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TRANSFER PRICING DISPUTES TRENDS

Report 2015

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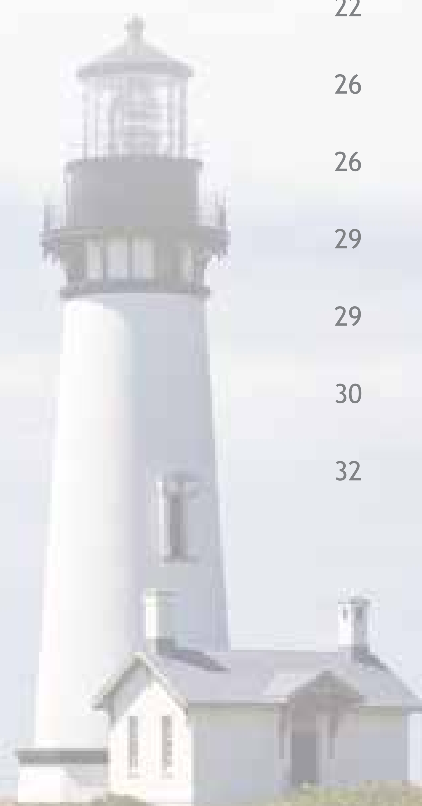


Foreword

The Indian tax system of transfer pricing can be traced from section 42(2) of the erstwhile Indian Income tax Act, 1922, which enable the revenue to attribute reasonable profits upon a resident if he transacts with a non-resident or ordinarily resident and have close connections. This was transformed to section 92 in the present Income-tax Act, 1961 and went under a sea change in 2002 wherein, section 92 was substituted by sections 92 to 92F.

Prior to 2002, there were hardly transfer pricing disputes in the country. In 1991, when the gates for globalization opened which resulted in expansion of business cross-border, there was immediate need to check if profits in India are being off loaded to foreign countries. This led the benchmark for evasive Indian transfer pricing regime.

Since 2002, there has been a steep escalation in transfer pricing disputes in the country, the 'Taxsutra's TP Trends Report', is a perfect compendium which encompasses this escalation. The Chapter under which Transfer Pricing provisions were introduced was with the intent to ensure that there is no avoidance of tax. On the contrary, the 'TP Trends Report' reveals that the intent of the Revenue has been allocation of revenue targets rather than a tool to minimize tax avoidance.

The statistics reflected here shows the manner in which escalation, rather, the massive speed with which Transfer Pricing disputes have increased in last five years and the consequent increase in the amount of tax adjustments. The 'TP Trends Report' succinctly shows the evolution of Transfer Pricing adjustments in the Indian Tax system. The reason being non-alignment of Indian Transfer Pricing provisions with that of the global standards. India has seen the largest Transfer Pricing litigations across the world and without exaggeration one can say that India also has maximum Transfer Pricing disputes compared to world. This 'TP Trends Report' just proves it.

The four corners of this 'TP Trends Report' are as follows: Transfer Pricing adjustments; Transfer Pricing litigation; sectors and location of Transfer Pricing adjustments; and most litigated adjustments. The 'TP Trends Report' finally sums up predicting the future of Transfer Pricing disputes in the Country in realm of fresh legislative measures.

The first corner gives a complete analysis of the nature of adjustments that have been happening in the last decade and the manner in which they have been dealt by the authorities and the Government. The second corner demonstrates how our Courts and Tribunals have reacted to Transfer Pricing disputes and revealing statistics. The third corner gives industry specific issues on the nature of adjustment being undertaken. The fourth corner is the most interesting, as to how the assessees have fought the economic battle of methods and margins across the country. After the end of every chapter views of tax professional, such as Deloitte, put on display the serious efforts taken to ensure that the this 'TP Trends Report' is not only statistical analysis but also experts analysis on the subject.

The 'TP Trends Report' ends with an excellent summary of the legislations and methods being introduced by the Government to be better equipped to tackle Transfer Pricing disputes which will help the industry in planning and strategizing.

The 'Taxsutra's TP Trends Report' is a welcome addition to the library of every practitioner & MNCs. It will also be an eye-opener to the Government in crafting their legislative policies and ensuring a tax friendly regime.

ARVIND P. DATAR
October 14, 2015

List of Abbreviations/Acronyms

Abbreviation / Acronym	Expansion
ADR	Alternate Dispute Resolution
AE	Associated Enterprise
ALP	Arm's Length Price
AMP	Advertisement, Marketing and Promotion
AO	Assessing Officer
APA	Advance Pricing Arrangement
BEPS	Base Erosion and Profit Shifting
BPO	Business Process Outsourcing
CBDT	Central Board of Direct Taxes
CIT	Commissioner of Income Tax
CIT (A)	Commissioner of Income Tax (Appeals)
CRISIL	Credit Rating Information Services of India Limited
CUP	Comparable Uncontrolled Price
DC	Development Centre
DRP	Dispute Resolution Panel
DIT	Director of Income Tax
FAR	Functions, Assets, Risks
FY	Financial Year
GIC	Global In-house Centre
HC	High Court
IT	Information Technology
ITA	Income Tax Appeal
Tribunal	Income Tax Appellate Tribunal
ITeS	Information Technology enabled Services
KPO	Knowledge Process Outsourcing
MAM	Most Appropriate Method
MAP	Mutual Agreement Procedure

List of Abbreviations/Acronyms

Abbreviation / Acronym	Expansion
MNC	Multi-National Corporations
OECD	Organisation for Economic Co-operation and Development
OEM	Original Equipment Manufacturer
Pharma	Pharmaceuticals
PLI	Profit Level Indicator
PLR	Prime Lending Rate
SC	Supreme Court
TARC	Tax Administration and Reforms Commission
The Act	The Income-Tax Act, 1961
The Rules	The Income-Tax Rules, 1962
TNMM	Transactional Net Margin Method
TP	Transfer Pricing
TPO	Transfer Pricing Officer
USA	The United States of America

1.0 Introduction

Transfer Pricing Disputes Trends Report 2015

The era of globalization, that we live in and on whose journey the world embarked a couple of decades ago, albeit with a bit of trepidation, is almost irreversible. A natural fallout of the same has been businesses going global, trying to expand their footprint in developing countries with a big population/market and propensity for consumption. But well, what might seem simple economics can at times lead to a complex tax scenario/outcome. The world knows this by the name of 'Transfer Pricing', which seeks to ensure that the transactions between related parties, or holding & subsidiary company are at 'arm's length.' The objective is to dissuade "mis-pricing", which allows corporates to pay higher taxes in a low tax jurisdiction and vice-versa.

India, which in 2001 became only the third developing country to introduce a Transfer Pricing legislation, did so after an Expert Committee set up for this purpose, recommended introduction of TP regime in income tax law, mainly with the aim to prevent shifting of profits from India to other jurisdictions. But while the initial roll out did not create a disruption for taxpayers, as the tax officers slowly got a grasp of the new law and started unraveling some of the mysteries surrounding it as well as experimenting with it, the direct consequence was the taxpayers feeling the heat and how! Transfer Pricing adjustments at first increased progressively and then in geometric proportions; at one point doubling every year and reaching a peak of Rs. 70,000 crores (FY 13), until an outcry from foreign investors restored some semblance.

The figure currently stands at a still high figure of Rs. 46,000 crores in 50% of the 2,300 odd cases selected for scrutiny. Given the huge monetary stakes involved, India's policy makers have actively kept TP on their radar, and are constantly taking clues from the latest developments internationally, so as to imbibe some of the best practices.

There is still a fair distance to be traveled on this front though and which is precisely the reason why we, at Taxsutra & Deloitte, thought it apt to bring out our inaugural 'Transfer Pricing Disputes Trends Report 2015.'

The report aims to provide a well researched analysis on how the TP litigation landscape in India has shaped up during FY 2014-15, specifically highlighting the below mentioned points:

- Statistics on TP rulings and respective success rates of taxpayers & revenue authorities at Tribunal, HC & SC; *
- Sectoral dispersion of TP litigation & locational trends in TP disputes; and
- Experiences with Alternate Dispute Resolution mechanism.

Deloitte's expert take on the statistical trends, coupled with incisive comments from senior corporate tax directors, makes this TP Trends Report an insightful as well as a revealing read for transfer pricing professionals. The appendix to this report also provides summary of jurisprudence on emerging & critical issues impacting the TP regime in India.

* The statistical analysis contained in this 'Transfer Pricing Disputes Trends Report 2015' has been carried out by Taxsutra's editorial team based on rulings reported on its portal, www.tp.taxsutra.com

2.0 Executive Summary

FY 2014-15 - Indian TP related statistics

50% TP adjustments made out of the cases selected for TP audit

22% 22% reduction in quantum of TP adjustments in FY 2014-15 (in the audit cycle completed on January 31, 2015) vis-a-vis the earlier year

500+ 4 SC rulings, 41 HC rulings & 486 Tribunal rulings

69% rulings (from Tribunal, HCs and SC) in favour of taxpayers

45% cases relate to IT & ITeS sector

38% cases involve dispute on selection of appropriate comparable entities

69% Tribunal rulings are from 3 locations viz., Delhi (124 cases), followed by Mumbai (92 cases) and Bangalore (78 cases)

In the last decade, there have been significant TP disputes in India which had made headlines in India as well as globally. In summary, over 24,000 cases were scrutinized by the TPOs with almost 45% of the cases scrutinized having faced adjustments. The total value of these adjustments is estimated to be about INR 2700 billion.

Whilst this trend of TP litigation in India may not be totally different from many other parts of the world, the concern is the inordinately delayed litigation resolution process that results in continued uncertainty until a binding decision is rendered at the highest level i.e., the Supreme Court. This is also accentuated by the sheer volume of companies that are audited, that too annually. Further, TPOs continue to make adjustments for each of the subsequent years leading to multiplicity of cases for the taxpayers suffering year-on-year adjustments and a huge backlog in the Tribunal and Courts. This has resulted in taxpayers carrying a large burden of uncertain tax positions and the Revenue unable to fully collect the tax, it believes are due, from the taxpayer.

Majority of the TP litigation to-date has largely been due to the non-alignment of Indian TP rules with global standards on two fronts - the use of arithmetic mean and single year data. While the legislative amendments in the Finance Act, 2014 paved way for these two concepts, the final Rules are eagerly awaited. It is everyone's earnest hope that if these rules are principally aligned with and are also implemented based on the globally accepted best practices, the number of TP disputes in India should decrease manifold.

2.0 Executive Summary

The Government did introduce certain measures in the past viz., DRP and Safe Harbour, to reduce the litigation, but these measures resulted in very little success. The credibility of the tax administration of a country depends on its dispute resolution mechanism. Currently, all TP disputes are routinely carried from DRP or CIT(A) to the Tribunals and thereafter to the Courts. This has resulted in unprecedented increase in litigation at the Tribunal level and delay in administration of justice. On the positive side, Tribunals and HCs in FY 2014-15 had disposed over 500 cases. The average time of 2.5 years, taken by the Tribunals for disposing the cases is reasonable, but given the current circumstances, unless the number of dedicated TP benches is increased, the average disposal period may increase due to the huge backlog.

The high success rate for taxpayers at the Tribunal level and HC of 69% and 86% respectively, is an affirmation of the independence, efficiency and fairness of the Indian judicial system which should shore up the confidence of investors. Having said that, two areas which need immediate consideration are uniformity in the judgment of different benches of the Tribunals and appeal by the Revenue to higher courts should be preferred only on substantive matters of law and not as a matter of routine.

The sector-wise dispersion and location-wise trends are clearly dominated by the IT/ITeS sector which comes as no surprise, considering that a vast number of companies from this sector are repeatedly facing adjustments year after year. The Tribunal decisions in almost all the cases, cover comparability related issues, specifically around filters applied and quantitative/qualitative analysis of comparables. Given that most issues around comparability are now under the realm of covered issues, the Tribunals have disposed of a large number of IT/ITeS cases.

In FY 2014-15, the Tribunals and Courts also pronounced some landmark decisions covering issues such as valuation of shares, marketing intangibles, location savings and financial transactions. The observations made and the inferences drawn from international jurisprudence in these judgments provide assuring testimony that the Indian TP has evolved considerably.

