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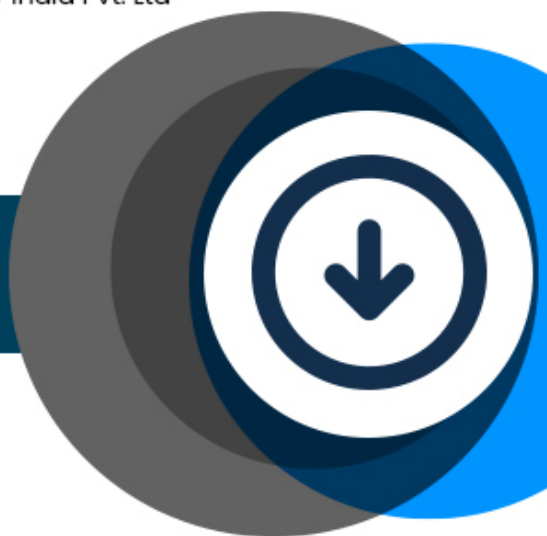
International Taxation
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Highlights



- ▶ CBDT extended return filing due date for TP assessees
- ▶ CBDT notified safe harbour rules for AY 2024-2025
- ▶ CBDT issued revised Guidelines for Compounding of Offences
- ▶ CBDT condones delay in filing income returns for deductions u/s 80P for AY 2023-24
- ▶ Switzerland announced suspension of MFN clause with India, citing Supreme Court's ruling in Nestle
- ▶ OECD issued 2023 Peer Review Reports on the Exchange of Information on Tax Ruling
- ▶ Free of Cost ('FoC') transactions in Transfer Pricing
- ▶ Pr. Commissioner of Income Tax. Vs. M/s. Burberry India Pvt. Ltd

What's Inside



NEWS HIGHLIGHTS

1



INDIAN GLOBAL UPDATES

3



TRANSFER PRICING/BEPS

4



ISSUE OF THE MONTH

5



LEGAL CORNER

8



GLOSSARY OF TERMS

11

News Highlights



CBDT extended return filing due date for TP assessees

CBDT extended the due date for filing the 'tax return' for assessees which were required to file 3CEBs or for the assessees having international related party transactions subject to transfer pricing regulations. The due date was extended from November 30, 2024 to December 15, 2024.

CBDT notified Safe Harbour Rules for AY 2024-2025

CBDT, in its Safe Harbour Rules for AY 2024-2025, introduced safe harbour of 4% of gross receipts for foreign company engaged in selling raw diamonds in any notified special zone.

CBDT issued revised Guidelines for Compounding of Offences

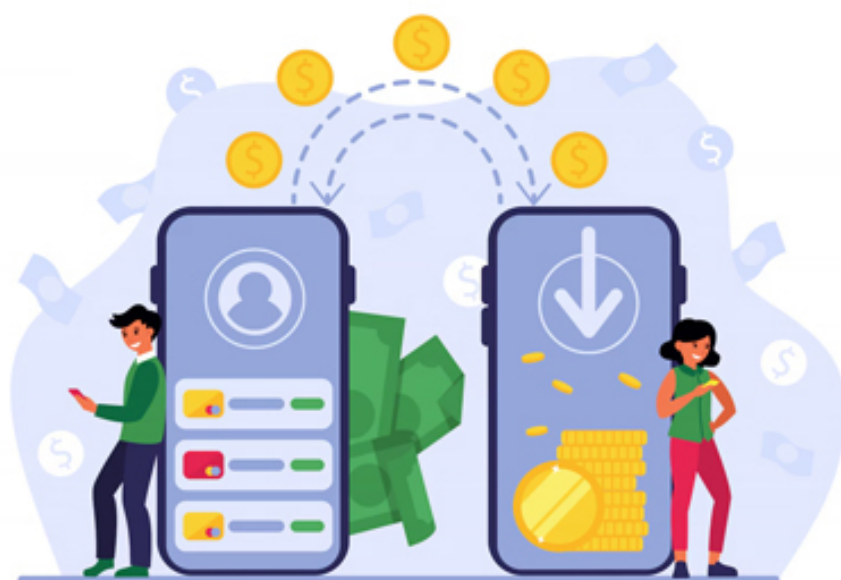
The CBDT issued revised guidelines for the compounding of offences under the Income-tax Act, superseding earlier guidelines. The new guidelines allow compounding applications for offences across one or more years/quarters to be filed with the relevant authorities (Pr.CCIT, CCIT, Pr.DGIT, DGIT). The application fee is Rs. 25,000 for a single case and Rs. 50,000 for a consolidated application, non-refundable but adjustable against total compounding charges. All outstanding taxes, interest, penalties, and dues must be cleared before filing, with any remaining dues to be paid within 30 days after department intimation. Defective applications can be revived if corrected within a month. Certain offences, such as



those under the Black Money and Benami Acts, require CBDT Chairman approval. Companies or HUFs can file applications separately or jointly with co-accused, and co-accused under specific sections can pay charges using their PAN. The revised guidelines are effective from Oct 17, 2024.

