

In the past fortnight, three decisions have been rendered in context of Transfer Pricing. This special edition summarizes our analysis and impact of the same.

Moser Baer India Ltd and Others vs. Addl CIT (Delhi High Court)

In the case under question, writ petitions were filed before the Delhi High Court by Moser Baer India Ltd and five other co-petitioners ("taxpayer"). The above petitions were against the orders passed by the Transfer Pricing Officers ("TPO") who had undertaken an upward adjustment to the income.

The appeals to the Court were on the following common grounds:

- TPO had not granted an oral hearing before determining the arm's length price in respect of international transactions;
- There was a failure on the part of the TPO to consider documents and information filed and the TPO had erred in not disclosing the material used in the determination of arm's length price.

High Court's ruling

The High Court, after hearing the contentions, passed an order quashing the orders passed by the TPO. It was adjudged that the TPO should commence proceedings from the stage at which show cause notice was issued. The Court made the following important observations:

Oral hearing

It is mandatory for the TPO to provide an oral hearing to the taxpayer before determination of arm's length price. Section 92CA(3) of the Act and

Feedback

Expert Speak

1. HC upheld revenue department's jurisdiction
2. FDI through Mauritius: Has the dust settled?

Awards

1. BMR wins ITR's India Transfer Pricing Firm of the Year award
2. European CEO Legal award for best TP Firm
3. BMR is Tier 1 Firm in ITR's World Tax Guide 2009
4. BMR wins two Employer Branding awards

Events

UPCOMING EVENTS

1. USIBC's conference on US and India: Doing Business in Today's Economy

RECENT EVENTS

1. Workshop on Successful EPC Contracting in India – Addressing Fiscal Challenges
2. Executive briefing on Transfer Pricing in Bangalore and Chennai
3. International Taxation Conference – 2008

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first proviso to section 92C(3) casts an obligation on the TPO to accord an oral hearing to the taxpayer before he proceeds to determine the arm's length price on the basis of material or document available with him.

Further an oral hearing can be dispensed with only where there is a specific provision. Tribunal rejected the contention of the Revenue that failure to grant an oral hearing is a defect which can be cured by providing such an opportunity in the appellate forum.

Production of material

As regards the material being used by the TPO for determining the arm's length price, it was held that the taxpayer should be provided with an opportunity to rebut the material. The Court held that the show cause notice issued by TPO should refer the documents or material available with him in relation to the international transaction and should give an option to the taxpayer:

- To inspect the material available and to file further material or evidence if he so desires, and
- To seek personal hearing on the matter.

BMR Comments

The case throws fresh insights and guidelines on the manner in which Transfer Pricing proceedings are required to be undertaken. The case imposes a mandatory requirement on the TPO to adhere to the principles of natural justice, by providing an opportunity for an oral hearing and providing it with an option to rebut the material which is to be used by the TPO. The principle is likely to discourage an arbitrary action in Transfer Pricing proceedings.

Essar Shipping Limited vs. DCIT (ITAT Mumbai)

Essar Shipping Limited ("taxpayer") is an Indian Company engaged in the business of operations of ships. The taxpayer hired a ship from Essar International Limited ("EIL"), its wholly owned subsidiary registered outside India. For demonstrating arm's length nature of international transaction, Comparable Uncontrolled Price method ("CUP") was used as a primary method. Revenue rejected the taxpayer's analysis and made an upward adjustment to the income.

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As no relief was granted by the Commissioner Appeals ["CIT (A)"] the taxpayer filed an appeal to the Income tax Appellate Tribunal ("Tribunal"). The Tribunal addressed various issues raised before it and observed as under:

Rejection of the comparability analysis of taxpayer

The taxpayer relied on data published in Clarkson Report for the purpose of adopting the CUP methodology. The Clarkson's report provided an average one year time charter rate for a similar size of vessel. However, the report referred to modern ships, which were around 10 years old, whereas, the ship hired by the taxpayer was 22 years old. To adjust for such age difference, the taxpayer computed the arm's length charter hire rate at 25 percent of the rate published in the independent report. Although the Tribunal agreed that adjustment should be carried out for the age difference, considering the vast age difference and adhoc deduction provided, the comparability analysis was rejected.