An important measure on the part of the Government towards ensuring certainty for taxpayers was the introduction of APA, which signals a paradigm shift in India's tax policy initiatives.14 APAs including 2 bilateral with Japan and UK, have already been concluded. While there are certain provisions in the Rollback rules which need reconsideration by the CBDT, by and large the entire APA program has got a big thumbs-up from the MNC community. The success of the APA regime will to a large extent hinge on whether the Government can quickly augment the bandwidth of the APA team to expeditiously deal with 575 plus cases. Further, strengthening of the India-US bilateral corridor has resulted in conclusion of over 35 MAP cases, recently.

The BEPS project, which recently reached finality, is expected to bring clarity, coherence and consistency in the global tax environment. Implementing the project will have its own set of challenges in India. The transparency required in capturing country by country reporting data and the mechanism of information exchange, may lead to more disputes.

Needless to add, that the Indian transfer pricing landscape has evolved and will continue to evolve rapidly with many of the basic or fundamental issues no longer occupying centre stage. However, transfer pricing disputes will continue to increase in number and complexity, as the Indian revenue authorities will be under tremendous pressure for increased tax collection and would consequently conduct stricter audits. The disputes not only lead to uncertainty for taxpayers but also require significant time and resources of taxpayers and the Revenue authorities. The onus is therefore on both the taxpayer as well as the Revenue authorities to improve the situation.

Taxpayers should have comprehensive transfer pricing documentation clearly capturing the value chain analysis and the functional and risk profile of the taxpayer. Another ask from the Revenue authorities to the taxpayer is around maintenance of robust and necessary supporting documentation to substantiate the intra-group transactions.

2.0 Executive Summary

From the Government's part, there is an immediate need for issuance of standard positions to revenue officers and taxpayers on various contentious issues (i.e. marketing intangibles, intra-group fees, corporate guarantees, royalties, etc.) Further, alignment of Safe Harbour margins to pragmatic levels, increase in the threshold to maintain TP documentation and audits, convergence of TP with customs laws, and lastly, augmenting the manpower at APA office will go a long way in reducing the litigation and consequently providing certainty to the taxpayers.

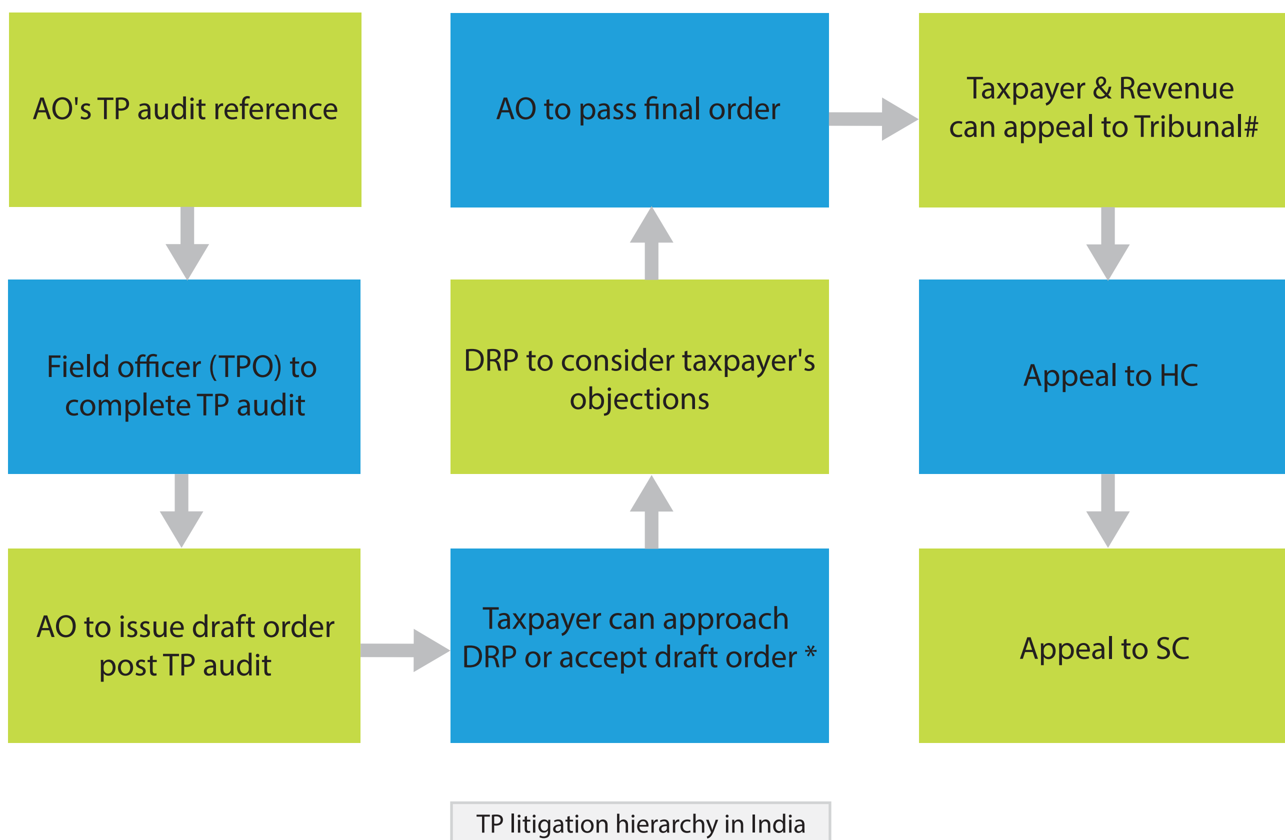
"Transfer pricing both as legislation and practice has evolved significantly since its introduction in 2001. With the jurisprudence currently available and experiences drawn, it is time for the tax administration to have a comprehensive relook at the implementation of this important piece of legislation, bearing in mind of its potential in impacting the much needed foreign direct investment. As the statistics suggest, it is time to move on from the needless litigation around routine issues, which are almost settled at the tribunal level.

With the final BEPS action plans/recommendations from OECD in place now, it is also time for Indian government to adopt these guidelines based on their relevance to our economy and having a fair taxation system/practices. It is also important to provide a conducive framework for quick resolution of disputes. Of course, it goes without saying that the MNCs on their part also have to revisit their transfer pricing policies and documentation, and make necessary changes, if required."

- Vishweshwar Mudigonda,
Partner & National Head - Transfer Pricing Deloitte Haskins & Sells LLP

3.0 TP Litigation - Backdrop

The litigation cycle in India is protracted in general, thanks to the prevalent rules around long drawn tax scrutiny andv hierarchical appellate system for dispute resolution. A snapshot of the TP audit and appellate system in India is explained below:



TP litigation hierarchy in India

**Where the taxpayer accepts the draft order, it also has an option to file an appeal before the CIT(A), instead of approaching the DRP. The Act provides a time limit (non-mandatory) of one year for the disposal of appeals before the CIT(A). However, in practice, it has been observed that an appeal before the CIT(A) takes approximately two to three years for disposal. The DRP, on the other hand, is legally bound to dispose of matters within a period of nine months.*

#Both, the taxpayer and revenue authorities, can file an appeal before the Tribunal against the decision of the DRP or the CIT(A).

If a case is selected for TP audit, the Act permits an extension of time limit for completing the assessment by one year (thus totalling to a period of four years from the end of the relevant FY). It is also seen that in practice, where an adjustment has been made in a particular FY, the field officers continue to replicate the same adjustment in future FYs as well, on the basis that there is no final decision on the matter from the SC (it being the highest appellate authority in India).

"A dispute arising at the assessment stage may take anytime between 12 to 20 years approximately before it attains finality at the Supreme Court level."

Discussion paper on Dispute Resolution in Tax Matters by FICCI released in March 2013

While the Act does prescribe a mandatory time limit for completion of TP audits (after being through the DRPs appeal route), no such time limit has been prescribed for completion of appellate proceedings before the CIT(A) or subsequent appellate proceedings [i.e. post DRP or CIT(A)] before the Tribunal, HC and the SC. Accordingly, taxpayers are generally faced with long drawn litigation once an adjustment has been made in any FY (given that most litigation matters in India find their way upto the SC).

"In the direct tax area, ordinarily, TP examination between associated enterprises should be used as a tool to minimize tax avoidance. In India, TP measures are used for revenue generation, which comprises a completely wrong approach. This is revealed through the allocation of revenue targets to TP officers (TPOs) from TP adjustments. This is unheard of internationally."

-TARC - First Report (May 2014)

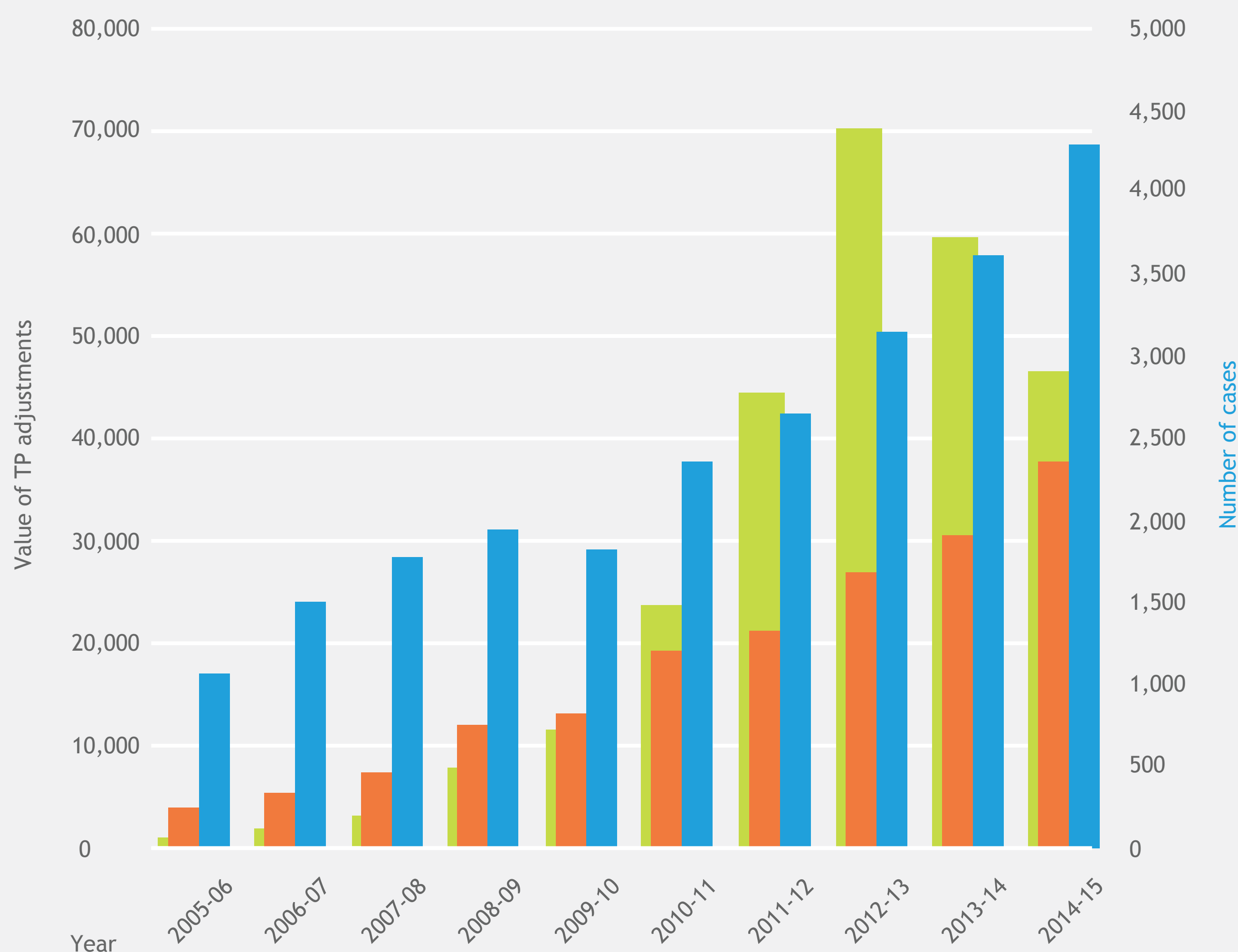
"The statistics in this report speak a lot about where our focus should be - not only on resolving these past disputes quickly but also on adopting policies and processes by the Tax Department such that these disputes arise only in appropriate cases. Alternate dispute resolutions mechanism like APA have great potential in ensuring that these disputes do not arise. We need to leverage judicial decisions that are now available, learning from past assessments and adopt risk based approach rather than mechanical approach which has reduced TP mostly into a mathematical exercise."