CBDT condones delay in filing income returns for deductions u/s 80P for AY 2023-24

CBDT received applications from co-operative societies claiming deduction under Section 80P requesting condonation of delay in filing return of income for the Assessment Year 2023-24 and allowing them to be treated as submitted on time due to delay in getting their accounts audited as per respective State Laws. Therefore, in order to alleviate the hardships faced by the Assesseees, CBDT extended the applicability of Circular No. 13/2023 to the AY 2023-24.



Indian/Global Updates



Switzerland announced suspension of MFN clause with India, citing Supreme Court's ruling in Nestle

Switzerland has announced the suspension of the application of the Most Favoured Nation (MFN) clause in the protocol to the Agreement between the Swiss Confederation and the Republic of India for the avoidance of double taxation with respect to taxes on income. This decision follows a ruling by the Indian Supreme Court in the Nestle case, which clarified that India does not align with Switzerland's interpretation of the Protocol. As a result, Switzerland, citing the absence of reciprocity, has decided to waive the unilateral application of the MFN clause, effective from January 1, 2025.



Transfer Pricing / B E P S



OECD issued 2023 Peer Review Reports on the Exchange of Information on Tax Rulings

Under the BEPS Action 5 minimum standard, members of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) are committed to countering harmful tax practices, with a focus on improving transparency. A key component is the transparency framework, which mandates the compulsory exchange of information on certain tax rulings. This exchange is crucial for tax administrations to access relevant data, assess corporate tax affairs, and address tax avoidance and BEPS risks. Over 140 countries participate in the Inclusive Framework, undergoing a peer review process to ensure compliance with this framework. The review assesses

five areas: information gathering, information exchange, confidentiality, statistics on exchanges, and transparency in intellectual property regimes. This report presents the findings of the eighth annual peer review of Action 5.



Issue of the month

Free of Cost ('FoC') transactions in Transfer Pricing

Background

In the realm of Transfer Pricing ('TP'), benchmarking of different international transactions is done to ensure that the arrangements between two transacting related parties are undertaken at arm's length. The aforesaid arrangements can vary entity wise one example of such arrangement being Cost + mark-up model of charging consideration.

Under this model, the cost of rendering the services/-goods incurred by one party is summed up with a specific mark-up percentage and is charged to the other party as consideration. Generally, when the Indian goods/services provider receives raw material/required expertise/pre-requisite tools FoC, there is no such problem as section 92(3) of the Income Tax Act, 1961 ('the Act') provides for TP regulations not to be applied on such transaction(s) which results in reducing the taxable income or increasing the loss.

However, under Cost + mark-up model, the Indian goods/services provider (receiving raw material/required expertise/pre-requisite tools FoC) finds various practical difficulties to charge consideration and consequently making benchmarking of such international transactions illogical & nearly impossible.

In this article, we will discuss about the complexity posed by FoC transactions in Cost + markup model of charging consideration.

Types of FoC transactions

Broadly, there can be two different types of FoC transactions:

1. *Receipt of FoC services/goods:*



Certain FoC services may be provided by the overseas group entities to the Indian entities. These may not be recorded as expense of the Indian Company in the absence of any defrayal of expenses by the Indian Company.

Keeping in mind the above, in case of cost-plus mark-up model, tax officers may contend that cost base used for charging mark up, by the Indian entity, is understated, leading to understatement of revenue. In addition, tax authorities may seek to tax the value of these supplies as benefit/perquisite u/s 28(iv) of the Act.

Example: Certain free of cost software/ applications made available for the use of the Indian entity by its foreign Associated Enterprise ('AE') or Certain Information Technology supplies made available for the use of the Indian entity free of cost by its foreign AEs.

2. Receipt of FoC Capital goods:

AEs may provide capital equipment to Indian entities on a FoC basis. Under Indian Generally Accepted Accounting Principles (IGAAP), these assets are generally not recorded in the Indian entity's books. However, for the companies applying Ind-AS, the equipment is recorded as a notional asset with notional depreciation being charged on it.

Consequently, for arm's length price determination, the aforesaid notional depreciation may also be added to cost by the tax authorities and the corresponding markup may also be subject to tax.

In addition, the value of such FoC capital equipment may also be brought to tax under Section 28(iv) of the Act.

Impact of TP on FoC transactions

In TP, transactions between AEs involving FoC goods and services are also subject to arm's length pricing criteria.

As per the ICAI Guidance Note on Report u/s 92E of the Act, international transaction between AEs and the Indian taxpayer, involving supply of FOC assets / services / tools need to be included in Form 3CEB along with a suitable note to explain their nature. The necessary facts/ conditions to assess and identify such FoC transactions needs to be carefully examined and an appropriate reporting for the same needs to be done. Further, it also provides that where the amounts of FoC transactions are recognised on a notional basis in the books of accounts due to applicable accounting standards or otherwise, the same should be in conformity with arm's length principle.

Rule 10B of the Income Tax Rules, 1962 provides methodologies to evaluate transfer pricing, including for transactions with no explicit consideration ('FoC').

The OECD TP guidelines also suggest that the FoC transactions should be priced at arm's length, meaning that even if no explicit consideration is exchanged, the transaction should be treated as if it were between unrelated parties, and any benefit or cost incurred should be recognized and valued appropriately. Further, it also provides that the enterprises involved are required to document the reasons for any FoC transactions and ensure that their transfer pricing documentation reflects the terms and economic conditions that would prevail in a comparable transaction between unrelated parties. This includes ensuring that such transactions are not designed to shift profits or reduce tax liabilities inappropriately.

Risks present in FoC Transactions

Transactions undertaken by FoC entities, may be subject to various risks, discussed as under.

- **Scrutiny:** FoC transactions might be scrutinized by tax authorities to ensure that they do not result in profit shifting or erosion of tax bases.
- **Valuation Complexity:** Determining the appropriate arm's length price for free-of-cost transactions can be complex, especially if the goods, services, or intangibles provided have significant value.

Conclusion

Ideally, as per section 92(3) of the Act, the TP regulations should not lead to any implication when the FoC transactions are to the advantage of the Indian

taxpayer entity. However, when it comes to the cost + markup arrangement for charging consideration for such transaction, it becomes practically difficult to determine the actual cost at which the markup shall be charged so that there is no scope of understatement of income arising out of such transactions.

In such a situation, the tax officers consider the cost attributable towards depreciation or other such related expenses, to the cost base subject to mark up. Further, the value of the FoC goods/services/assets can also be subject to tax u/s 28(iv) of the Act.

Legal Corner



In the High Court of Delhi

Pr. Commissioner of Income Tax. Vs. M/s. Burberry India Pvt. Ltd.

Introduction and Brief Facts

M/s. Burberry India Pvt. Ltd ('the assessee') is engaged in trading of imported luxury goods bearing the trademark 'Burberry'. The assessee is a joint venture of Burberry International Holdings Ltd. UK and Genesis Colours Private Limited, India.

During the AY 2012-13, the assessee filed its return of income on 30.11.2012, declaring a loss of ₹1,80,33,018. The assessee had undertaken the international transactions relating to import of finished goods, reimbursement of cost and marketing and the same was reflected in Form-3 CEB

In respect of the above, the case of the assessee was selected for scrutiny & assessment u/s 143(3) of the Income Tax Act, 1961 ("the act") and a reference to Transfer Pricing Officer ('TPO') was made for determining the ALP under Section 92CA(3) of the Act.

The TPO did not accepted the assessee's transfer pricing study in respect of the international transactions relating to the import of finished goods for a value of ₹28,88,97,371/-

The assessee used the Comparable Uncontrolled Price ('CUP') method, and had corroborated the same by Resale Price Method ('RPM'), to establish the arm's length price ('ALP'). However, the TPO did not accept CUP or RPM as the most appropriate methods. Instead, the TPO adopted the Transactional Net Margin Method ('TNMM') and selected operating profit/operating cost (OP/OC) as the profit level indicator ('PLI') for determining the ALP. The TPO also rejected two of the three entities selected by the assessee due to differences in functional profiles.



The TPO selected four comparable for determining the ALP with arm's length margin of 2.80%. The TPO has determined the ALP's Adjustment as under

Operating Cost	66,62,78,780/-
Arm's Length Margin (%)	2.80%
Arm's Length Price (ALP)	68,49,34,586/-
Price received	61,54,75,995/-
Shortfall being adjustment	6,94,58,591/-

The TPO passed an order under Section 92CA (3) of the Act directing the Assessing Officer ('AO') to enhance the assessee's declared income by sum of ₹6,94,58,591/- under Section 92CA of the Act.

In accordance with the above directions, the AO issued the draft assessment order on 04.03.2016 under Section 143(3) of the Act.

The Assessee aggrieved by the aforementioned draft assessment order, filed an objection before Dispute Resolution Panel ("DRP") which upheld the findings TPO.

Thereafter, the AO passed the final assessment order dated 30.11.2016, based on the directions issued by the DRP.

Aggrieved by the above-mentioned final order, the assessee approached the Income Tax Appellate Tribunal ("ITAT") which ruled in favor of assessee and held RPM as most appropriate method.

The Hon'ble ITAT noted that the TPO and DRP rejected RPM as the most appropriate method for computing the ALP due to the significant AMP expenses incurred by the assessee. However, the Hon'ble ITAT disagreed with this reasoning, criticizing the rejection of RPM and concluded that, based on the case facts, RPM was the most appropriate method.

Aggrieved & dissatisfied by the same, the Revenue filed an appeal before the Honourable High Court ("Hon'ble HC") of Delhi.

Arguments of the Assessee

The assessee relied upon the OECD Guidelines as well as the Guidance Note issued by the ICAI in support of its contention regarding use of RPM as the most appropriate method for benchmarking the international transactions in question.

The assessee had argued that RPM would be the most appropriate in cases where the reseller does not add any value to the products purchased and sold.

Further, before the Hon'ble ITAT, the assessee had argued that it had not incurred significant AMP expenses and that comparable entities had similar expenses.

Order of Hon'ble HC

After carefully examining all the facts & circumstances of the case, the Hon'ble HC ruled in the favour of assessee and dismissed Revenue's appeal noting that no substantial question of law arises.

The issue before Hon'ble HC was whether the Hon'ble ITAT erred in concluding that RPM is most appropriate method.

The Hon'ble HC observed that the conclusion of ITAT, that RPM was most appropriate method, was based on the fact that assessee does not add any value to the goods from AEs and the same are sold in the same condition as imported.

The Hon'ble HC holds that the question of whether RPM is the most appropriate method in cases where a distributor purchases products from its Associated Enterprise and resells them to unrelated parties without any further processing has been addressed in several decisions.

These include the Bombay High Court's ruling in L'Oreal India (P) Ltd., as well as decisions from the coordinate benches in Matrix Cellular International Services (P) Ltd. and Fujitsu India P Ltd.

Further, Hon'ble HC accepted the findings of Hon'ble ITAT that its AMP expenses were not excessive and were similar to those incurred by other comparable entities.

Comment

Time and time again, it has long been accepted that the RPM is the most appropriate method in cases where a distributor purchases products from its Associated Enterprise and resells them to unrelated parties without further processing.

Further, decision of Hon'ble HC affirms this principle along with several judicial precedents.

¹(2015) 53 taxman.com 432(Bombay)

²(2018) 90 taxman.com 54 (Delhi)

³2023: DHC:7952-DB

Glossary



Act	Income Tax Act, 1961
APA	Advance Pricing Agreement
A.Y.	Assessment Year
ALP	Arm's Length Price
FoC	Free-of-cost
AO	Assessing Officer
ITAT	Income tax Appellate Tribunal
IGAAP	Indian Generally Accepted Accounting Principles
UK	United Kingdom
BEPS	Base Erosion and Profit Shifting
PCIT	Principal Commissioner of Income Tax
PGBP	Profit and Gains from Business and Profession
CBDT	Central Board of Direct Taxes
CIT	Commissioner of Income Tax
US	United States
ICDS	Income Computation & Disclosure Standards
IT	Income Tax
ITR	Income Tax Return
TDS	Tax Deducted at Source
ITO	Income Tax Officer
OECD	Organization for Economic Co-operation and Development
ITR	Income Tax Return
PAN	Permanent Account Number
ITBA	Income Tax Business Application
MAP	Mutual Agreement Procedure
MNE	Multinational Enterprises
MCAA	Model Competent Authority Agreement
ROI	Return of Income
SLP	Special Leave Petition
SDT	Specified Domestic Transaction

GET IN TOUCH

Do write us back your Feedback/Queries/Comments, if any at taxhelpdesk@llca.net

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