A significant observation by the Tribunal has been in relation to the use of external publications as CUPs in determining the arm's length price. The Tribunal observed that comparable uncontrolled transaction may take the shape of any reliable data justifying the market price of similar services. It was observed that if the taxpayer was to rely on Clarkson's report, the comparable cases provided should have been similar to the one to be tested. Thus in principle, the use of external publication as CUP was not drawn any adverse inference upon.

Application of Cost Plus method

During the course of proceedings before the Transfer Pricing Officer ("TPO"), an alternate methodology applying the Cost Plus Method ("CPM") was furnished. While applying the CPM, EIL was chosen as the tested party. The taxpayer considered interest on loan for purchase of ship, depreciation and notional dividend as the cost components for CPM. The taxpayer provided no mark up over the cost in his computation. The TPO in his order reduced the notional dividend while determining the rental of the ship chartered and thus concluded that the transaction was not at arm's length.

The Tribunal rejected the argument of the taxpayer on inclusion of dividend while determining cost base for CPM. Tribunal considered 10 percent gross profit rate to be reasonable for inclusion over the cost in the relevant case.

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As the mark up of 10 percent was approximately equal to the amount of dividend which was considered as part of cost by the taxpayer, the transactions of the taxpayer were considered to be at arm's length.

BMR Comments

There is often a debate on whether data available in publications or industry indices can be used as reliable CUPs. The Tribunal has not drawn any adverse reference insofar as use of Clarkson's report is concerned. Whether after the decision, the Indian Revenue authorities will accept such use of data for comparability is to be seen.

The Tribunal has laid down certain important principles regarding the application of Transfer Pricing methods. The Tribunal has commented on the comparability requirements as required under CUP. Also, in relation to application of CPM, the correct manner in which the method should be applied has been provided for. It should however be noted that provision of 10 percent gross profit mark up by the Tribunal without any Transfer Pricing analysis is contrary to the principle of determination of arm's length price on basis of a detailed benchmarking analysis.

Coca Cola India Inc vs. Assistant CIT (Punjab and Haryana High Court)

In the case under question, Coca Cola India Inc ("the taxpayer") had a branch office in India, which was engaged in rendering advisory services to an Associated Enterprise ("AE"). The Assessing officer ("AO"), on the basis of order passed by the Transfer Pricing Officer ("TPO") for Assessment Year 2002-03, issued notice for past four years after forming an opinion that the income of the taxpayer had escaped assessment. Further, the TPO on reference made by AO issued Transfer Pricing notice for subsequent four years. The taxpayer filed writ petition before the Punjab and Haryana High Court.

The main questions raised in the writ were as follows:

- Whether an order passed by TPO could form reasons for reassessment for period prior to introduction of comprehensive Transfer Pricing regulations
- Whether Transfer Pricing provisions shall apply in a scenario

where both the parties to the transaction are subject to Indian tax jurisdiction, and

- Whether opportunity of being heard is required before reference is made by the AO to the TPO.

High Court's ruling

The High Court, referring to plethora of judgments, held as follows:

Invoking of reassessment provisions under Section 147 of the Act

As long as the requirement of Section 147 is fulfilled, and the AO legitimately forms an opinion that an income has been incorrectly assessed, there is no bar against invoking the provisions of section 147. Section 147 of the Act was independent and was not in any manner bound by section 92 of the Act.

Applicability of TP provisions where both parties subject to tax in India

The Court held that the only condition precedent for invoking Transfer Pricing provisions is:

- There should be income arising from international transaction; and
- Such income has to be computed having regard to arm's length price

The Court was thus of the view that there was no ambiguity or absurd consequence of application of Transfer Pricing in a scenario where both the parties to the transaction are subject to jurisdiction of taxing authorities in India.