- Deepak Dhanak

(Executive Vice President - Finance, Head of Tax - India & Asia, Star TV)

3.1 TP adjustments - last 10 years

India has more number of TP rulings (over 1,800 reported TP rulings as on date) than most other countries in the world where TP law has been in existence for several decades prior to introduction of this law in India in 2001. The TP litigation, which has occurred in last decade consistently shows an upward trend, as evident from the chart below -



Amt. of Adjustments (in cr.)	1,220	2,287	3,432	7,754	10,908	24,111	44,532	70,016	59,602	46,466
No. of TP audits completed	1,061	1,501	1,768	1,945	1,830	2,368	2,638	3,171	3,617	4,290
No. of adj.cases	239	337	471	754	813	1,207	1,343	1,686	1,920	2,353

● Amt. of Adjustments (in cr.) ● No. of TP audits completed ● No. of adj.cases

Note: The values in orange colour above represent the number of cases where TP adjustments have been made.

Source: Statistics appearing in Annual Reports 2013-14 and 2014-15 published by Ministry of Finance

3.1 TP adjustments - last 10 years (contd...)

"Overarching revenue collection targets set out for tax officials and jurisdictional commissioners inherently conflict with taxpayers' expectations of fair interpretation of prevailing legislation and due regard being accorded to judicial wisdom enshrined in tax jurisprudence; at times, power-driven motives are behind multiple frivolous tax demands that drag taxpayers into forced disputes with revenue authorities in India."

TARC – First Report (May 2014)

It is pertinent to note that the number of TP audits have almost doubled in the last five years. In each of these FYs, **the revenue authorities have made TP adjustments in more than 50% of the selected cases.**

It is also interesting to observe that the quantum of TP adjustments during FY 2011-12 exceeded Rs. 44,000 crores, which is a whopping 85% increase when compared with the earlier FY (i.e. FY 2010-11).

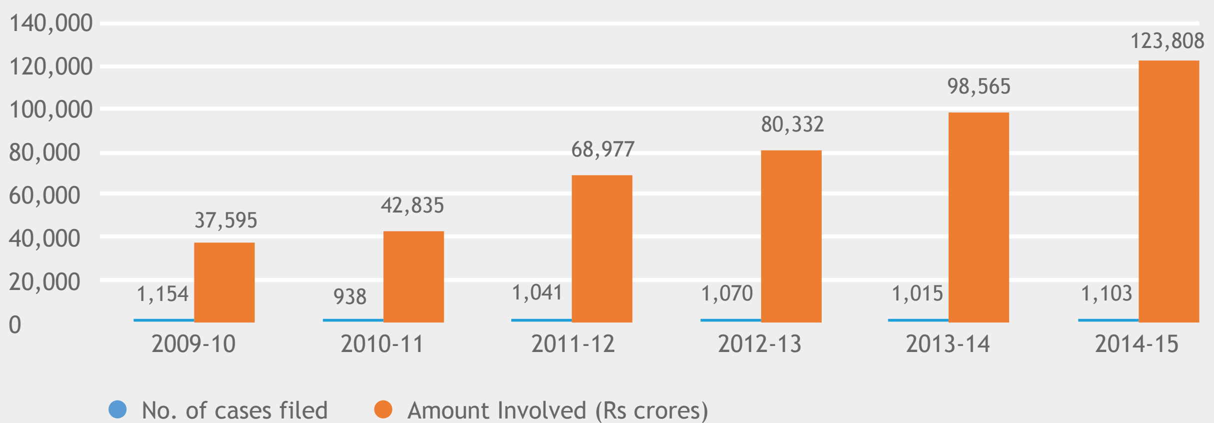
The next FY (i.e. FY 2012-13) witnessed massive adjustments to the tune of Rs. 70,000 crores, and this is the highest in any year to date. One of the primary reasons for the huge surge in TP adjustments in FY 2012-13 is the TP dispute relating to valuation of shares.

However, FY 2014-15 has seen a reverse trend. **In fact, there has been a reduction of 22% in the quantum of adjustments when compared with FY 2013-14.**

3.2 DRP – a mixed bag

In 2009, the Indian Government introduced a new dispute resolution mechanism, the DRP, with the aim of expeditiously resolving TP disputes. The key benefit of the DRP mechanism is the time bound conclusion of proceedings (i.e. within 9 months) that it offers, coupled with abeyance of the corresponding tax demand until the final order is passed by the AO. The chart below captures the number of cases filed and quantum involved in DRP proceedings since its inception-

(DRP statistics shown below include TP and corporate tax issues of Indian companies & foreign company cases).



Data for FY 2014-15 is upto December 31, 2014.

Source: Statistics appearing in Annual Report 2014-15 published by Ministry of Finance

The above statistics indicate that the number of cases before DRP has remained more or less static since inception, though the number of TP audits resulting in adjustments has increased significantly in the same period.

For example, in FY 2013-14, TP adjustments were made in over 1,900 cases (See Para 3.1), whereas only about 1,000 cases were dealt with by the DRP in FY 2014-15.

In the initial years, it has been experienced that DRP largely confirmed the orders of the TPO. The primary reason for such a trend was due to the fact that the revenue authorities could not appeal against an adverse DRP order. However, the Act was amended in 2012 to allow revenue authorities to file appeals before the Tribunal against DRP's directions. Nonetheless, even after this change in the law, taxpayers have had very limited success at the DRP level.

Hence, on observing the trends in DRP proceedings, one can fairly conclude that it has fallen short of its object of providing a successful mechanism of settling the TP disputes at the shortest possible time. Although it has provided relief in a number of cases, from a perception standpoint, most taxpayers still continue to view it as a 'fast-track' route to appeal before the Tribunal, as also the obvious added benefit of deferring payment of tax demand till the final order is passed by the AO.

3.2 DRP – a mixed bag (contd...)

"While the DRP was instituted to provide an alternate, yet fair, fast track dispute resolution forum to taxpayers, the implementation of the DRP as an institution has been far from satisfactory. The functioning of the DRP has come under intense criticism even by judicial authorities.

Practically, it has been observed that the DRP rarely affirms a position different from the one proposed by the AO. Statutorily too, the powers of the DRP is constrained vis-à-vis the powers of the first appellate forum, i.e. CIT (Appeals) - the DRP does not have the power to annul or set aside the draft assessment, nor can it work out a compromise or arbitrate in a dispute.

The credibility of the DRP as an effective ADR forum received a major setback when a provision was introduced by the Finance Act, 2012, which enabled the Commissioner to challenge the DRP's directions. This, in a way, meant that the department was challenging its own order."

TARC - First Report (May 2014)

Another area of debate in the DRP mechanism related to constitution of the DRP Panel. It comprised of CIT(s) / DIT(s), who were earlier part of TP audits (albeit in different jurisdictions). Based on the recommendations of the TARC, from the current year, the Government has appointed dedicated persons on the Panel who are of the rank of CITs, and not entrusted with TP audit charge.

3.3 Government's response

The Indian Government has responded with several other measures in the recent years to address the increasing volume of TP litigation. Some of these measures so introduced are as follows:

- Issuance of internal guidance notes[1] to TPOs for consistent application of Income Tax Department's views across India;
- Issuance of clarificatory circulars on critical TP issues (e.g. Circular on Research & Development Centres[2]);
- Introduction of safe-harbour guidelines;
- Introduction of range concept[3] and allowing use of multiple years data;
- Dedicated DRP charge for commissioners;
- Introduction of APA (along with rollback provisions);
- Introduction of risk based approach for manual selection of TP cases[4] instead of compulsory audit of cases selected based on criteria of threshold limit (for international transactions) of INR 150 million and above; and
- Acceptance of the Bombay HC decision in favour of the taxpayer on non-applicability of TP on issuance of shares and providing consequential instructions to the field officers.

[1]***Statistics published in Annual Report 2014-15 published by Ministry of Finance***

[2]*Circular No. 6 issued in June 2013* [3]*Final rules prescribing range and use of multiple year data are yet to be notified.* [4]*Instruction No. 6/2014 dated 2 September 2014, issued by CBDT*

Deloitte Debrief

Not surprisingly, India tops the chart in so far as TP litigation across the globe is concerned, and this does not augur too well for the Indian Government, which is seriously looking at restoring the confidence of foreign investors and wooing them to invest in India. Statistics reflect that the number of cases scrutinized had increased from 1,061 in the first round of audit in FY 2005-06 to 4,290 in FY 2014-15 (See Para 3.1). Given that there are approximately 50-60 TPOs pan-India, it implies that every officer audits more than 70 cases. This has impacted the quality of assessment orders adversely, which has also been acknowledged by TARC in its report. The primary reason for large number of cases being audited is the low threshold of INR 150 million (aggregate value of international transactions). With the introduction of risk based scrutiny assessment, one will have to wait and see whether the number of cases picked up for scrutiny will significantly reduce or not.

Majority of the TP litigation to-date has been due to the non-alignment of Indian TP rules with global standards on two fronts – the use of arithmetic mean instead of range and use of single year data for benchmarking instead of multiple years data. In the 2014 Budget, the Indian Government has taken a positive step on this front to introduce the range concept and multiple-year data. Draft rules have already been issued for public comments. However, the final rules are still awaited. If the two standards are introduced in line with globally accepted principles, it is expected that the number of TP disputes in India would substantially decrease.

When the DRP was first introduced in 2009, it was welcomed as a step in the right direction to facilitate expeditious resolution of TP related matters. However, the DRP did not achieve its objectives. Further, the amendment brought about by the Finance Act, 2012, wherein the AO was granted the power to appeal before the Tribunal against the directions of the DRP, has put serious concerns on the very objective of setting up the DRP (i.e. speedy disposal of disputes).

While the appointment of dedicated CITs on the DRP panel is a move in the right direction; a lot more still needs to be done to sharpen the DRP mechanism to achieve its stated objectives. It is interesting to note that whilst the number of cases which have been subjected to TP adjustments has steadily increased from 813 in 2009-10 to 2,353 in 2014-15 (See Para 3.1), the number of taxpayers opting for the DRP route has, in fact, decreased from 1,154 in the first year to 1,103 in 2014-15 (See Para 3.2).

With the focus of the Indian Government on ease of doing business in India, there have been a number of positive actions taken in the last few years. The position adopted by the Indian Government to not appeal further to the SC against the Bombay HC decision in case of Vodafone on the share valuation issue is particularly encouraging and should go a long way in restoring investor confidence.

Some other measures which would go a long way in boosting investor sentiments are –

- Issuance of standard positions to revenue officers and taxpayers on various contentious issues (i.e. marketing intangibles, intra-group fees, corporate guarantees, royalties, etc.);
- Reduction in Safe Harbour margins:
- Increase in threshold to maintain TP documentation;
- Convergence of TP with customs laws; and
- Increase in manpower at APA office – given the substantial number of APA applications being filed.

4. Court Litigation Trends

Forum	No. of cases FY 2014-15
Supreme Court	4
High Court	41
ITAT	486
Total	**531**

Indian Courts (including the Tribunal) have delivered over 1,800 TP rulings till date. During FY 2014-15, the number of rulings pronounced shows an increase of over 40%, when compared with the earlier FY.

The current TP litigation trend exhibits that majority of the rulings are being pronounced at the Tribunal level, which is the final fact-finding authority.

The accelerated rate at which cases are being disposed of at the Tribunal level can be primarily attributed to 'covered' issues. Broadly, such issues include choice of comparables, computation of 5% range, etc.
On the legal principles of TP, the HCs have delivered landmark decisions on some contentious issues such as marketing intangibles, issue of shares, applicability of Chapter X, relevance of functional analysis, etc. Nonetheless, the SC and HCs are yet to examine and lay down principles on many other complex TP issues, which are waiting to be conclusively addressed.

4 .1 Average disposal time before Tribunals[5]

The overall TP compliance and litigation process (i.e. from the time of filing of TP certificate to the completion of litigation) is long drawn. As per statistics available in the report of the TARC[6], almost 75% of the direct tax cases (which includes TP cases) have been disposed of by the Tribunals in a period of less than 2 years.

