



Reference made by the Assessing Officer to Transfer Pricing Officer set aside, as no opportunity of being heard allowed by the Assessing Officer

Background

The Delhi High Court (High Court) in the case *Indorama Synthetics (India) Ltd.*¹ (the taxpayer) held that where the taxpayer raises an objection regarding the existence of international transaction within the meaning of Section 92B of the Income-tax Act, 1961 (the Act), the Assessing Officer (AO) is bound by law to deal with such an objection on merits before making a reference to the Transfer Pricing Officer (TPO). In such case, an opportunity of being heard to be given to the taxpayer by the AO is required by law. The High Court also held that Instruction No.3 of 2016 dated 10 March 2016 (which replaced Instruction 15/2015 and specifically lays down the procedure to be followed by the AO before making reference) clarifies the correct legal position and is to be applied even in the present case where a reference was made by the AO to the TPO before the date of the said Instruction.

Facts of the case

- The taxpayer has imported raw material from Indorama Petrochem Limited (IPL), a company incorporated in Thailand. During the assessment proceedings, the AO required the taxpayer to explain why Transfer Pricing provisions should not be made applicable in respect of the said transaction.

- The taxpayer submitted that IPL was not an Associated Enterprise (AE) of the taxpayer as defined in Section 92A of the Act and both the companies are independent in terms of management and Board of Directors.
- The AO, without giving any further opportunities to the taxpayer, referred the case to TPO for determination of Arm's Length Price (ALP). Similar references were made by AO for Assessment Years (AYs) 2011-12 and 2012-13.
- The taxpayer filed three writ petitions (AYs 2010-11, 2011-12 and 2012-13) involving a common question of law regarding the procedure adopted by the AO while making a reference to TPO under Section 92CA of the Act.

Taxpayer contentions

- The AO was bound to deal with the taxpayer's objections on merits before making a reference to TPO. The AO ought to have recorded the reasons why it was 'necessary and expedient' to refer the matter to TPO and was also obliged to give the taxpayer an opportunity of being heard before recording his satisfaction or otherwise.
- Reliance was placed on the decision of the Bombay High Court in *Vodafone India Services (P) Limited*² wherein, it was held that the requirement of giving the taxpayer an opportunity for hearing prior to making a reference to TPO, is necessary where the jurisdiction of the AO to make such a reference is challenged by the taxpayer.

¹ *Indorama Synthetics (India) Ltd. v. ADIT – (Delhi High Court) – (W.P.(C) 6422/2013 & CM No.14002/2013 (Stay), W.P.(C) 4558/2014, W.P.(C) 12072/2015 – Taxsutra.com*

² *Vodafone India Services (P) Limited v. Union of India [2014] 361 ITR 531 (Bom)*

- Central Board of Direct Taxes (CBDT) Instruction No. 15 of 2015 recognised the necessity of giving the taxpayer a hearing.

Tax department's contentions

- Section 92CA (1) of the Act does not entail any requirement of a hearing being given to the taxpayer by the AO before making a reference to TPO. The principle of natural justice is satisfied as long as the taxpayer is given notice by the AO regarding the proposed reference and the objections thereto are considered by AO.
- Though the order of the AO making a reference to TPO does not record that AO considers it 'necessary or expedient' to make a reference, it must be assumed that AO had come to this conclusion.
- No prejudice would be caused to the taxpayer if TPO were to proceed with the reference made by AO as the taxpayer would be heard by TPO and if aggrieved by the report of TPO, the taxpayer would have other remedies in accordance with law.
- CBDT's Instruction No. 3 of 2016 did not envisage any hearing being given to the taxpayer. CBDT's Instruction No. 15 of 2015 (now replaced by Instruction 3 of 2016) was prospective and would not invalidate AO's order dated 31 March 2013.

High Court ruling

- In the present case, the main issue is whether it was incumbent on AO to have given the taxpayer an opportunity of being heard before making a reference to the TPO under Section 92CA (1) of the Act.
- Section 92CA contains certain jurisdictional prerequisites for the making of a reference by AO to TPO. Where the taxpayer raises a threshold objection that it has not entered into any international transaction within the meaning of Section 92B of the Act, it is imperative for AO to deal with such an objection on merits before making a reference to the TPO. Where the AO decides to make a reference, he has to record the reasons as to why he considers it necessary and expedient to make such a reference to the TPO.
- CBDT's Instruction No. 3 of 2003 categorically states that in order to make a reference to TPO, AO has to satisfy himself that the taxpayer has entered into an international transaction with its AE.

- The opportunity of being heard to the taxpayer is essential where an objection is raised on the jurisdiction of AO to make a reference to TPO. It appears to be implicit in the very nature of the procedure that is expected to be followed by AO even though Section 92CA(1) does not state a hearing to be given to the taxpayer.
- The High Court relied upon the decision of Bombay High Court in the case of Vodafone India Services (P) Limited (supra) wherein it was observed that where the objection is raised on the applicability of Chapter X of the Act, it becomes necessary for AO to consider the objection at the very threshold i.e. before determination of ALP.
- The CBDT has specifically accepted the legal position as explained by the Bombay High Court in the case of Vodafone India Services (P) Limited v. Union of India (supra) which is reflected in the Instruction No. 3 of 2016.
- Instruction No.3 of 2016 dated 10 March 2016 clarifies the correct legal position and is to be applied even in the present case where a reference was made by the AO to the TPO before the date of the Instruction No. 3 of 2016.
- The High Court set aside the references made by AO to TPO for all the three relevant AYs since the taxpayer was not afforded an opportunity of being heard as required by law.

Our comments

This ruling clarifies the importance of the principle of natural justice to be always adhered to by the Revenue. It also indicates whether implied or explicitly provided in law, the requirements of the provisions given in the Act ought to be adopted in its intent. The ruling also clarifies the position on the applicability of the Instruction no. 3 of 2016 in such situations.

One has to see the acceptability of the judgment by the revenue authorities given the fact that Instruction No. 3 of 2016 stands withdrawn as on date and replaced by the Instruction No. 4 of 2016 which does not cast numerous conditions upon the Revenue to pick-up cases for scrutiny or give opportunity of being heard as compared to the Instruction no. 3 of 2016.

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