Opportunity of being heard before making the reference

It was held that decision to make reference under section 92CA of the Act does not in any manner visit the taxpayer with any civil consequence. Though quasi judicial authorities were expected to act as per principles of natural justice in all matters, it is dependent upon statutory provision or how adversely the person was affected, that such opportunity was to be granted. Since in the present case the question was whether the AO was to compute arm's length price or make reference to TPO, the court did not

find any merit in interfering.

BMR Comments

In summary, High Court has strictly applied the interpretation on Section 147 which authorizes and permits the AO to assess or reassess income chargeable to tax, if he has reason to believe that income for any assessment year has escaped assessment. The word 'reason' in the phrase 'reason to believe' would mean cause or justification and cannot be read to mean that the AO should have finally ascertained the fact by legal evidence or conclusion. Further, an important implication is that Revenue will have an avenue to reopen prior year's cases (pre comprehensive Transfer Pricing regulations). However, the law applicable for those years would be as it existed for such prior years.

The decision assumes importance as it upholds the applicability of Transfer Pricing provisions to transactions where both the parties are subject to Indian tax jurisdiction. The existing view that no opportunity of being heard is required to be provided to the Taxpayer before making the reference to the TPO, also lies further strengthened by the judgment.

For a detailed analysis of the respective rulings please follow the link provided below:

[Moser Baer India Ltd](#) | [Essar Shipping Ltd](#) | [Coca Cola India Inc](#)

AWARDS AND RECOGNITION

BMR wins India Transfer Pricing Firm of the Year at ITR's Asia Awards 2008

BMR emerged as the India Transfer Pricing Firm of the year at the International Tax Review's Asia Awards 2008 held in Singapore. BMR received this award for the second consecutive year, and was chosen over three of the Big 4 Firms.

For more details, please click [here](#).

BMR is the Best Transfer Pricing Team of the Year – India, at the first annual CEO Legal Awards 2008

At the inaugural CEO Legal Awards 2008, BMR was adjudged the Best Transfer Pricing Team in India. These awards recognised the organisations around the world which represent the highest standards of service,

innovation and competence in their respective fields.

For more details, please click [here](#).

BMR is Tier 1 Firm in ITR's World Tax Guide 2009

In the latest World Tax Guide 2009, brought out by the international Tax Review, BMR has been ranked a Tier 1 Firm.

This ranking is based on a rigorous process that involves research among all participating Firms, and interviews with their representatives.

For more details, please click [here](#)

BMR wins two Employer Branding awards

BMR has been adjudged winner in two categories – Continuous HR Strategy and Innovative Retention at the 3rd Annual Awards 2008-2009, of The Employer Branding Institute, recently held in Bangalore. These awards are a reiteration of BMR being one of the Great Places to Work in India, an award that the organization was conferred upon earlier in the year 2008.

For more details, please click [here](#).

EVENTS

UPCOMING EVENTS

USIBC's conference on US and India: Doing Business in Today's Economy, January 10, 2009, New Delhi

US-India Business Council, supported by BMR and in cooperation with American Bar Association Section of International Law, Practising Law Institute (PLI) and Bar Association of India, will organise a legal conference on "US and India: Doing Business in Today's Economy" on January 10, 2009 in New Delhi, India.

For more details, please click [here](#).

RECENT EVENTS

Workshop on Successful EPC Contracting in India – Addressing Fiscal Challenges, December 11 and 12, 2008, Hyderabad, India

BMR Advisors, in association with Infraline hosted the 4th Conference and Interactive Workshop on “Successful EPC Contracting - Fiscal Challenges” on December 11 and 12, 2008 at Hyderabad, India.

For more details, please click [here](#).

Executive briefing on Transfer Pricing in Bangalore and Chennai, December 3, 2008

As part of the Thought Leadership series, BMR organised an Executive Briefing on Transfer Pricing in Troubled Times, in Bangalore and Chennai

on December 3, 2008.

For more details, please click [here](#).

International Taxation Conference – 2008, Mumbai

The Foundation for International Taxation (FIT), supported by BMR, organised a three day technical conference on December 4-6, 2008, at ITC Maratha Hotel in Mumbai, India. The theme for this year's conference was "Transfer Pricing Issues".

For more details, please click [here](#).

[Back](#)

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TAX EDGE

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