However, in the TP cases decided by the Tribunals during FY 2014-15, the average time taken for disposal (other than stay applications) is approx. 2.5 years, ranging from a lowest of 2 months (approx.) to a maximum of over 10 years.

Tribunals, therefore, may consider setting up more dedicated benches for TP considering the volume and complexity of the issues involved.

Average TP case disposal time before Tribunal - 2.5 years

[5] In absence of the exact date on which the appeals were filed with the Tribunal in all these cases, the period from January 1 of the year in which the respective appeal was filed with the Tribunal (determined based on ITA number) till the date of the appellate order of the Tribunal is considered as time taken for the disposal of the respective case.

[6] Table 5.3 of the Report dated May 30, 2014. The statistics relates to FY 2012-13.

4.2 Success rate in favour of taxpayers

On an overall basis, 69% of the cases across SC, HCs and the Tribunals have been adjudicated in favour of the taxpayers.

- Tribunals delivered 486 rulings, of which 57 related to stay of demand. In the balance 429 cases (dealing with substantive issues), 292 cases (69%) were in favour of taxpayers, whilst only 21 cases (i.e. less than 10%) were concluded in favour of the revenue authorities. In the balance cases, the various appellate grounds have been ruled partly in favour of the taxpayer and partly in favour of revenue authorities.
- Out of the total HC rulings, 86% verdicts were in favour of taxpayers, involving issues such as significance of FAR analysis, choice of comparables, corporate guarantee, intra group services, MAM, selection of PLI, issuance of shares, etc. Only 7% of the rulings[7] were in favour of revenue authorities and pertained to issues such as entity re-characterisation, validity of re-assessment and jurisdiction of the TPO / DRP.

"The tax administration in India is excessively dispute ridden. A large number of tax disputes are avoidable as evidenced by the low success rate of the Government."

TARC - First Report (May 2014)

TP Litigation - Double Whammy

Taxpayers' high success rate with the appellate authorities beyond the DRP / CIT(A) suggests that the Indian Government is eventually not able to collect taxes towards the demands raised post completion of TP audit.

Further, a refund granted (if any) pursuant to the court's order also creates a burden of interest liability on the Indian Government.

[7] *Mitsubishi Corporation India Pvt. Ltd. [TS-200-HC-2014(DEL)-TP]; LG Electronics Inc. [TS-234-HC-2014(ALL)-TP]; Nektar Therapeutics (I557ndia) Pvt. Ltd. [TS-243-HC-2014(AP)-TP]*

4.3 Revenue as litigator

In India, the revenue authorities themselves are a major litigator before various HCs and the SC. **During FY 2014-15, out of 41 HC decisions, 70% cases were arising out of appeals filed by the revenue authorities. Even at the Tribunal level, 53 cases (around 10% of the total rulings) were arising out of appeals filed by the revenue authorities.**

The presence of the revenue authorities as a significant litigator does not augur too well for the tax administration. As a measure to reduce litigation, the Indian Government should consider providing guidance / affirming its position on complex issues and raising the threshold for quantum of adjustments.

"It is widely acknowledged that the Government is by far the largest litigant. The National Litigation Policy (NLP), 2010, candidly acknowledges this. It states that "Government must cease to be a compulsive litigant.

The philosophy that matters should be left to the courts for ultimate decision has to be discarded. The easy approach, "Let the court decide," must be eschewed and condemned."
TARC – First Report (May 2014)

"Except for a few bright spots around the APA program, the overall experience of taxpayers about the TP regime in India has not been a happy one. And this is clearly reflected in the TP Disputes Trends Report compiled by Taxsutra & Deloitte India. Time has come for the CBDT to intervene and take some concrete measures not only to fast-track resolution of the existing disputes but also to eliminate them significantly going forward."

- Subhankar Sinha
(Senior Vice President, Head of Tax South Asia & Middle East, Siemens)

Deloitte Debrief

Currently, all TP disputes are routinely carried from DRP or CIT(A) to the Tribunal. This has resulted in unprecedented increase in litigation at the Tribunal level and delay in administration of justice. The pendency of cases on trial can be traced to inadequate infrastructure marked by inadequate number of benches / judges and the inordinate delay in filling up vacancies.

Having said that, it is heartening to note the significant increase in disposal of cases at the Tribunal level during FY 2014-15. One of the reasons for the increase in disposal is that a large number of taxpayers have been filing applications for stay of demand post the directions of the DRP. The Tribunals typically do not give an adjournment for stay granted matters, which has resulted in expeditious disposal of nearly 500 Tribunal cases.

Incidentally, what has also been observed is that Tribunals in several cases have remanded matters back to the files of the TPOs for a fresh assessment with certain directions. While statistically, this does result in disposal of the case, it also causes a round trip for the taxpayer with perpetuation of the cycle of litigation.

The average time taken of approximately 2.5 years is encouraging; but given that there are approximately 2,000 cases which have suffered adjustments in each of the last 2 financial years, it would take a minimum of 8 years for disposal of all these cases (on the presumption that there is no prior year backlog of cases which is obviously incorrect), if the Tribunals continue to dispose only 500 odd cases every year (with the current structure and methodology being followed to resolve disputes). Therefore, as a part of the judicial reforms, to tackle this issue of pendency and to ensure fast track disposal of the huge backlog of cases, there is a need to have increased number of dedicated TP benches and establishment of virtual and online dispute resolution facilities.

The high success rate of taxpayers at the Tribunal and HC levels reflects the independence, efficiency and fairness of the Indian judicial system, and this should shore up the confidence levels of the investors. However, lack of uniformity in judgements of various benches of Tribunals does come out as a matter of concern. To illustrate, judicial opinion on corporate guarantee, turnover filter, KPO v/s BPO classification debate, treatment of foreign exchange as operating or non-operating, intra-group charges, etc., is divided, and this has created confusion for both, the taxpayers and the revenue authorities.

It is further seen that the revenue authorities have, in the past, filed appeals with the Tribunals and HCs as a routine matter. CBDT has issued internal guidelines to revenue authorities for proper care to be exercised on filing of appeals. However, to address this better, the Government could consider constituting panels / committees to deliberate on the issues and positions that the revenue authorities would like to adopt, and then take a considered view as to whether to appeal further or not.

The high success rate in favour of taxpayers at the appellate levels, and also guidance from the recently concluded MAP cases with US Competent Authority emphasises on the greater need for guidance to the TPOs undertaking TP audits, so as to avoid disputes arising on mundane issues (which have been resolved by the higher appellate authorities). Such guidance could be in the form of instructions or position papers expressly analysing the issues and providing positions of the Indian Government on the same.

Reforms to settle tax disputes are long pending, and the efficiency of our current systems need an unbiased relook and overhaul. Indian policy makers need to focus on strengthening not only the ADR mechanisms, but also the judiciary, and look for ways to provide a fair and speedy disposal of pending cases.

"The report is extremely insightful. It is interesting to note that in the period under consideration, while almost half the cases in dispute relate to the IT-ITES sector, the ITAT rulings in Bangalore, arguably the hub of the industry, accounted for merely 18% of the overall rulings in the country. It is heartening to note that more than two thirds of the cases have been decided in the assessees' favour, and it is hoped that the judicial precedents help in making future assessments and reducing needless litigation.

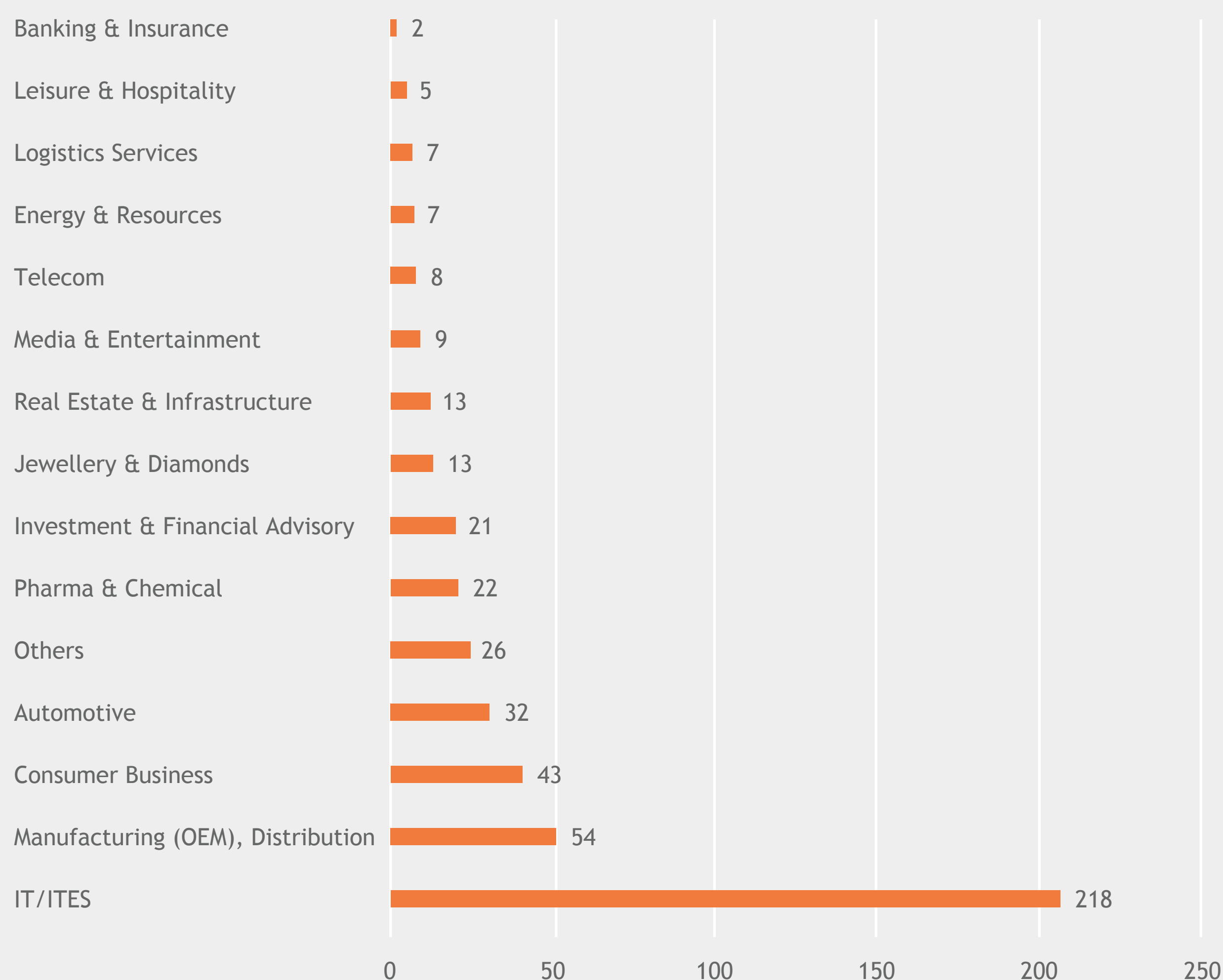
- S Gayathri

(Senior VP & Head Direct Taxation, Essar Energy Limited)

5. Sectoral and Locational Trends

5.1 Sectoral dispersion of TP disputes

MNCs operate across several industries in India, and TP issues are spread across all sectors. However, in specific, our analysis of rulings pronounced in FY 2014-15 shows a heavy concentration of cases amongst a few sectors, as evidenced in the chart below:



"Transfer pricing disputes are a major cause of concern for captive DCs [Development Centers] in India." -

- Rangachary Committee Report on "Taxation of Development Centres and the IT Sector" published in September 2012

5.1 Sectoral dispersion of TP disputes

The sectoral analysis indicates that 45% of the rulings relate to taxpayers from IT & ITeS sector. Over the years, this sector has contributed immensely to the Indian economy in terms of foreign exchange earnings and employment generation; and it was therefore, given support in the form of a tax holiday.

One of the main challenges faced by the IT/ITeS sector relates to the significantly very high margins alleged by the TPOs. A critical observation is that the Act does not extend the tax holiday benefit to the additions (if any) made consequent to a TP audit. Considering the extent of TP litigation in the IT & ITeS sector, it is not surprising that majority of the APA applications filed in India in the last three years are from the MNCs operating in this sector.

Besides IT & ITeS sector, other industries facing considerable TP litigation include OEM, distribution, automotive, pharma and chemicals. Some of the major consumer business companies have had TP adjustments on account of AMP expenses as part of distribution / licensed manufacturing arrangement.

Certain generic TP issues, viz. aggregation of closely linked transactions, selection of MAM, internal v/s external comparability analysis, royalty, notional interest, financial transactions of loan and guarantee, etc., have been common across all sectors.

45% of the cases in FY 2014-15 relate to IT & ITeS sector!

"With release of the final BEPS package to reform the international tax system and policies, I strongly hope that the Indian Transfer Pricing provisions will also adopt these reforms gradually which will help in reducing the interpretation issues and ultimately reduce litigation and disputes. I think multinational companies look forward to see the first flavor of such changes in the forthcoming Union of India Budget 2016, to the extent that the BEPS recommendations apply to developing countries like India."

-Sanjeev Agarwal
(Head of Financial Reporting & Direct Tax, BMW)

5.2 Locational trends in TP disputes

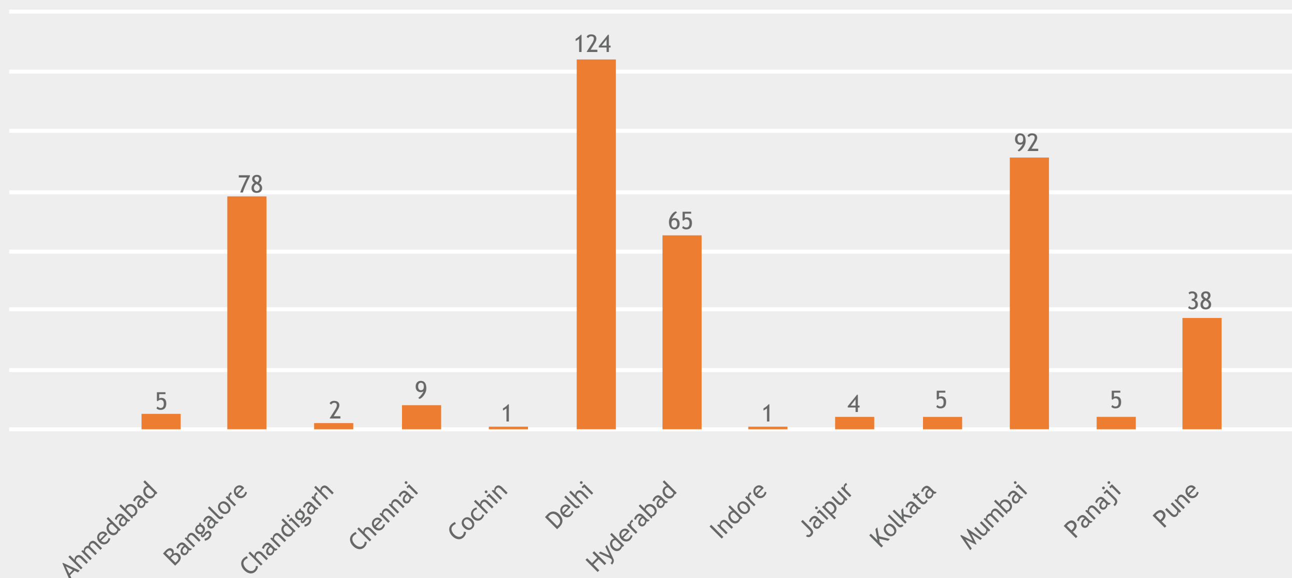
HC and Tribunal benches at Delhi and Mumbai dealt with highest number of TP cases

An analysis of the location-wise rulings delivered in FY 2014-15 shows that a large majority of the cases were decided by the Tribunals and HCs at Delhi and Mumbai. This, of course, flows out of the fact that many of the MNCs have their registered offices in the jurisdiction of courts at Delhi and Mumbai, and the highest tax collections have been reported from these locations.

Out of 429 Tribunal rulings (excluding rulings on stay matters), **69% were delivered from just 3 locations - Delhi (124 cases), Mumbai (92 cases) and Bangalore (78 cases).**

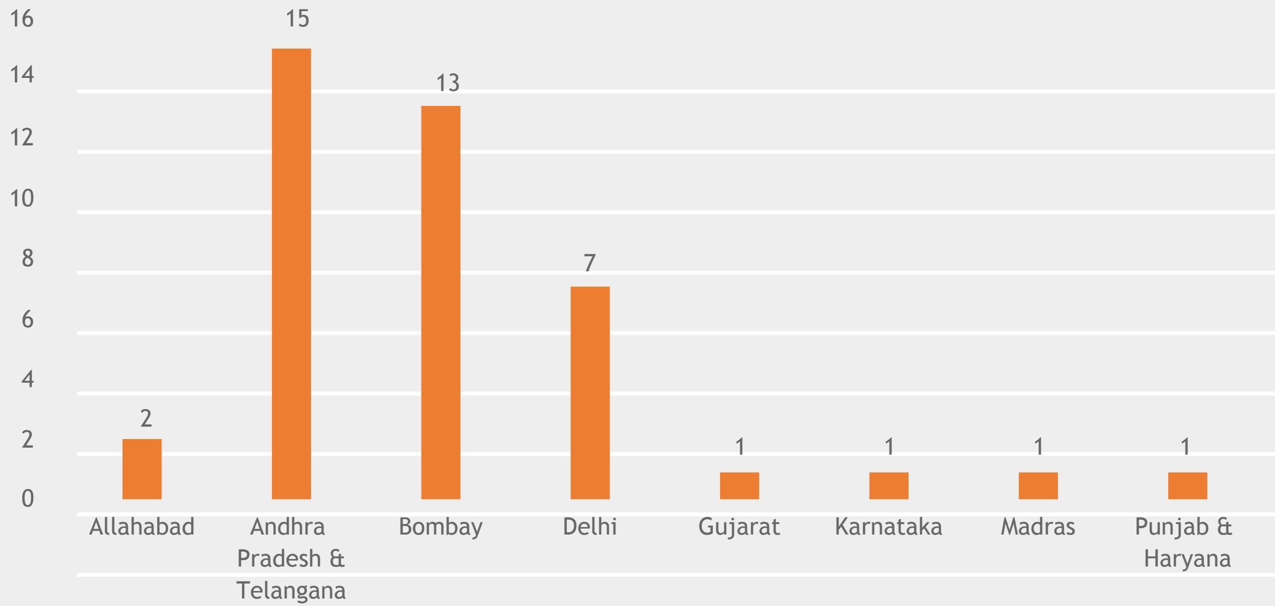
The location-wise distribution of Tribunal rulings is presented below -

Tribunal Cases - Location-wise dispersion



It is interesting to note that 65 Tribunal members (37 judicial members and 28 accountant members) delivered TP rulings during FY 2014-15.

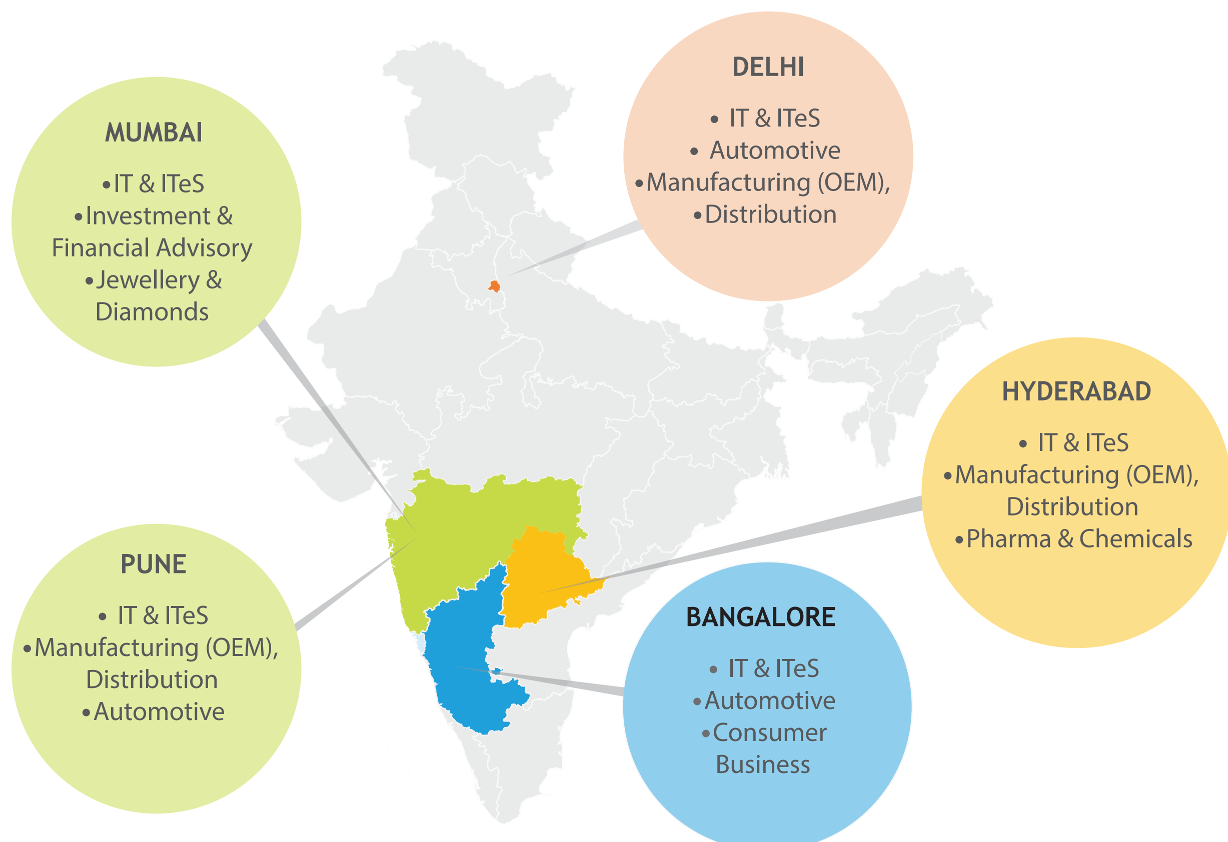
At the level of HC, out of 41 judgments, Andhra Pradesh & Telangana HC has delivered the highest number of rulings (15) followed by the Bombay HC (13 cases) and the Delhi HC (7 cases). The location-wise distribution of cases decided at HC is given on the next page.



It is interesting to note that 30 HC judges dealt with TP cases during FY 2014-15.
Further, the success rate in each of these locations is consistent with the national average - where over 60% rulings are in favour of taxpayers.

All the key locations in India have had highest litigation in the IT & ITeS sector. In cities like Delhi, Mumbai, Bangalore, Hyderabad and Pune, there is a concentration of specific industries. For example, Mumbai is considered as the financial capital of the country, whereas Pune has large automotive industries, apart from IT. Likewise, Hyderabad has many companies in the pharmaceutical & IT/ ITeS sectors.

This geographical spread of various sectors is also reflected in the TP disputes across locations as below:



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TP disputes have embroiled the sunshine IT /ITeS sector since the first round of audit. It is therefore seen that sector-wise dispersion and location-wise trends are clearly skewed towards this sector.

The contribution by the IT/ITeS sector to the GDP has increased from a nominal 1.2% in early 2000 to approximately 9.5% in FY 2015[8]. India has emerged as the most preferred destination for outsourcing services in this sector with greater volumes of cross-border transactions being undertaken between various multinational group companies. It is for this reason that the sector has gained immense importance from an economic perspective, and the significant TP disputes plaguing the sector has been a bit of a show-stopper from the perspective of growth of the Indian economy.

The Tribunals have, over the past couple of years, passed several landmark judgements in the IT /ITeS space, and these have been valuable in terms of providing guidance to taxpayers on how to deal with their industry specific TP issues. The key principles on which the Tribunals have delivered orders are covering the comparability related issues such as filters applied and quantitative / qualitative analysis of comparables. The Tribunals have not commented or expressed any opinion on the general level of mark-up that ought to be applied. However, based on certain Tribunal rulings (where principle based approach on comparability has been determined), it is observed that the resultant margins for the IT /ITeS sectors have been significantly much lower than the margins alleged by the TPOs.

Given that most comparability issues are now covered, Tribunals have disposed of a large number of IT/ITeS cases, and this fact is clearly emerging from the statistics. A favourable ruling from the Tribunal does not guarantee any certainty for the taxpayer, as in most cases involving comparability, the revenue authorities have been appealing to the HC. This has resulted in TPOs continuing to make adjustments for each of the subsequent FYs, leading to multiplicity of cases for the taxpayers suffering year-on-year adjustments and a huge backlog at the Tribunals, HCs and the SC.

While recognizing the challenges faced by the IT / ITeS industry, the Indian Government had introduced Safe Harbour provisions in 2013 - in a bid to provide certainty to small and medium sized taxpayers operating in the IT / ITeS industry and a few other sectors. However, the same was met with luke-warm response from the taxpayers right from the first year itself due to the high margins as well as the ambiguities in classification of the activities under different segments. The burden on the Tribunals, HCs and the SC, and even on the APA team can be substantially reduced if the Indian Government revamps the Safe Harbour rules (i.e. devising calibrated and more reasonable margins for the sector consistent with the margins finally arrived at post Tribunal orders / MAP / APA and providing clarifications on what constitutes software development activities, KPO, contract R&D, etc.)

APA has been the silver lining for taxpayers, and considering the aggressive positions adopted by the revenue authorities at the audits, taxpayers especially in the IT/ITeS sectors, have preferred invoking the MAP and APA routes. Additionally, with the proposed introduction of range concept and multiple-year data, one can only hope that IT/ITeS companies can look forward to a predictable and fair environment.

Litigation in other sectors like automotive manufacturing and consumer business has largely been due to a shift in the approach adopted by TPOs from the traditional 'aggregation approach', (wherein, TPOs scrutinized the overall margins earned at an enterprise level) to a more 'transaction based approach' (whereby, individual transactions are being scrutinized), and its resultant impact on the tax contribution of the entity.

In the recent past, TPOs have moved from the routine comparability issues to more sophisticated transactions like marketing intangibles, financial transactions and business restructuring. Whilst the issue of marketing intangibles has reached the HC level, the other issues are yet to be adjudicated at the HC level. Having said that, the rulings delivered on various complex issues (i.e. location savings, issuance of shares, financial transactions, etc.) clearly indicate and provide assuring testimony of the fact that the Tribunals and HCs have been more rational, and they are seeking to percolate to the depth of the matter.

[8] *http://www.ibef.org/industry/services.aspx*

Deloitte Debrief

Though many of the transfer pricing related disputes cover factual issues with the tribunals being final fact finding authority, it is interesting to note that many of these matters are being admitted by the HCs. This trend can be understood in the light of the need for appropriate jurisprudence on the issues relating to TP matters. An interesting statistical data point emerging from the location trend analysis is the significant number of disposals by both, the Hyderabad Tribunal and the Andhra Pradesh & Telangana HC. On the other hand, Mumbai and Delhi Tribunals and HCs seem to have fewer disposals relative to the large number of cases filed in these jurisdictions. Given that the revenue authorities have been filing appeals routinely in respect of a majority of the Tribunal decisions, the Indian Government may need to consider setting up special / dedicated courts if the back-log of cases is to be disposed expeditiously.

"On the basis of past TP assessments completed, ITAT/HC orders, income tax department can come out with suggested fees that can be charged for Corporate Guarantee, interest rate applicable on inter-corporate loan transaction, mark-up for common management services, clarity on AMP expenses, etc. This will save considerable time on litigation and give certainty to the issues. Further, considerable litigation is also expected at the time when audit of specified domestic transactions will start during next round of TP audits for March 2013 (will start from Feb 2016)."

- Ramesh Khaitan
(Senior Vice President - Direct Tax Head, Lupin Limited)

6. Most Litigated Issues

TP regulations in the Act are largely aligned with OECD TP guidelines but for two main differences - the first being use of arithmetic mean instead of range, and the second being use of single year data as opposed to multiple years data[9]. Significant volume of litigation in India is largely due to these two fundamental differences.

The Indian Government recently released draft rules on multiple-years data and range for public consultation. The final rules are awaited and it is hoped that this amendment will bring down TP disputes.

In FY 2014-15, the Tribunal decisions, predominantly, were related to selection of appropriate comparable companies, computation of PLI, selection of MAM and intra-group services. In over 50% of the cases[10], these four specific issues were at the fore-front. As regards the outcome, in most cases, the judgement was delivered in favour of taxpayers.

38%	Selecting appropriate comparable companies
13%	Computation of PLI
09%	Selecting most appropriate method
08%	Intra-group services and commercial expediency

6.1 Analysis of most litigated issues

Selecting appropriate comparable companies

Both the OECD and the Indian TP regulations have provided guidance with respect to comparability factors / parameters. However, 201 of 531 cases i.e. 38% of the total rulings dealt with this single issue, i.e. selecting appropriate comparable companies.

It has been observed that general issues relating to comparability include the following:

- Functional similarity
- Timing and availability of comparable data
- Use of secret comparables / cherry picking
- Applicability of suitable filters for identifying comparable companies
- Acceptability of outliers

[9] Finance Act 2014 introduced the concept of multiple year data and range, and draft rules were issued for public comments. The final rules are yet to be notified.
[10] In many cases, a single ruling has dealt with more than one issue.

6.1 Analysis of most litigated issues (contd...)

Computation of PLI

As per the TP provisions in the Act, under TNMM, the taxpayer is required to use profitability ratio, which allows comparison of profits arising from inter-company transactions. The selection of the appropriate ratio would depend on the characterisation of the tested party and availability of data of comparables. In 70 rulings (i.e. 13%), the issue of PLI computation has been considered by the Courts.

Selecting the MAM

Selecting the MAM has been another area of dispute between the revenue authorities and taxpayers. Rule 10B of the Rules prescribes the situations under which each of the prescribed methods could be applied. The TP provisions in the Act cast onus on the taxpayer to demonstrate selection of MAM. Availability of reliable financial information plays a critical role in selection of the methods. In 46 rulings (i.e. 9%), the issue of selection of MAM has been analysed.

Intra-group services and commercial expediency

Determination of ALP for intra-group services (for royalty, management fees, technical fees, etc.) is often challenged in TP audits. The challenge includes substantiating whether services were actually received, benefits received by the taxpayer, basis for allocation of costs and the arm's length mark-up. The taxpayers have also faced challenges in substantiating commercial expediency in such transactions. In 42 rulings (i.e. 8%), the issue of intra-group services and commercial expediency has been dealt with by the courts.

Deloitte Debrief

In FY 2014-15, the major litigation when applying TNMM revolved around selection and rejection of comparables based on application / rejection of filters adopted by the taxpayers. Aspects like turnover filter, high profit margin, related party threshold, export to sales ratio, etc., have been subject matters of disputes which have now been adjudicated by a number of Tribunals, and in some cases, by the HC. However, whilst majority of the Tribunals have affirmed a particular view, there have been a few cases where a contrary view has also been adopted, and this has created more confusion and uncertainty for both, the taxpayers and the TPOs.

With evolved jurisprudence[11], it is more or less settled that comparables cannot be rejected solely on the ground of being a loss or abnormal profit company, unless they involve a duly justified abnormal business condition. However, with the introduction of the range concept, the issue of outliers that tend to distort the ALP is expected to be put at rest.

Significant litigation on the issue of selection of comparables demonstrates that the basic functionality has not been appreciated earlier (i.e. at the field officer level). The need of the hour, thus, is to carry out a qualitative analysis with the help of suitable ratio analysis, to arrive at the set of appropriate comparables.

Choice of appropriate PLI is typically required to be done bearing in mind the characterization of the tested party, nature of comparables selected and the quality of information available. Historically, from a PLI perspective, application of cash profit ratio or Berry ratio has been a contentious area between the taxpayers and TPOs. In FY 2014-15, the Delhi Tribunal, in a landmark ruling in the case of Mitsubishi Corporation India[12], upheld the applicability of Berry ratio as the PLI under TNMM for Japanese 'Sogo Shosha' companies. The application of cash profit ratio was examined in prior years by Tribunals, and contradictory judgements do exist on this issue.

Tribunals in India have ruled that there is no hierarchy or priority of methods prescribed under the Indian TP regulations. Disputes about selection of the most appropriate TP method have related to aspects on the functional analysis and comparability. For example, whether CUP method is the most appropriate to a particular transaction or not would depend on the reliability and availability of comparable data. Tribunals, in the past years have upheld, in several cases, the use of price-based quotes for applying the CUP method. Further, in an interesting ruling in the case of Toll Global Forwarding India Pvt. Ltd.[13], the Tribunal held that the 'other method' prescribed in Rule 10AB is not a residual method, and is on par with the rest of the methods.

As regards intra-group services, TPOs have frequently questioned the commercial wisdom of taxpayers in making payment of royalty, management fees, technical fees, etc., to their related parties. The Delhi HC, in two landmark judgements - EKL Appliances[14] and Cushman and Wakefield[15], held that the TPO cannot question the business decision of the taxpayer, and cannot determine the ALP of a transaction as 'Nil' on the basis that the assessee did not receive any benefit from the transaction. These principles have been upheld in a number of Tribunal decisions in FY 2014-15.

Whilst the decisions delivered in FY 2014-15 predominantly relate to the above four aspects, a number of landmark decisions on other complex issues were also pronounced (i.e., marketing intangibles by the Delhi HC in the case of Sony Ericsson Mobile Communication[16], share valuation by the Mumbai HC in the case of Vodafone[17], location savings by the Mumbai Tribunal in the case of Watson Pharma[18], interest on loans by the Delhi HC in the case of Cotton Naturals[19], issue of outstanding receivables by the Delhi Tribunal in the case of Kusum Healthcare[20], amongst others). These decisions clearly reflect the evolution of Indian TP jurisprudence and the fair understanding of the complex TP issues by the Indian courts, which should go a long way in reposing confidence of the taxpayers in the Indian judiciary.

[11]Chryscapital Investment Advisors (India) Pvt. Ltd. (TS-173-HC-2015(DEL)-TP) [12]TS-458-ITAT-2014(DEL)-TP
[13]TS-383-ITAT-2014(DEL)-TP [14]TS-206-HC-2012(DEL)-TP [15] TS-150-HC-2014(DEL)-TP [16] TS-96-HC-2015(DEL)-TP
[17] TS-308-HC-2014(BOM)-TP [18] TS-3-ITAT-2015(Mum)-TP [19]TS-117-HC-2015(DEL)-TP [20] TS-129-ITAT-2015(DEL)-TP

7. Way Forward - Alternate Dispute Resolution

The analysis of litigation trends clearly suggests that the appellate route for TP litigation is time-consuming, and also poses uncertainty on the eventual outcome. To manage the TP litigation risk, taxpayers have an option of using Alternative Dispute Resolution mechanisms such as APA, MAP and Safe Harbour.

Safe Harbour has not had many takers due to the high margins prescribed and the ambiguity in definitions of some critical terms. In that sense, APA and MAP are the only silver lining, and they have been discussed below.

7.1 Advance Pricing Agreement

APA – 9 years certainty

The APA scheme was introduced in India three years ago in 2012. However, the rollback rules were introduced only in March 2015. This has now increased the total number of APA years to nine – five future years and four prior years. Thus, APA effectively provides nine years of certainty.

Upto September 2015, more than 575 APA applications have been filed with the APA authorities. 14 of these APAs have been concluded, of which 12 are unilateral and 2 bilateral (with Japan and United Kingdom). This includes one roll back APA, which was signed in August 2015, within four months of introduction of APA rollback rules.

APAs concluded are in diverse sectors like telecom, oil exploration, pharma, finance / banking, software development and BPOs, covering international transactions, such as interest payments, corporate guarantees, non-binding investment advisory services, contract manufacturing, trading and IT / ITeS services. It is interesting to note that roughly over 40% of APA applications are from the IT & ITeS sector, consistent with the litigation trends that have been observed.

The relationship between the Indian and the US Competent Authorities has been cordial over the last year. On the back of this relationship, of late there have been some significant and much needed developments with the US IRS on the APA front. The US IRS started the process of pre-filing conferences in the US with the first one having been held in May 2015. Further, the Indian and US Competent Authorities recently met in September 2015.

APA – Key Differentiators

• Practically, the TP audit process between the taxpayer and the TPOs involves extreme options without any possibility of settlement. APA, on the other hand, is a win-win option for both, taxpayers and the revenue authorities (to arrive at a mutually acceptable solution through the negotiation process).

