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Highlights



- CBDT is conducting a 'mismatch communication' exercise for the AY 2021-22 under the e-Verification Scheme.
- CBDT notified certain institutes as scientific research institutions for Sec 35(1)(ii) weighted deduction
- CBDT waived late fee & interest on delayed filing of Form 26QE
- Net direct tax collections for FY 2023-24 grow at 19.88%, Advance Tax at 22.31%
- CBDT issues guidelines for priority disposal of appeals
- Australian Federal Court dismisses SingTel's appeal on cross-border related party financing dispute
- OECD Secretary-General's Report apprises on status of Two Pillar Solution, BEPS actions & information exchange
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News Highlights



CBDT is conducting a 'mismatch communication' exercise for the AY 2021-22 under the e-Verification Scheme.

The CBDT has released a Press Release regarding the e-Verification Scheme of 2021, informing taxpayers about discrepancies in information for the AY 2021-22. The Income Tax Department is reaching out to taxpayers via their registered email addresses, urging them to review their AIS on the e-filing portal and file ITR-U where necessary. Eligible non-filers can also submit ITR-U under Section 139(8A), with the deadline set for March 31, 2024. This initiative addresses mismatches found in certain ITRs for AY 2021-22. Additionally, cases where ITRs haven't been filed and the Department possesses information on specified high-value financial transactions require further examination as part of this exercise.

CBDT notified certain institutes as scientific research institutions for Sec 35(1)(ii) weighted deduction

CBDT vide notification No. 29/2024, 30/2024 & 31/2024 approved 'Indian Institute of Technology, Kharagpur', 'Sardar Vallabhbhai National Institute of Technology, Surat' and 'National Forensic Sciences University, Gandhinagar' for 'Scientific Research' under the category of 'University, College or Other Institution' mentioned under Section 35(1)(ii). The said notification came into effect from Mar 13, 2024 and shall be applicable for AYs 2024-25 to 2028-29.

CBDT waived late fee & interest on delayed filing of Form 26QE



CBDT vide circular no. 04/2024, retrospectively, extended the due date of filing Form No. 26QE to 30.05.2023 for specified persons who deducted tax u/s 194S between 01.07.2022 to 28.02.2023. The circular also provided that the fee and/or interest charged u/s 201(1A)(ii) of the Income Tax Act, 1961, shall be waived on account of non-availability of Form No. 26QE during its filing period.

Net direct tax collections for FY 2023-24 grow at 19.88%, Advance Tax at 22.31%

CBDT issued press release on provisional direct tax collections for FY 2023-24 as on Mar 17, 2024. The net direct tax collections are at Rs.18.90 Lac Crore as compared to Rs. 15.76 Lac Crore in the corresponding period of the preceding financial year which represents an increase of 19.88%. Gross direct tax collection has grown at 18.74% to reach Rs.22.27 Lac Crore as compared to Rs.18.75 Lac Crore in the corresponding period of the preceding financial year. Advance tax collections for FY 2023-24 is at Rs. 9.11 Lac Crore which shows a growth of 22.31% as against Rs.7.45 Lac Crore for the corresponding period of the immediately preceding financial year.

Further, refunds amounting to Rs.3.36 Lac Crore have been issued in FY 2023-24 which show an increase of 12.74% as compared to Rs.2.98 Lac Crore issued during the same period in the preceding Financial year.

CBDT issues guidelines for priority disposal of appeals

The CBDT had issued guidelines for expediting the disposal of appeals by various tax authorities such as CIT(A), JCIT(A), and Addl.CIT(A). According to the office letter, requests for priority disposal of appeals, based on genuine and exceptional circumstances, will be assessed by the PCCIT, CCIT, or DGIT, upon recommendations from jurisdictional PCIT, PCIT (Central), or CIT(IT).



Indian/Global Updates



Australian Federal Court dismisses SingTel's appeal on cross-border related party financing dispute

The Australian Federal Court had dismissed a taxpayer's appeal regarding transfer pricing benefits for deductions related to interest paid on loans between two subsidiaries for the acquisition of Optus Telecommunications in Australia. The appeal focused on comparing actual deductions against a hypothetical scenario without Non-Independence Conditions. Despite arguments about interest rates, the court upheld the primary judge's decision that the taxpayer failed to demonstrate excessive assessments. The court found the taxpayer's application of tax laws flawed and upheld the primary judge's findings, rejecting all alleged errors raised by the taxpayer and ordering them to pay costs.



Transfer Pricing / B E P S

OECD Secretary-General's Report apprises on status of Two Pillar Solution, BEPS actions & information exchange

OECD provided an update on the Two Pillar Solution in his Tax Report to G20 Finance Ministers and Central Bank Governors. The report highlights that over 35 jurisdictions have already implemented or to be implemented the Pillar Two global minimum tax, significantly reducing low-taxed profits globally. The Inclusive Framework aims to finalize the Multilateral Convention to Implement Amount A of Pillar One by March's end, with a signing ceremony expected by June 2024. Further, progress has been made on Amount B, which has been incorporated into OECD Transfer Pricing Guidelines. The report emphasizes ongoing work on the interdependence of Amount B and Amount A. Progress continues on implementing BEPS Actions, especially the four minimum standards. The report suggests enhancing capital taxes to

reduce income and wealth gaps. It commends the expansion of the Global Forum, with high compliance levels noted in peer reviews. Technical discussions have begun on the Crypto-Asset Reporting Framework, aiming for widespread implementation by 2027.



Issue of the month

Risk Adjustment

Introduction

The core principle in transfer pricing is ensuring that the transactions between related parties are priced as if they were done with unrelated parties. Typically, the price of a transaction between unrelated parties reflects the functions performed, assets utilized and risks undertaken by the participants of such transaction. Therefore, it is imperative that any difference in such functions, assets and risks be carefully analysed and compared to determine the arm's length price. Risk borne by participants of a transactions can significantly affect the price of a transaction. Entities undertaking more risk typically attract a higher return. Thus, any difference between the risk profile of tested transaction / tested party and comparable, should be carefully analysed to determine whether there are material differences between them and if so whether such difference(s) can be eliminated by means of a reliable adjustment.

Risk adjustment thus plays a significant role in arm's length analysis. Risk adjustment refers to the process of eliminating the impact of differences in risk profile

of controlled transactions and uncontrolled transactions, on the arm's length price.

The risk adjustment is undertaken when comparables chosen for determining the arm's length price have different business complexities and bear a different level of risks or other business risks to that of the taxpayer

Rule 10B (3) of the Income-tax Rules, 1962, states that an uncontrolled transaction will be comparable to an uncontrolled transaction, if there are no significant differences between the transactions being compared or between the enterprises involved in such transactions, that are likely to materially impact the price, cost, or profit generated from these transactions in the open market or reasonably accurate adjustments can be made to eliminate the material effects of such differences.



How to make risk adjustment?

The Indian regulations silent as to methodology of making adjustments to eliminate differences between the transactions being compared or between the enterprises involved in such transactions. While it is very difficult and highly subjective to qualify the risk, the tax practitioners have attempted to make risk adjustment by employing various methodologies, some of which are discussed hereunder;

1. Capital Asset Pricing Model ('CAPM'):

CAPM model determines the expected return on an investment based on its risk and the market's expected return. CAPM use formula given below:

$$CAPM = R_f + \beta(R_f - R_m)$$

where,

R_f = Risk free rate in the market

β = Beta coefficient. It is measure of a stock's volatility in relation to the overall market.

R_m = Expected market return

This method was discussed first in the case of **Motorola Solutions India (P.) Ltd. vs ACIT Motorola Solutions India Pvt. Ltd.** [TS-240-ITAT-2014(DEL)-TP], where ITAT directed TPO to consider computation of risk adjustment as per CAPM by availing services of technical experts.

2. Interest Rate Differential Method

Interest rate differential method measures the difference between the interest rates of two similar assets or investments. This method simply measures the differences between interest rates. For instance,

$$IRD = PLR - BR$$

where,

PLR = Prime lending rate

BR = Bank rates

Interest rate differential method was discussed in the case of *Philips Software Centre P Ltd* [TS-8-ITAT-2008(Bang)-TP] - September 26, 2008, Bangalore, wherein the assessee comparability adjustment on account of difference in risk profiles and risk adjustment of 5.25% was claimed by assessee, which was the difference between the Prime Lending Rate and the Bank Rate.

Further, in the case of *Vishay Components (P.) Ltd. vs. Assistant Commissioner of Income tax* [2017] 83 taxmann.com 319 (Pune - Trib.) [31-05-2017], The assessee computed risk adjustment on account of difference in risk profile by taking difference of average prime lending rates and average bank rates. The Hon'ble tribunal directed AO to allow risk adjustment.

