

Transfer pricing provisions are not applicable, when taxpayer suo-moto disallows expenditure in the nature of international transaction and does not claim any benefit for the same in subsequent years

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Background

Recently, the Pune Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Eaton Technologies Pvt. Ltd¹ (the taxpayer) held that the Transfer Pricing (TP) provisions are not applicable to an international transaction, when taxpayer on a suo-moto basis has disallowed such payments made to Associated Enterprise (AE) and further has not claimed any benefit vis-à-vis the same in the subsequent years. While laying down the aforementioned important principle, the Tribunal also upheld the taxpayer's contention that there cannot be double disallowance/addition of the same amount applying TP provisions, which has been suo-moto disallowed by the taxpayer.

Facts of the case

- The taxpayer was a subsidiary of Eaton Asia International Limited, which in turn was a Subsidiary of Eaton Corporation.

- During the year under consideration the taxpayer provided customer support service and business support services to Eaton Group. Whilst the taxpayer was rendering customer support services from an Software Technology Park of India (STPI) unit and was claiming a tax holiday under Section 10A of the Income-tax Act, 1961 (the Act) thereon, the taxpayer was rendering business support services from a non-STPI unit.
- The taxpayer was being remunerated on the basis of cost plus a mark-up for the above mentioned services provided to Eaton Corporation.
- During the year under consideration, the taxpayer had also reimbursed certain pre-incorporation costs incurred by the AE which were relating to a new business unit.

Customer support services

- During the assessment proceedings, the Transfer Pricing Officer (TPO) accepted the transaction relating to provision of customer support services.

¹ Eaton Technologies Pvt. Ltd. v. DCIT [ITA Nos. 1621/PN/2011] Assessment Year 2007-08

Payment to AE on account of pre-operative expenditure

- The TPO noted that during the year the taxpayer had paid an amount of INR 74.2 million (approximately) to Eaton Ltd. UK on account of certain pre-operative expenditure in connection with setting up of a new business unit.
- The TPO held that the aforesaid transaction was an international transaction which should have been benchmarked. The TPO took the value of the international transaction entered into with the AE on account of the above expenditure as NIL and proposed consequent increase in the income of the taxpayer accordingly.

Business support services

- With regard to business support services, whilst the taxpayer had benchmarked the transaction using multiple year data of the identified comparable companies, the TPO sought to use single year data of the comparable companies. The taxpayer's claim for risk adjustment which the taxpayer had put forward during the assessment proceedings was rejected by the TPO stating that the taxpayer had not put forward any such claim and had not provided any computation thereof. Based on the aforesaid, the TPO proposed an adjustment to the taxpayer's income for the difference between the taxpayer's operating margin and the single year operating margin of the comparable companies.

Assessment proceedings

- The Dispute Resolution Panel (DRP) upheld the action of the TPO. The Assessing Officer (AO) passed the assessment order by making the above additions to the total income of the taxpayer. Aggrieved, the taxpayer lodged an appeal at the Tribunal.

Taxpayer's contentions

Payment to AE on account of pre-operative expenditure

- The transaction of payment of pre-operative expenditure does not have any bearing on the income/ profits since the taxpayer itself had disallowed the expenditure while computing the taxable profit for the relevant year. The taxpayer had added the amount as "items debited to profit and loss account, not allowable under the act".

- The taxpayer had not taken any benefit, in subsequent years on account of the expenditure. The taxpayer had not capitalised it towards the cost of any asset and had not claimed any depreciation on it. Therefore, even if the said transaction is assumed to be an international transaction, it does not impact the taxable income of the taxpayer.
- As per the provisions of Section 92(1) of the Act any income arising from an international transaction shall be computed having regard to the Arm's Length Price (ALP). Since there is no income arising from this international transaction, therefore, the provisions are not applicable.
- As per provisions of Section 92B(1) of the Act the transaction must have a bearing on the profit. Since the taxpayer has not claimed any deduction on account of this expenditure, the same is not applicable.
- The TPO was not justified in determining the value of international transaction at NIL. As per the provisions of Section 92C(3) of the Act the TPO has to determine the ALP in relation to the international transaction in accordance with the sub-section (1) and sub-section (2) of Section 92C of the Act. Since the AO/TPO in the instant case had determined such ALP at NIL, therefore, the same is not proper and liable to be quashed.

Business support services

- With regard to the TPO's use of single year data of comparables, the taxpayer contended that multiple year data will improve the reliability of transfer pricing analysis.
- The taxpayer further contended that, due to differences between the risk profile of the taxpayer and its comparables, risk adjustment should be granted, the claim for which was put forward and the computation thereof was provided to the TPO during the assessment proceedings.

Tax department's contentions

Payment to AE on account of pre-operative expenditure

- As per the provisions of Section 92B(1) of the Act the taxpayer and Eaton Ltd. UK are AEs within the meaning of Section 92A of the Act. Since payment has been made from the funds of the taxpayer and the same was debited to its profit and loss account, the transaction is a valid international transaction under Section 92B of the Act.

- The amount paid by the taxpayer to the AE has a bearing on the assets of the enterprise and thus it is a valid international transaction. Since the taxpayer did not give any break up or details of the amounts paid to the AE, therefore, the TPO was justified in determining such value at NIL.
- These expenditures were pre-operative in nature and the taxpayer was unable to show that any corresponding services have been received against such payments.

Business support services

- No risk adjustments had been claimed by taxpayer during any time of the assessment proceedings. The risk adjustment, thus claimed in the case of the taxpayer is beyond the purview of law and not allowable.

Tribunal's ruling

Payment to AE on account of pre-operative expenditure

- As per the provisions of Section 92 of the Act, the allowance of any expenditure arising from an international transaction shall also be determined having regard to the ALP.
- However, in the instant case the taxpayer has not claimed the expenditure and has itself disallowed the same while computing its taxable income for the impugned assessment year and no benefit of the same has been taken in subsequent years by capitalising it and claiming depreciation on it.
- The Tribunal observed that there cannot be double disallowance / addition of the same amount and upheld the taxpayer's contention that the provisions of Section 92 of the Act are not applicable in the instant case.

Business support services

- With regard to the risk adjustment claimed by the taxpayer, the Tribunal observed that the details furnished by the taxpayer have not been properly appreciated by the AO/TPO. Thus, Tribunal restored the issue to the file of the AO with a direction to decide the issue afresh after giving due opportunity of being heard to the taxpayer.

Our comments

This ruling provides welcome relief to taxpayers as the Tribunal has acknowledged the fact that when the taxpayer on a suo-moto basis has disallowed a payment made to AE and has not taken any benefit in subsequent years, the TP provisions would not apply even though the transaction falls within the definition of international transaction. Whilst the Tribunal has reiterated that there can be no double disallowance of an amount, the onus shall lie on the taxpayer to demonstrate that the taxpayer has not claimed the amount as deduction either in the year under consideration or any of the subsequent years.



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