Even though in earlier years, the taxpayer itself had accepted the department’s stand in MAP proceedings, this should not be considered as a consent of the taxpayer for the adjustment proposed by the department in earlier years

Background

Recently, the Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Turner International India Pvt. Ltd.1 (the taxpayer) held that where in an earlier year, the taxpayer itself had accepted the tax department’s stand as under the Mutual Agreement Procedure (MAP) proceedings, USA had agreed to provide a co-relative relief and the taxpayer did not press appeal in good faith, such act of taxpayer should not be considered as a consent for the proposed adjustment. A due functional and economic analysis have to be carried out every year to reflect changes in the market or changes in the nature of its intra-group transaction.

Facts of the case

- The taxpayer is engaged in the business of distribution of satellite TV channels and soliciting advertisement to be telecasted on TV channels. Taxpayer aggregated its transactions pertaining to the distribution functions (i.e. subscription fee paid, purchase of distribution and advertisement rights and commission for marketing of advertisement) and benchmarked them by comparing its operating margin with companies engaged in the distribution of retail products. The Transfer Pricing Officer (TPO) ignoring the FAR (functions performed, assets utilised and risks assumed) analysis, used service providers as comparables for the distribution segment of the taxpayer and proposed an adjustment.

- Before the Commissioner of Income-tax (Appeals) [CIT(A)], taxpayer contended that international transactions of the taxpayer under the distribution segment met the arm’s length standard. The taxpayer further contended that if comparables as selected by TPO, which are service providers, are considered, then Operating Profit/Value Added Expenses (OP/VAE) should be considered as the Profit Level Indicator (PLI) as the total operating cost of the taxpayer under the distribution segment also included the cost of purchase of distribution/advertisement rights as paid to its Associated Enterprises (AEs) while the companies selected by TPO do not have input costs in their cost base. Thus, in order to overcome the accounting difference between the taxpayer’s distribution segment and the comparable companies, OP/VAE of the taxpayer should be selected as PLI.

- The taxpayer also submitted that in Transfer Pricing (TP) documentation, it had carried out a detailed FAR analysis based on which the taxpayer was characterised as a distributor that assumed normal risk in undertaking such distribution activities.

- The CIT(A) agreed with the taxpayer’s contention for using OP/VAE as the PLI and since the OP/VAE of the taxpayer was higher than the average OP/VAE of the comparables companies considered by the TPO, TP adjustment was accordingly deleted.


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Tribunal ruling

- The Tribunal relied upon the decisions of the Delhi Tribunal in the case of Cheil Communication wherein PLI of OP/VAE was approved; and Mitsubishi Corporation India Pvt. Ltd. which upheld the use of Berry Ratio as PLI for the trading segment. It also referred to Organisation for Economic Co-operation and Development (OECD) (Para Nos. 2.100 to 2.102) and UN Guidelines (Para Nos. 6.3.7.5 and 6.3.7.6) wherein berry-ratio has been discussed.

- The Tribunal thereupon held that TP addition made was not tenable due to the difference in the functional profile of the taxpayer and companies selected by TPO. The Tribunal stated that TPO, rejecting the economic analysis of the taxpayer, had merely relied on the service companies considered as comparable by his predecessor.

- The taxpayer was characterised as a distributor that assumed normal risk in undertaking distribution activities and had identified companies engaged in the distribution of retail products as comparables since companies engaged in the distribution of channel/airtime inventory were not available in public domain. The TPO ignored the same and erred in selecting service companies as comparables for the distribution segment of the taxpayer. The TPO was also not justified in ignoring the companies presented by the taxpayer in TP documentation and the fresh search submitted during the proceedings.

- For benchmarking a distributor like a taxpayer, only distributors should be selected as comparables, and since distributors of channels were not available in public domain, distributors of broadly comparable products/services should have been selected. In the appeals pertaining to assessment years (AY) 2007-08 and 2008-09 in the case of taxpayer itself on similar issues, the Tribunal had upheld that the comparables selected by both the Revenue and the taxpayer were not appropriate, and the matter was remitted back to the Assessing Officer (AO) to undertake fresh search of comparable companies.

- In earlier years also, the taxpayer had taken distributors as comparables whereas the department used service providers as comparables. The taxpayer itself had accepted this stand during MAP proceedings. The Tribunal held that TPO failed to appreciate the fact that for the earlier years, on behalf of AEs, an application was made under Article 27 of India-USA tax treaty to settle the disputes arising from their assessments, and it was pointed out that assessments in India resulted in double taxation especially in view of TP adjustment made in the case of taxpayer. In the settlement reached between CAs of India and USA, USA agreed to provide co-relative relief in the assessments of AEs for the TP adjustment made in the hands of the taxpayer to avoid double taxation.

- The Tribunal thus held that such act of taxpayer’s should not be considered as the consent of the taxpayer about the adjustment proposed by the department in earlier years as the taxpayer, in good faith had not pressed for any appeal. A due functional and economic analysis have to be carried out every year to reflect changes in the market or changes in the nature of its intra-group transaction.

- In view of above submissions and the findings of the Tribunal in the appeal for the AY 2007-08 and 2008-09 in the case of a taxpayer on an identical issue, the Tribunal set aside the matter to the file of the AO to decide the issue afresh after undertaking a fresh search of comparable companies.

Our comments

The above ruling emphasises that taxpayer’s acceptance of the department’s stand during the MAP proceedings for any year cannot be taken as acceptance or consent to approach adopted by the revenue authorities in the domestic litigation proceedings.

It would also provide guidance where the revenue department tries to apply principles applied in taxpayer’s MAP proceeding without paying heed to the fact that MAP is merely accepted by a taxpayer so as to avoid double taxation as in domestic litigation proceedings, the taxpayer does not get any relief from double taxation.

Further, the ruling also underlines that in the absence of companies having similar product profile in the public domain, broadly comparable companies can be considered.
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.

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