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# Two enterprises treated as Associated Enterprises without satisfaction of the deeming fiction set out under Section 92A(2) of the Act

## Background

Recently, the Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Kaybee Private Limited[1] (the taxpayer), held that two enterprises will be treated as Associated Enterprises (AEs) if the conditions of Section 92A(1) of the Income-tax Act, 1961 (the Act) are independently satisfied irrespective of the deeming fiction set out under Section 92A(2) of the Act.

## Facts of the case

- The taxpayer was engaged in the business of running business centre by providing amenities. The taxpayer had received service charges/commission charges for making purchase of textile, yarns, etc. on behalf of Kaybee Exim Pte Limited, Singapore (Kaybee, Singapore).
- During the course of assessment proceedings, the Assessing Officer (AO) observed that the taxpayer and Kaybee, Singapore had a common director, who was also the shareholder of the taxpayer and held key position i.e. Chief Operating Officer (COO) in the management of Kaybee, Singapore.
- Based on the common directorship and participation in management of both the enterprises, the AO held that the said enterprises are AEs.
- Against the aforesaid action of the AO, the taxpayer appealed to the Commissioner of Income-tax (Appeals) [CIT(A)]. The CIT(A) confirmed the action of the AO and the taxpayer carried the matter in appeal before the Tribunal.

## Taxpayer's contentions

- The taxpayer argued that the conditions as prescribed under clause (a) to (m) of sub-section (2) of Section 92A are not satisfied. Therefore, the taxpayer and Kaybee, Singapore do not qualify as AEs as per the provision of Section 92A of the Act.
- It was contended by the taxpayer that the meaning of AE as per Section 92A(1) is subject to the fulfillment of the criteria specified in Section 92A(2). Consequently, an enterprise can qualify as an AE of the other enterprise as per the terms of Section 92A(1) only when any of the conditions prescribed under clause (a) to (m) of Section 92A(2) are satisfied.
- The taxpayer relied on Memorandum of explanation to Finance bill, 2002, wherein it has been clarified that the mere fact of participation by one enterprise in the management or control or capital of other enterprise or the participation of one or more persons in the management or control or capital of both the enterprises shall not make them AEs, unless the criteria specified in sub-section (2) are fulfilled.
- The taxpayer contended that the conditions stipulated under Section 92A(1) have to be read in conjecture with the criteria prescribed in clause (a) to (m) of Section 92A(2) of the Act.
- The taxpayer submitted that since there is no criteria prescribed in sub-section (1) to understand how one enterprise would be treated as participating directly or indirectly or through one or more intermediary in the management or control or capital of the other enterprise the criteria prescribed in sub-section (2) has to be considered.

[1] Kaybee Private Limited v. ITO (ITA No. 3749/Mum/2014) – Taxsutra.com

## Tax department's contention

The tax department contended that Section 92A(2) does not restrict the scope of Section 92A(1) of the Act but it enlarges/widens the scope of meaning of AEs and therefore, if the criteria as prescribed under sub-section (2) are satisfied, then the two enterprises which may not be the AEs as per provisions of sub-section (1) shall be deemed to be AEs as per provisions of Section 92A(2) of the Act.

## Tribunal's ruling

- The Tribunal observed that the language of Section 92A(1) of the Act is unambiguous and does not leave any scope for importing any meaning to expression 'AE'.

- While addressing the question as to whether the meaning of expression 'AE' as per Section 92A(1) is subjected to Section 92A(2), the Tribunal held that if the condition provided in clause (a) and (b) of Section 92A(1) are independently satisfied, then the two enterprises for the purpose of Section 92B to 92E of the Act will be treated as AEs.

- The Tribunal observed that Section 92A(2) of the Act sets out deeming fiction which enlarges the scope and meaning of expression 'AE' provided under Section 92A(1) of the Act and hence it can be applied only in the specific facts of the case where any of the conditions stipulated in the clauses of this section are fulfilled. The Tribunal further observed that, sub-section (1) does not begin with subjective clause i.e. subject to sub-section (2).

- As regards the taxpayer's reliance on Memorandum of explanation to Finance bill, 2002, the Tribunal observed that none of the clauses of Section 92A(2) of the Act prescribe any criteria with respect to one enterprise's participation in the management of the other which is one of the conditions prescribed under clauses (a) and (b) of Section 92A(1). Thus, the condition of participation in the management, as per clause (a) of Section 92A(1) does not get effected by the criteria prescribed under Section 92A(2) of the Act.

- The Tribunal observed that since the said companies had a common director who is a major shareholder of the taxpayer company and holds key position (COO) in the management of the other enterprise, the condition of participation in management or control or capital as prescribed under Section 92A(1) of the Ac is satisfied. Therefore, the said companies qualify as AEs as per the provisions of Section 92(A) of the Act.

## Our comments

This ruling upsets a generally followed principle that the operation of criteria laid down under Section 92A(1) of the Act is circumscribed by deeming fiction set out under Section 92A(2) of the Act.

The Tribunal held that satisfaction of the deeming fiction set out under Section 92A(2) of the Act is not mandatory to qualify two enterprise as AE as per Section 92A(1) of the Act. This stand of the Tribunal could have far reaching implications, as satisfaction of the criteria laid down under Section 92A(1) of the Act i.e. 'participation in the management, control and capital of other enterprise' is subjective and could result in conflicting interpretation. Conversely, the quantitative deeming fiction set out under Section 92A(2) of the Act reduce subjectivity and provide useful guidance in deciding whether the AE relationship exists between two entities.

While the view pronounced by the Tribunal could be subject matter of intense debate, it is pertinent to note that control on decision making by virtue of holding key management position in one enterprise and holding significant stake in another enterprise is considered to be an important factor by the Tribunal in holding both the enterprises as AE.

Generally, several common stake holders have control on decision making of two or more enterprises in their routine dealings. One can consider the impact of this ruling and build robust documentation to substantiate the independent and bona fide behavior in such scenarios to avoid protracted litigation.

Based on this decision, it appears considering the 'anti-avoidance' nature of transfer pricing provisions, the courts may be inclined to look into the 'substance' of the relationship in determining whether AE relationship exists.

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