Challenges

There are numerous challenges faced by tax practitioners while adjusting the risks so involved in the transactions, some of which are:

- **Subjective Nature:** One significant challenge is the subjective nature of risk, which can lead to various interpretations, causing disputes between taxpayers and tax authorities.

- **Quantifying Risk:** Quantification of risk is a complex procedure and often require human judgement.

- **Data Availability:** Finding reliable data on comparable transactions with similar risk profiles can be a hurdle, especially

Evolution of Risk Adjustment in Transfer Pricing: A Legal Journey

Transfer pricing regulations have long been a battleground for companies and tax authorities. However, one of the most controversial issues within transfer pricing has been the concept of risk adjustment.

Over the years, courts and tribunals have struggled with the question of how to accurately assess and adjust for the risks undertaken by multinational corporations.

One of the earliest cases addressing risk adjustment in India's transfer pricing history is that of E-gain Communication (P.) Ltd. vs. ITO. Here, the Tribunal emphasized the necessity of incorporating risk adjustments, particularly when the taxpayer assumes minimal risk in transactions with its parent company.

In principle, the need for risk adjustment was confirmed in various subsequent ITAT rulings also. However, the quantification of risk adjustments remained a highly contentious issue. The case of

Philips Software Centre Private Limited vs. ACIT marked a turning point in this regard. ITAT approved comparability adjustments being made to eliminate differences on account of differences in risk profile, working capital and accounting policies and The Tribunal allowed a flat risk adjustment of 5.25 percent on account of differences in the prime lending rates and the prevailing bank rates.

The issue continued to evolve, with courts delving deeper into the various types of risks involved in multinational transactions. In Sony India Ltd vs. ITO, the Delhi ITAT highlighted significant risks such as market risk, contract risk, and intellectual property infringement risk, assessing their impact on transactional value. This marked a shift towards a more comprehensive understanding of risk factors and their implications.

As transfer pricing disputes became more complex, courts struggled with issues such as single customer risk and political risks. The case of DE Shaw India Software Pvt. Ltd. exemplifies this, with the Hyderabad ITAT acknowledging the unique risk profile of captive service providers and granting a 1% risk adjustment. Similarly, in Outsource Partners International Pvt Ltd, the Bangalore ITAT recognized the differential risk profiles between captive service providers and independent entities.

Based on the aforementioned rulings, it may be said clear that taxpayers are eligible to claim Risk adjustment, provided they can substantiate it with accurate calculations and supporting documentation. This necessitates the ability to quantify risk and furnish the necessary computations. Additionally, taxpayers must be capable of showcasing that comparable entities have genuinely assumed similar risks, significantly impacting their profit margins.

Conclusion

Risk adjustment is essential for accurately determining the Arm's Length price, particularly when comparing entities have varying risk profiles. While methodologies such as the CAPM and Interest Rate Differential Method offer frameworks for quantifying risk adjustments, challenges persist, including subjectivity in risk assessment, complexities in quantification, and data availability issues.

Court rulings have underscored the necessity of accurate projections, evidence, and documentation in justifying risk adjustments, emphasizing consistency and fairness in their application. Recent cases have reaffirmed taxpayers' eligibility to claim risk adjustments, provided they can substantiate them with accurate calculations and supporting evidence.



Legal Corner



In the Income Tax Appellate Tribunal

Jamshedpur Continuous Annealing & Processing Company (P) Ltd. vs. National e-Assessment Centre

Introduction & Brief Facts

Jamshedpur Continuous Annealing & Processing Company (P) Ltd. (**"the Assessee"**) is a joint venture between Tata Steel Ltd., Nippon Steel and Sumitomo Metal Corporation which was incorporated for constructing, owning and operating Continuous Annealing and Processing Line in Jamshedpur for the production of continuously annealed, cold-rolled steel/coils and sheets for catering to the niche product requirements of the automotive sector which was not very established in India.

For the Assessment Year (**"AY"**) 2017-18 and 2018-19, the Transfer Pricing Officer (**"TPO"**) made adjustments of value Rs. 35,27,000 and Rs. 20,33,322 for both the years respectively while determining the arm's length price (**"ALP"**) of the international transactions entered into by the assessee.

During the calculation of the Net Profit margin of assessee the TPO had considered the depreciation

charged by the assessee, which in the view of assessee should not be considered while coming at the ALP as it is a newly setup business entity.

Further, the TPO rejected two comparables (Vallabh Steel Ltd. and Uttam Galva Steel Ltd.) considered by the assessee for the purpose of benchmarking. The TPO in place of these two rejected comparables, selected two other companies (Tata Steel BSL Ltd. and M/s Stelco Ltd.) which according to the assessee were engaged in functionally different operations.

Subsequently, the assessee also requested for acceptance of cash PLI (**"Profit Level Indicator"**) for calculation of ALP. However, the TPO rejected the same and although the assessee's plea was accepted by the Dispute Resolution Panel (**"the DRP"**), the same was not considered by the TPO.



¹Cash PLI = Cash Credit ÷ Operating Revenue

The assessee, being aggrieved by the assessment order, filed an appeal before the Income Tax Appellate Tribunal ("ITAT").

Arguments of Assessee

The Id. counsel of the assessee submitted that the assessee was using Transactional Net Margin Method ("TNMM") as Most Appropriate Method ("MAM") where the cash PLI margin (excluding depreciation) comes at 3.45%. However, when the depreciation is included, the margin inflates upto 16.92%.

The Id. counsel further added that the company is a newly set up business entity so all the fixed assets were yielding huge depreciation and excluding the same will result in cash PLI being almost similar with the comparables.

Hence, the Id. counsel contended that considering depreciation as a part of Total Cost would not be appropriate for the purpose of benchmarking.

In this regard, significant reliance was also placed on the case of DCIT vs. M/s Epcos Ferrites Ltd.

The assessee also prayed to reject Stelco Ltd. and Tata Steel BSL Ltd. as comparables on the grounds that these companies were functionally different and accept M/s Vallabh Steel Ltd. and M/s Uttam Galva Steels Ltd. in place of these rejected companies.

Honourable ITAT Order

After hearing all the rival submissions and considering all the documents available in the record, ITAT ruled that the depreciation should be removed for calculation of net profit margin and considered cash PLI as a justified method for calculation of ALP.

Further, ITAT directed TPO/AO to remove both Stelco Ltd. and Tata Steel BSL Ltd. as comparables and add M/s Vallabh Steel Ltd. and M/s Uttam Galva Steels Ltd. after considering the functions and activities of the two companies, during calculation of fair net profit for ALP.

Conclusion

Rule 10B of the Income Tax Rules, 1962, allows any reasonable accurate adjustment(s) to the comparable transaction(s) which eliminates material effects of differences occurring in the price, cost or profits. By placing reliance on this principle, the exclusion of a line item which results in distortion of profit margins plus accentuates the difference(s) between the profits/revenue of the assessee vis-à-vis comparables seems rationally acceptable.

Similar adjustment has been supported in several other ITAT rulings like *Bosch Automotive Electronics India (P) Ltd. [TS-135-ITAT-2021(Bang)-TP]* and *Gates India (P) Ltd. [TS-649-ITAT-2017(DEL)-TP]*, specifically when the distortion was found on account of charging depreciation expenditure during initial phase of business operations of the assessee.

Glossary



Act	Income Tax Act, 1961
A.Y.	Assessment Year
AE	Associated Enterprises
ALP	Arm's Length Price
AO	Assessing Officer
APA	Advance Pricing Agreement
BEPS	Base Erosion and Profit Shifting
CSP	Captive Service Providers
CBDT	Central Board of Direct Taxes
CIT	Commissioner of Income Tax
CAPM	Capital Asset Pricing Model
DRP	Dispute Resolution Panel
DGIT	Directorate General of Income Tax
DST	Digital Service Tax
FA	Finance Act
GMT	Global Minimum Tax
HC	High Court
ITAT	Income Tax Appellant Tribunal
IRD	Interest Rate Differential Method
ITO	Income Tax Office
JCIT	Joint Commissioner of Income Tax
MNE	Multi-National Enterprise
MAM	Most Appropriate Method
NR	Non-Resident
OECD	Organisation for Economic Cooperation and Development
PCCIT	Principal Chief Commissioner of Income Tax

Glossary



SDT	Specified Domestic Transactions
TDS	Tax Deducted at Source
TP	Transfer Pricing
TNMM	Transaction net margin method
TPO	Transfer Pricing officer

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

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