under section 92CA will have a significant bearing, not only on the assessment procedure for transfer pricing going forward, but also on all past cases where references to the TPO have been made mechanically. Since the validity of a reference made to the TPO is a jurisdictional question, it may be possible to raise this issue even in the course of pending appeals at any stage. While this decision is unlikely to be the final word on the subject, it may be useful for taxpayers to reassess the impact of this decision on their existing and past TP assessments.

Key Contacts

Dinesh Kanabar, CEO
dinesh.kanabar@dhruvaadvisors.com

Punit Shah, Partner
punit.shah@dhruvaadvisors.com

Rakesh Dharawat, Partner
rakesh.dharawat@dhruvaadvisors.com

Sandeep Bhalla, Partner (Delhi)
sandeep.bhalla@dhruvaadvisors.com

Vishal Gada, Partner (Ahmedabad)
vishal.gada@dhruvaadvisors.com

Ajay Rotti, Partner (Bengaluru)
ajay.rotti@dhruvaadvisors.com

Our offices

Mumbai

12th Floor
Discovery of India Building (Nehru Centre)
Dr. Annie Besant Road
Worli, Mumbai 400 018
Tel: +91-22-6108 1000
Fax: +91-22-6108 1001

Bengaluru

Prestige Terraces
5/1, Union Street
Infantry Road
Bangalore 560001
Tel: +91-80-4660 2500
Fax: +91-80-4660 2501

Ahmedabad

B3/3rd Floor, Safal Profitaire, Prahladnagar,
Corporate Road,
Opp. Auda Garden, Ahmedabad 380 015.
Tel: +91-79-6134 3400
Fax: +91-79-6134 3434

Delhi

1st Floor, Tower 4B
DLF Corporate Park
M G Road, Gurgaon, Haryana
Tel: + 91-124 6687000
Fax: + 91-124 6687001

About Dhruva Advisors LLP

Dhruva Advisors offers a wide range of services in the tax and regulatory space to clients in India and around the world

We are a cohesive team of tax professionals who are focused on providing our clients with high quality tax and related services. With strong research and technical skills coupled with extensive experience, we provide well-thought out and strategic solutions to complex problems

Our professionals have advised on some of the largest transactions in the world and have handled several of the largest tax controversies in India. Our professionals also have a strong track record of designing and implementing pioneering solutions in several areas of domestic and international tax

This information contained herein is in summary form and is therefore intended for general guidance only. This publication is not intended to address the circumstances of any particular individual or entity. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation. This publication is not a substitute for detailed research and opinion. Before acting on any matters contained herein, reference should be made to subject matter experts and professional judgment needs to be exercised. Dhruva Advisors LLP cannot accept any responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication.