

TAX FLASH NEWS

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Companies for which data is not available in the public domain can be selected by the Transfer Pricing Officer as comparables by using their power to call for information under Section 133(6) of the Income-tax Act

Background

The Kolkata Bench of the Income Tax Appellate Tribunal (the Tribunal) in the case of Philips Medical Systems (P.) Ltd.¹ (the taxpayer) has pronounced its ruling on certain Transfer Pricing (TP) issues. Firstly, the Tribunal ruled in the favour of the taxpayer by holding that an entity engaged in both manufacturing as well as trading activity, in the absence of segmental accounts, cannot be treated as a comparable company for benchmarking the taxpayer (engaged mainly in trading activity).

Secondly, the Tribunal disallowed the ground raised by the taxpayer that comparables whose results are not available in the public domain should not be considered. The Tribunal upheld the order of the Commissioner of Income-tax (Appeals) [CIT(A)].

Facts of the case

- The taxpayer is a distributor and commission agent for medical equipment in India. During the year it has imported equipment and spares for distribution from its associated enterprise (AE). It has also received commission income from its AE. The taxpayer justified the arm's length nature of transactions by application of Transactional Net Margin Method at entity level. The taxpayer used 10 comparable companies and operating profit to sales as the profit level indicator.
- The Transfer Pricing Officer (TPO) however rejected all the comparable companies selected by the taxpayer (providing reasons such as substantial related party transactions, functional comparability, low turnover, etc.). The TPO selected two comparable companies for which data was not available in the public domain.

- Upon appeal, the CIT(A), while reducing the adjustment by accepting 5 out of 10 comparable companies of the taxpayer, also held that restriction to use publicly available data does not apply to the AO. Hence the two comparable companies selected by the TPO were also accepted resulting in selection of seven comparable companies including two selected by the TPO.
- Cross appeals were filed both by the taxpayer as well as the department.

Tribunal's decision

- The Tribunal upheld the decision of the CIT(A) that the restriction stipulated in Rule 10D is applicable only to the auditor and not to the TPO, who has an inherent power to make enquiry and collect and use the information and material which is found to be relevant for the purpose of transfer pricing analysis in order to determine the arm's length price of the relevant international transactions between the AE.
- The Tribunal rejected a comparable engaged in manufacturing as well as trading activity in the absence of segmental details as it is not functionally comparable to the taxpayer which is mainly engaged in trading activity.

Our comments

The Tribunal in the present case has laid down two important precedents:

- No restriction on exercise of powers under Section 133(6) of the Income-tax Act, 1961 by the TPO to call for information
- A company engaged in both manufacturing and trading cannot be treated as functionally comparable to the taxpayer engaged in trading activity if appropriate segmental accounts are not available.

¹ Philips Medical Systems (P.) Ltd. v. ITO [2019] 102 taxmann.com 441 (Kol)

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