



## The transfer pricing officer and the taxpayer are directed to avail services of a technical expert to opine on the nature of functions carried out by the taxpayer

### Background

The Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Carrier Airconditioning & Refrigeration Ltd<sup>1</sup> (the taxpayer) held that, it is essential to carry out a detailed functional analysis for determining the comparability of a transaction and that rejection of functional comparability based on broad parameters without going into the actual substance of functions performed is inappropriate. Thereby, the Tribunal restored the matter back to the Transfer Pricing Officer (TPO) directing the TPO and the taxpayer to avail services of technical experts before concluding on the functional comparability. Further, on the contention of the tax department to examine the correctness of the segmental details furnished by the taxpayer before the TPO afresh which were never disputed by the TPO, the Tribunal adjudicated that the controversy cannot be enlarged as the TPO had already accepted the segmental details and it is not a case where the entire order of the TPO is challenged.

### Facts of the case

- The taxpayer is a wholly owned subsidiary of Carrier Corporation, U.S.A. its Associated Enterprise (AE), engaged in the business of manufacturing, assembly and sale of transport, air-conditioning and commercial refrigeration equipment.
- The business of the taxpayer is classified into various divisions comprising of – segment A, dealing in refrigeration and cooling of all movable systems (transport division); segment B, dealing in industrial refrigeration systems; segment C, dealing in commercial refrigeration systems; and other segment dealing in air-conditioning products.
- For the Assessment Year (AY) 2006-07, the taxpayer had international transactions in the nature of import of raw materials/components and finished goods, export of finished goods, payment of royalty, provision of marketing support services and cost recharges with its AE.

<sup>1</sup> Carrier Airconditioning & Refrigeration Ltd. v. ACIT (I.T.A. No. 5123/Del/2010) – Taxsutra.com

- The taxpayer in its transfer pricing study determined the Arm's Length Price (ALP) of the international transactions relating to import of raw materials/components and finished goods of all divisions by applying the Transactional Net Margin Method (TNMM), considering the Operating Profit to Operating Revenue (OP/OR) ratio as the Profit Level Indicator (PLI) and in respect of the export of finished goods by applying TNMM considering Operating Profit to Operating Cost (OP/OC) ratio as the PLI.
- For transactions under the transport and refrigeration division, the taxpayer benchmarked the same with the aid of internal transactional margins (internal TNMM). The taxpayer explained that the products manufactured/assembled under segment C were made from raw materials and components procured from unrelated entities and accordingly, the profitability of segment C was considered as an internal comparable with the profitability of segment A and segment B. The taxpayer in relation to the import of raw materials and finished goods determined the PLI of segment A as a loss of 6.13 per cent and compared it to the internal comparable margin of segment C at a loss of 9.30 per cent. Further, in relation to the export of finished goods, the taxpayer determined the PLI at a loss of 4.32 per cent on cost and compared it with the internal comparable margin of segment C at 8.51 per cent and concluded it to be at arm's length.
- The TPO accepted segment B to be at ALP by observing that though there was a small difference in products, the segments were broadly comparable as both dealt with the functions of manufacturing of refrigeration systems i.e. segment B being industrial refrigeration systems and segment C being commercial refrigeration systems. Further, in respect of the air-conditioning division, the TPO accepted the ALP for all the transactions namely import of raw materials and finished goods, payment of royalty and marketing support services.
- The TPO, however, rejected the comparability of segment A with segment C. The TPO concluded that the functions performed by the transport division (segment A) cannot be compared to the functions performed by the commercial refrigeration division (segment C) and that the taxpayer itself had considered these as separate line of business vis-a-vis the transport and refrigeration divisions. The TPO concluded that there were no internal comparables available for the transport division (segment A) and hence, carried out a fresh benchmarking analysis. The TPO selected Subros Ltd as an external comparable and proposed an adjustment of INR5,13,69,711 by computing the PLI of the comparable company at 6.98 per cent.
- In this entire exercise, the TPO neither disputed the various segments being maintained by the taxpayer nor challenged the segmental results with regard to segment A, B and C as provided by the taxpayer.
- Subsequently, the Dispute Resolution Panel (DRP) upheld the adjustment made by the TPO. Aggrieved by the final order of the Assessing Officer (AO) passed pursuant to DRP directions, the taxpayer filed an appeal before the Tribunal.

## Taxpayer's contentions

### *Functional comparability of the segments*

- The taxpayer contended that internal comparable transactions were less influenced by contractual and functional differences vis-à-vis external comparable data and that internal TNMM should be accepted.
- The taxpayer further contended that no detailed functional analysis was carried out by the lower authorities and that they have not considered the detailed functional comparability of segment A with segment C. The lower authorities have rejected the taxpayer's contention merely on the broad ground that segment A deals with moving refrigeration systems which apparently was entirely different from manufacturing of commercial refrigeration systems.