• APA site visits make a decisive difference when compared with the regular TP audit process. Here, the APA team gets a chance to have a real look at and the understanding of the activities of the taxpayer. The site visits also provide an opportunity to the taxpayers to explain the functional analysis based on the actual activities being performed by the employees of the taxpayer.

• APA is relatively much less time consuming when compared with normal TP litigation process.

• APA process requires intense readiness on the part of the taxpayer on tax, legal & economic analysis.

Certain key aspects that need to be kept in perspective while opting for an APA are that bilateral APAs and multi-lateral APAs do consume some time, leading to a strain on resources for taxpayers and revenue authorities. Further, the taxpayer may be asked to provide detailed information about transactions that is generally not otherwise required in a routine audit. Hence, confidential information may have to be submitted, in case called for.

7.2 Mutual Agreement Procedure

MAP is an effective tool for addressing disputes relating to tax treaty interpretation and TP matters. US, UK and Denmark tax treaty also provide for suspension of tax demand until such time the case is resolved under MAP. Given the aggressive positions generally adopted by the revenue authorities during audits, some taxpayers have preferred to invoke MAP under the respective tax treaties.

During the calendar year 2014, meetings for resolving MAP cases were held with several countries like the UK, Japan, Switzerland, Netherlands, China, Australia etc., with considerable progress[21].

Meetings were held with -

- Chinese authorities in July 2014: One MAP was resolved. Positions on other cases were exchanged.
- Swiss authorities at Bern in August 2014: All MAP cases were discussed.
- Dutch authorities at The Hague in August 2014: Economic analyses done by India in respect of software companies was agreed to be shared. All pending MAP cases were also discussed.
- The UK authorities at Delhi in October 2014: A number of cases were discussed. A few MAP cases were resolved.
- Japanese authorities (4 meetings): A number of cases involving TP disputes were resolved.

"A Framework Agreement was recently signed with United States under the Mutual Agreement Procedure (MAP) provision of the India-US Double Taxation Avoidance Convention (DTAC). This is a major positive development. About 200 past TP disputes between the two countries in Information Technology (Software Development) Services [ITS] and Information Technology enabled Services [ITeS] segments are expected to be resolved under this Agreement during the current year. So far, 35 disputes have been resolved and another 100 are likely to be resolved in the next three months.

The Framework Agreement with the US opens the door for signing of bilateral APA with the US. The MAP programs with other countries like Japan and UK are also progressing very well with regular meetings and resolution of past disputes. These initiatives will go a long way in providing stable tax environment to foreign investors doing business in India."

Indian Government's Press Release issued on August 6, 2015

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[21] *Annual Report by the Ministry of Finance for FY 2014-15*

Deloitte Debrief

Considering the aggressive positions adopted by the revenue authorities at the time of audit, some of the taxpayers had preferred invoking the MAP under the respective tax treaties. Though MAPs are very entity-centric, the general approach by the Competent Authorities has been to settle multiple cases within an umbrella framework because of the significant number of MAP cases pending settlement.

APA programme has received overwhelming response in India in the last few years. Much desired relief from, or altogether avoidance of TP litigation, an impending need for tax certainty, procedural ease of the APA mechanism, affordable cost, and last but not the least, faith in the APA process are some vital reasons for the APA route being actively pursued by the taxpayers. Further, the APA process appears to be efficient and is being driven by pragmatic decision-making by the APA Authorities.

However, certain provisions in the rollback rules need serious reconsideration by the Indian Government. For example - the condition that the 'same AE' should continue for the APA period as well as for the rollback period is restrictive in nature. Further, the current Rules provide that in a case where two entities merge to form a new entity (the merging entity being the APA applicant), the merged entity will not be eligible for the rollback. Also, the applicant does not have the option to pick and choose the years of rollback for the eligible period of 4 years. It is either all 4 years or none (unless some years are not eligible).

The entire effort of the Indian Government in the APA process is to find a pragmatic 'solution' to TP disputes. Therefore, keeping in perspective the 'spirit' of these provisions, the Government should be flexible and not deny APA roll back by imposing such restrictive conditions.

The key challenge which now arises with over 575 APA applications is – how the APA authorities would brace themselves to manage such large number of cases? The Finance Minister, in his Budget Speech in 2014, specifically mentioned about strengthening the administrative set up of APA to expedite disposal of APA applications. For the APA scheme to be successful, it would, therefore, be imperative for the Indian Government to ensure that the strength of the APA team is significantly enhanced. Additionally, an appropriate succession plan for officers should be put in place, so that taxpayers are not adversely impacted by any changes caused due to movement / transfers / retirement of APA officers.

Aggressive TP audits and protracted litigation have been the triggers for such large number of taxpayers opting for MAP and APA. The open–minded and non-intrusive approach adopted during the APA process has further helped in reposing confidence of the taxpayers on this mechanism. It is heartening to see that the Indian Government seems to have acknowledged the faith reposed by taxpayers, through all the measures it has been proactively taking for implementing and expediting the conclusion of APA and MAP cases.

"It should be appreciated that when tax authorities are giving a solution / certainty for 9 years, they will always have a fear that perhaps higher profit may be earned than what is agreed upon. This perception of tax authorities needs to be clearly revoked by a consistent, reasonable and transparent stand by the taxpayer throughout the entire APA process."

Mr S P Singh - Senior Director - Tax - Deloitte Haskins & Sells LLP

Appendix 1

TP Jurisprudence on Emerging Issues

The Bombay HC verdict on issuance of shares by a subsidiary company to its parent company reiterates the fundamental principle that TP provisions are not applicable to international transactions that do not give rise to any income. The judgment has resulted in tax relief of thousands of crores to several taxpayers. Notably, the Indian Government accepted the decision of the Bombay HC and did not file an appeal against the same before the SC.

Marketing intangibles is another area where the Delhi HC pronounced its decision rejecting the use of the bright-line test. The judgment lays down certain important principles to be considered on the vexed issue of AMP spend. Post this Delhi HC decision, several cases are being referred back to the revenue authorities for reconsideration so that the principles laid down by the Delhi HC can be duly applied to them.

The other emerging issues during FY 2014-15 are on location savings, BPO v/s KPO classification, funding transactions (i.e. interest and guarantee) and application of the sixth method for benchmarking.

In the following pages, Deloitte India has provided a summary of key rulings on the following TP issues-

- Issuance of shares;
- Marketing intangibles;
- Location savings;
- Application of the sixth method;
- BPO v/s KPO classification; and
- Funding transactions (interest and guarantee).

A. Issuance of shares

The Bombay HC delivered a landmark TP judgement in the case of Vodafone India Services Private Limited[22] on October 10, 2014. This decision laid to rest the controversy relating to issuance of equity shares by an Indian entity to its foreign AE.

The main questions before the Bombay HC were -

a. Whether the shortfall between the issue price of shares and alleged fair market value amounts to income?

b. Whether TP provisions apply to transactions not having any impact on taxable income?

Ruling in favour of the taxpayer, the Bombay HC held that TP regulations are applicable only to international transactions that give rise to some 'income'. Neither the capital receipt on issuance of equity shares nor the shortfall (if any) in share premium can be considered as taxable income within the ambit of the Act. Further, there is no specific provision in the Act for treating inflow of funds from shares issued to non-residents as taxable income. Hence, TP provisions do not apply to issuance of equity shares to a non-resident.

The Bombay HC rejected the contention of the revenue authorities that Chapter X is a complete code by itself and not merely a machinery provision to compute the ALP. It stated that even income arising from an international transaction with an AE must satisfy the test of 'income' under the Act and must find its home in one of the chargeable heads of tax (i.e. the charging provisions).

The Bombay HC categorically held that while interpreting a fiscal / taxing statute, the intent or purpose is irrelevant and the words of the taxing statute have to be interpreted strictly.

In connection with the subsequent secondary adjustment of notional interest income, the HC held that the reasoning of the Revenue that if the ALP were received, the Petitioner would be able to invest the same and earn income, is based on a mere surmise / assumption, which cannot be the basis of taxation.

In what is seen as a very positive move by the Government. The CBDT has issued an instruction[23] that it has accepted the decision of Bombay HC made in Vodafone IV and has directed that the ratio decidendi of the judgment must be adhered to by the field officers in all cases where this issue is involved.

Taxsutra Statistics: This issue was dealt with in 14 cases, including 7 cases by the Bombay HC.

[22] [TS-308-HC-2014(BOM)-TP]   *[23] Instruction No. 2/2015, dated 29 January 2015*

B. Marketing intangibles

The special bench of the Delhi Tribunal dealt with the issue of marketing intangibles in detail in the case of LG Electronics[24]. Herein, it was held that where AMP expenses are incurred by the licensee of a brand in excess of the AMP expenses of the comparables, the licensee (being the licensed manufacturer) should claim a reimbursement of this excess amount from the licensor of the brand (i.e. the AE), along with a mark-up, since it has allegedly provided the service of 'helping' the licensor to develop its brand. The excess of AMP expenses would be worked out using the AMP/sales ratio of the taxpayer (i.e. the licensee) and the comparables, termed as the 'Bright Line' test.

The Delhi HC, in the case of Sony Ericsson Mobile Communication India Pvt. Ltd. and others[25], has pronounced a landmark ruling relating to TP adjustment on AMP expenditure and brand building by Indian marketing and distribution companies, which are subsidiaries of the foreign companies. The Delhi HC addressed the controversies surrounding TP adjustments for AMP expenses arising out of the ruling of the Delhi Tribunal (special bench) in the case of LG Electronics.

Below are the key principles emerging from the decision:

• AMP was accepted as being a transaction with an AE, i.e., as an international transaction. The Delhi HC judgment has been challenged before the SC, and one of the grounds appealed is that the AMP transaction is not an international transaction, and therefore, it is not liable to TP.

• Brand value is created by synergetic impact of reputation, quality and other facts relevant to a particular business and not just by incurring AMP expense.

• The HC rejected the application of bright line test for determining non-routine AMP expense and TP adjustment on account of separate consideration for such alleged non routine AMP expense incurred by the taxpayers.

• When marketing and distribution functions are closely connected and reliable comparables are available, then they could be aggregated and the arm's length price can be computed together, and TNMM would be appropriate to use in such situations.

• TNMM relies on the assumption that the functions, assets and risks are broadly similar, and that once suitable adjustments have been made, net profit margins should be compared. If the profit margin of the tested party matches with that of the comparables, it affirms that the transaction meets with arm's length standard.

• TNMM would not be an appropriate method in case of significant value addition by the Indian company, i.e., where the company is engaged in manufacturing activities, and also carrying out distribution and marketing activities.

• If on comparability analysis, gross profit earned by taxpayer is in line with the comparable margins earned by comparables carrying similar AMP function as that of the taxpayer, no further TP adjustment is warranted. In such cases, the gross profit margin includes the compensation for AMP expenses.

• Economic ownership concept was recognized and the HC held that the economic ownership arises only in case of long term contracts. Further, the valuation of such economic ownership is not done regularly but is done when it is transferred to third party or the rights are terminated. TP valuation would be mandated only at that point of time.

• Where the Indian TP Regulations do not provide for a contrary provision, reliance on the OECD guidelines or the UN transfer pricing manual could be made.

Post the HC ruling, other Tribunal rulings in the case of distributors were pronounced in a number of cases. In these cases, the Tribunals remitted the matter to the TPO to decide the cases afresh in light of the HC ruling. However, the Delhi Tribunal ruling in case of Toshiba India[26] is the first substantive ruling that incorporates the HC's decision on AMP.

This Delhi HC decision has been appealed against in the SC.

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[24] TS-11-ITAT-2013(DEL)-TP *[25] TS-96-HC-2015(DEL)-TP* *[26] TS-226-ITAT-2015(DEL)-TP*

Taxsutra Statistics:

The issue of adjustment on account of AMP expenses was dealt with in 20 cases by various benches of Tribunals during FY 2014-15; with a significant majority of the cases being decided by the Delhi Tribunal.

The litigation on this issue was mainly seen in companies engaged in consumer durables, equipment manufacturing & distribution and automotive sectors.

In majority of the cases, the issue was remanded back in view of earlier year's special bench ruling in the case of LG Electronics India P. Ltd [TS-11-ITAT-2013(DEL)-TP]. The Delhi HC judgment was delivered in March 2015 and will have a significant impact on the direction of litigation in FY 2015-16.

C. Location savings

One of the most common TP adjustments various Indian taxpayers have experienced in recent TP audits is the one on account of location savings. The same is a well-deliberated and immensely discussed topic not only in India, but also in the international TP circuits. Location savings has a broader meaning, going much beyond the situation of relocating a plant from a 'high cost' location to a ''low cost'' location. It relates to any comparative cost advantage that a company may benefit from in a certain country, which would have an impact on its transfer prices.

In most such cases, the revenue authorities have gone ahead to make adjustments on the basis that the Indian enterprise ought to be compensated (over and above its routine compensation) a fair share of the so called 'cost savings' that accrues to the multinational group by relocating the activities under consideration to India (viz., say, 50% of the cost savings due to relocation of operations to a low cost jurisdiction in the value chain should be attributed to the entity operating in that low cost location – herein, it being India).

In the case of Watson Pharma[27], the revenue authorities purported that the taxpayer should additionally receive extra compensation on account of the location savings that have arisen pursuant to the AE transferring the manufacturing activity from UK and other European countries to a low cost jurisdiction (i.e., India).

The Mumbai Tribunal, placing reliance on OECD Guidance on Transfer Pricing Aspects of Intangibles (issued under Action item 8 of BEPS project lead by G20 countries), held that where operating margin earned by the taxpayer is at arm's length based on local market comparables operating in similar economic circumstances as the taxpayer; and the taxpayer as well as AEs operate in a perfectly competitive business environment, further returns on account of location savings are not warranted. The Tribunal further observed that location savings are not regarded as an intangible asset unless specific advantages are capable of being owned or controlled by an individual enterprise.

The Tribunal also observed that in case TNMM has been accepted as the most appropriate method, and the taxpayer is considered as a tested party, the advantage accruing to the AE is irrelevant, once the profit margins earned by the taxpayer are considered as being at arm's length when compared with the margins earned by comparable companies.

This ruling is in line with the Rangachary Committee report in relation to Safe Harbour rules. The ruling clearly hints towards a mature evolvement of the Indian TP position on this matter in line with international standards and the position adopted by G20 countries.

Taxsutra Statistics:

This issue has been dealt with in two cases – one by the Delhi Tribunal in the case of GAP International Sourcing (India) Pvt. Ltd. [TS-667-ITAT-2012(DEL)-TP] , and the other in the case of Watson Pharma. In both these cases, the issue was held in favour of the taxpayer.

[27] [TS-3-ITAT-2015(Mum)-TP]

D. Application of the sixth method

The Delhi Tribunal, in two of its recent decisions[28], has held that the 'Other Method' is applicable retrospectively from the date of inception of Indian TP regulations, (i.e., April 1, 2002). While doing so, the Delhi Tribunal provided purposive interpretation to the introduction of 'Other Method' under Rule 10AB of the Rules by placing reliance on the observations made by the SC in the case of Vatika Township[29]. In this case, the SC had made an important observation that following doctrine of fairness, where a law is enacted for the benefit of community without inflicting a corresponding detriment on some other person or on the public, such legislation would have a retrospective application. Accordingly, the Delhi Tribunal held that Rule 10AB was introduced to confer the benefit of an additional method of determining the ALP, and hence, it ought to have retrospective application. It is interesting to note that the Delhi Tribunal upheld the retrospective application of 'Other method' even after considering the fact that Rule 10AB of the Rules was introduced specifically from April 1, 2012.

It recognized that the fundamental objective of TP is to ensure that intra group transactions are not artificially priced to deprive a tax jurisdiction of its due share of taxes. The Delhi Tribunal held that procedural issues (such as limitation of prescribed methods before the introduction of Rule 10AB of the Rules) cannot impede determination of ALP. Therefore, as long as there is an economic justification for the pricing, procedural law amended to afford convenience of 'Other Method' could be relaxed and applied retrospectively, if it does not adversely impact the interest of revenue.

Way forward-

An important point of consideration here is whether retrospective application of Rule 10AB of the Rules (to give purposive interpretation) is permitted when the law specifically provides for its effective date of operation. The reliance placed on the SC ruling could be debated, since the ruling was pronounced on the issue where the law was silent as to the date of application. While the Delhi Tribunal is in favour of the taxpayers, it still remains to be seen whether the higher judicial authorities will uphold such a view.

Taxsutra Statistics -

The first 2 judgments on this issue have been delivered in FY 2014-15 by the Delhi Tribunal.

[28]Toll Global Forwarding India Private Limited [TS-383-ITAT-2014(DEL)-TP] and Geodis Overseas Private Limited [TS-389-ITAT-2014(DEL)-TP] *[29]CIT vs Vatika Township Pvt Ltd [TS-573-SC-2014*

E. BPO v/s KPO classification

A number of contradictory judicial rulings have been pronounced on classification of taxpayer's activities for BPO or KPO services. While in most of the cases, the focus has been on acceptance / rejection of comparable companies based on criteria such as profitability, turnover, extraordinary events, etc., no specific attempt had been made by the judicial authorities to evaluate characterization of business activities, till the Mumbai Tribunal special bench ruling in 2014 in the case of Maersk Global[30] on segregation of services into BPO and KPO for the purpose of comparability analysis (discussed below).

The Indian Government had set up a committee in 2013, namely the Rangachary Committee, to review taxation of DCs and the IT sector. The committee dealt with several pertinent TP issues of the IT/ITeS sector. It, however, did not provide a separate classification for BPOs and KPOs and included them in the general rubric of ITeS industry. However, the CBDT, while issuing Safe Harbour rules in 2013, provided separate definitions for BPOs and KPOs.

The special bench the Tribunal dealt with the fundamental question of functional distinction between BPOs and KPOs and on the appropriateness to compare a company undertaking routine ITeS activities with those undertaking activities which require expert and technical knowledge, namely a KPO. The special bench ruled that there is no requirement to segregate the ITeS into BPO and KPO services for comparability analysis and that selection of comparable companies should be based on the functional comparability.

The principles emerging from the special bench decision are summarized below -

• There cannot be a further segregation of the ITeS services into BPO and KPO services.

• It is essential to analyze and compare the functional profile of the taxpayer with that of the comparable selected in order to determine the nature of ITeS.

• Selection of comparables should be based on such functional comparability.

The special bench suggested a two step approach for selection of comparables and placed significant reliance on a robust functional analysis, which would help in selecting comparable companies while undertaking TP analysis.

Taxsutra Statistics:

Needless to say, the litigation on this issue revolved around the IT/ITES sector. The issue was dealt with in 17 cases, mainly by the Mumbai Tribunal, followed by the Hyderabad and Bangalore Tribunals. The issue was decided in favour of the taxpayers in almost 65% of the total cases in which the issue was dealt with.

[30] *TS-74-ITAT-2014(Mum)-TP*

F. Funding transactions (interest & guarantee)

Debt pricing

Determination of ALP of intra-group debt (i.e. the interest rate) is based on either suitably adjusted internal comparable or an approach commonly referred to as an 'external CUP' approach. The comparability hinges on equivalence (or the ability to make appropriate adjustments) across a number of key factors such as issue date, maturity / duration, currency denominating the debt and credit worthiness of the borrower. A number of other factors (viz. the respective rights of the borrower and lender to repayment or prepayment) also need to be taken into account for arriving at the ALP of interest rate. Internal comparables, wherever available, also need to be suitably adjusted to reflect differences in the above factors. In the absence of internal comparables, an 'external CUP' approach is applied, which assesses the arm's length interest rate on the debt by reference to other comparable debts available in public domain.

However, the revenue authorities in the past have used a wide range of other means of pricing interest rates, such as 'bank quotes', 'PLR in India', "CRISIL bond yields", etc., but have failed to consider specific terms and conditions of the tested debt transaction while determining the arm's length interest rate.

Recently, the Delhi HC, in its judgement in case of Cotton Naturals[31], issued a ruling having far-reaching consequences on determination of arm's length interest rate in case of intragroup loan transactions. The Delhi HC held that interest rate should be market determined interest rate applicable to the currency concerned in which the loan has to be repaid. Interest rate should not be computed on the basis of interest payable on the currency or the legal tender of the place or the country of residence of either party.

It held that in an arm's length analysis, the purpose behind advancing the loans should also be taken into consideration. Further, the arm's length interest rate should be determined on the basis of terms and conditions of the transactions and the market determined interest rate applicable to the currency in which the loan is repayable, as opposed to the interest rate payable on the currency of the place of residence of the borrower or the lender.

Additionally, the Delhi HC also held that the revenue authorities are not authorized to re-write / re- structure legitimate business transactions unless some exceptional circumstances appear, as the purpose of TP analysis is restricted to ascertainment of the ALP of the transaction.

This decision should have a significant positive impact for taxpayers having disputes relating to intercompany funding arrangements.

[31] *[TS-117-HC-2015(DEL)-TP]*

F. Funding transactions (interest & guarantee)

Guarantees

A wide range of methods have been applied for determination of ALP of intra-group guarantee fees, which have been looked at from the perspective of the guarantor and also from the perspective of the guarantee recipient. However, the common and most widely used method is an assessment of the 'credit enhancement' to the guarantee recipient. This is arrived at by estimating what would have been the ALP of the cost of funds for the guarantee recipient in the absence of a guarantee, and then, comparing this to the actual external cost of funds for the guarantee recipient. This credit enhancement provides the maximum value a guarantee recipient would be willing to pay to a guarantor, with the precise payment then being subject to a number of possible analyses.

While this approach is considered scientific and rational, it has been observed that the revenue authorities often use 'bank quotes', or in certain cases also apply 'interest saved approach', without considering factors such as risk undertaken by the guarantor, credit standing and financial position of the guarantee recipient, terms and conditions of the guarantee, etc.

Post amendment by the Finance Act, 2012 to section 92B of the Act (which also covers within its ambit transactions such as guarantee issued to be an international transaction), the Delhi Tribunal, in the case of Bharti Airtel Ltd. v/s Addl. CIT[32], has held that issuance of corporate guarantee is not an 'international transaction' under section 92B of the Act, since the transaction does not have any bearing on profits, income, losses or assets of the enterprise. While passing this judgment, the Delhi Tribunal analysed the definition of the term 'international transaction', amended retrospectively vide Finance Act, 2012. It also observed that the AE had not taken any borrowing from the bank based on the taxpayer's guarantee. It noted that when a taxpayer extends any assistance to its AE without incurring any expenditure for which the taxpayer otherwise also would not have realized any income by rendering it to any third party, such assistance cannot be said to have any bearing on profits, income, losses or assets of the taxpayer. Hence, as a corollary, it cannot be regarded as an 'international transaction'.

However, the Bangalore Tribunal, in the case of Advanta India Limited Vs ACIT[33], noted that in the case of Bharti Airtel, it was an undisputed position that the issuance of the guarantee did not cost the taxpayer anything, and it was for this reason that the Delhi bench concluded that the issuance of guarantee did not have any "bearing on the profits, income, losses or assets or such enterprise", thus taking it out of the ambit of 'international transaction' (which could be subjected to ALP adjustment). The Bangalore Tribunal held that as the taxpayer had incurred costs on issuance of the guarantee in the present case, the issuance of guarantee indeed had a bearing on the profits and income of such enterprise, and hence, it cannot be said that the issuance of guarantee did not constitute an 'international transaction'.

It is often seen that TPOs adopt the rates of guarantee commission as charged by various banks commercially (generally in the range of 2% - 3%). But, this anomaly has been set right by a recent ruling of the Bombay HC in the case of CIT v/s Everest Kento Cylinders Ltd.[34] In the said case, the Bombay HC held that the comparison was not between like transactions, but was between guarantees issued by commercial banks, as against a corporate guarantee issued by a holding company for the benefit of its AE (i.e. a subsidiary company). Thus, the higher rate of 3% as guarantee commission was thereby not justified, and a rate of 0.5%, as charged by the taxpayer, was ultimately upheld.

The above ruling provided much needed relief to taxpayers facing TP adjustments arising out of comparison of guarantee rates of commercial banks with the rates of corporate guarantees. This once again places emphasis on the importance of having a comprehensive comparability analysis to support application of CUP method for determining the arm's length rate of guarantee commission.

[32]TS-76-ITAT-2014(DEL)-TP *[33]TS-327-ITAT-2015(Bang)-TP* *[34]TS-200-HC-2015(BOM)-TP*

Notes

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