### ***Dispute on de novo proceedings on segmental accounts***

- The taxpayer contended that when the TPO has accepted the results of segment B and has not disputed the segmental results, then the entire process cannot be resorted back for fresh consideration.

### **Tax department's contentions**

#### ***Functional comparability of the segments***

- The tax department asserted that the functions performed by segment A dealing with bus and truck refrigeration systems cannot be compared to segment C, which dealt in commercial refrigeration systems. In addition to the above, the tax department relied on the final order of the AO and the segmental accounts of the taxpayer to demonstrate that segment A was entirely different from segment B and C.

### ***Dispute on de novo proceedings on segmental accounts***

- Further, with regard to the matter being restored to the TPO for fresh examination, the tax department submitted that a *de novo* (fresh) exercise should be carried out, and the segmental results of the assessee should also be examined afresh.

### **Tribunal's ruling**

#### ***Functional comparability of the segments***

- The Tribunal held that the lower authorities have not carried out a detailed functional analysis to determine the comparability of the two segments and have rejected the taxpayer's claim on broad parameters without going into the actual substance of functions carried out by segment A and C. In this regard, the Tribunal has observed that the functions performed by these two segments require evaluation of the nature of technical services, and therefore, restored the matter to the TPO, directing the TPO and taxpayer to avail services of technical experts before arriving at a conclusion on functional comparability.

### ***Dispute on de novo proceedings on segmental accounts***

- The Tribunal held that the controversy cannot be enlarged by allowing the TPO to examine the correctness of the segmental accounts furnished by the taxpayer as the same was not disputed by the TPO in the first place, particularly when the TPO had accepted the segmental details and that the very premise of the proceedings cannot be altered while setting aside the matter as it is not a case where the entire order of the TPO is being challenged.

### **Our comments**

The ruling delivered by the Tribunal emphasises the significance of the functions performed with respect to any transaction for comparability analysis. The Tribunal laid down the principle that in instances where complex functions are performed, the opinion of technical experts shall be availed to form an opinion on functional comparability.

The ruling further strengthened the fact that resorting a matter for fresh examination cannot go beyond the issues that are challenged.



[www.kpmg.com/in](http://www.kpmg.com/in)

#### Ahmedabad

Commerce House V, 9th Floor,  
902 & 903, Near Vodafone House,  
Corporate Road,  
Prahlad Nagar,  
Ahmedabad – 380 051  
Tel: +91 79 4040 2200  
Fax: +91 79 4040 2244

#### Bengaluru

Maruthi Info-Tech Centre  
11-12/1, Inner Ring Road  
Koramangala, Bangalore 560 071  
Tel: +91 80 3980 6000  
Fax: +91 80 3980 6999

#### Chandigarh

SCO 22-23 (1st Floor)  
Sector 8C, Madhya Marg  
Chandigarh 160 009  
Tel: +91 172 393 5777/781  
Fax: +91 172 393 5780

#### Chennai

No.10, Mahatma Gandhi Road  
Nungambakkam  
Chennai 600 034  
Tel: +91 44 3914 5000  
Fax: +91 44 3914 5999

#### Delhi

Building No.10, 8th Floor  
DLF Cyber City, Phase II  
Gurgaon, Haryana 122 002  
Tel: +91 124 307 4000  
Fax: +91 124 254 9101

#### Hyderabad

8-2-618/2  
Reliance Humsafar, 4th Floor  
Road No.11, Banjara Hills  
Hyderabad 500 034  
Tel: +91 40 3046 5000  
Fax: +91 40 3046 5299

#### Kochi

Syama Business Center  
3rd Floor, NH By Pass Road,  
Vytila, Kochi – 682019  
Tel: +91 484 302 7000  
Fax: +91 484 302 7001

#### Kolkata

Unit No. 603 – 604,  
6th Floor, Tower – 1,  
Godrej Waterside,  
Sector – V, Salt Lake,  
Kolkata 700 091  
Tel: +91 33 44034000  
Fax: +91 33 44034199

#### Mumbai

Lodha Excelus, Apollo Mills  
N. M. Joshi Marg  
Mahalaxmi, Mumbai 400 011  
Tel: +91 22 3989 6000  
Fax: +91 22 3983 6000

#### Noida

6th Floor, Tower A  
Advant Navis Business Park  
Plot No. 07, Sector 142  
Noida Express Way  
Noida 201 305  
Tel: +91 0120 386 8000  
Fax: +91 0120 386 8999

#### Pune

703, Godrej Castlemaine  
Bund Garden  
Pune 411 001  
Tel: +91 20 3050 4000  
Fax: +91 20 3050 4010

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2016 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.

© 2016 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved.