



## Acceptance of arm's length price in case of one party cannot prevent the Revenue to determine the arm's length price of the same transaction in the hands of the other party

### Background

The Bangalore Bench of Income-tax Appellate Tribunal (the Tribunal) in the case of Filtrex Technologies Pvt. Ltd.<sup>1</sup> (the taxpayer) held that acceptance of Arm's Length Price (ALP) declared by one party cannot preclude Revenue from examining ALP in the hands of the other party to the same transaction. Relying on the second proviso to Section 92C(4) of the Income-tax Act, 1961 (the Act) and Circular No. 14/ 2001, dated 9 November 2001, the Tribunal held that the income of one Associated Enterprise (AE) is not required to be recomputed by reason of determination of ALP in the case of the other enterprise. Also, by applying the provisions of Section 92(3) of the Act, held that in case of an adjustment to the payment, corresponding adjustment leading to reduction in income cannot be made.

Further, opined that in case a transaction which could result in tax base erosion, the tax department is free to examine the ALP, irrespective of the fact that the income declared by one party was accepted to be at ALP.

### Facts of the case

- During Financial Year (FY) 2011-12, the taxpayer entered into international transactions related to payment of royalty and payment of administrative, financial and marketing services (here-in-after referred as 'management cross charge') with its AEs Filtrex Holdings Pte. Ltd. (FHPL) and Filtrex International Pte. Ltd. (FIPL) respectively.

- The Transfer Pricing Officer (TPO) examined the arm's length nature of the aforesaid international transactions.
- Due to lack of evidences submitted by the taxpayer to substantiate the need and benefit received for the payments made towards royalty and management cross charges, the TPO determined the ALP of both the transactions as nil.
- The Dispute Resolution Panel (DRP) upheld the action of the TPO and passed its directions in conjunction with the view of the TPO.
- Aggrieved by the order passed by the Assessing Officer (AO) incorporating the direction passed by the DRP, the taxpayer filed an appeal before the Tribunal.
- Post DRP proceedings, the income tax return filed by the AEs i.e. FHPL and FIPL were selected for income tax scrutiny and the returned income of the aforesaid entities were accepted by the AO. It is pertinent to note that the AO did not make a reference to the TPO, thereby accepting the income declared in the tax return to be at arm's length.
- Before the Tribunal, in addition to the primary grounds regarding determination of the ALP at nil, the taxpayer argued that the returned income of its AEs, being parties to the transactions under consideration with the taxpayer, have been accepted, thereby the Revenue presupposing that the amount received by AEs from the taxpayer is at ALP. Since the income is considered to be at ALP, the taxpayer contended that the expense should also be considered at ALP in the hands of the taxpayer.

<sup>1</sup> Filtrex Technologies Pvt. Ltd. v. ACIT, Circle-(3)(1) [IT(TP)A Nos.469/Bang/2017]

- The taxpayer relied on the judicial precedent in case of UE Development India Pvt. Ltd.<sup>2</sup> to support its argument.

### Tribunal's ruling

***Whether the income accepted at ALP in the hands of one party means that the corresponding payment by another party should also be regarded as at arm's length?***

- On merits, the Tribunal noted that AO accepted the returns of the AEs without making any adjustment on account of ALP.
- The Tribunal observed that AO has accepted the income earned by the AEs to be at arm's length, however has not accepted the expenditure claimed by the assessee, from the same transactions, to be at arm's length.
- The Tribunal placed reliance on proviso to Section 92C(4) of the Act and Circular No. 14/2001, dated 9 November 2001 and held that income of one AE from which tax has been deducted (or to be deducted) shall not be recomputed merely by reason of an adjustment made in the case of the other AE on determination of arm's length price by the AO. Therefore, the Tribunal opined that in case of an adjustment in the hands of the taxpayer, a corresponding adjustment cannot be made in the hands on the AEs i.e. FHPL and FIPL.
- Further, the Tribunal also held that in case of any transaction which could lead to tax base erosion, the AO is free to refer the case to the TPO for determination of the arm's length price. Whereas, corresponding adjustment in the assessment of the other enterprise to the transaction need not be made where there is no tax base erosion.
- The Tribunal affirmed its aforesaid view in light of Section 92(3) of the Act which lays down that the provisions of ALP will not apply in case the determination of ALP would result in reducing the income chargeable to tax or increasing the losses as the case may be.
- Also, the Tribunal highlighted that provisions of Section 92CA(4) and held that the AO is mandated to pass the order based on the adjustment made by the TPO and does not have a right to deny such adjustment. Therefore, in the instant case, the AO has to accept the adjustment made by the TPO in case of the taxpayer without making a corresponding adjustment in the hands of FIPL and FHPL in light of Sections 92C(4) and 92(3) of the Act.

- The Tribunal observed that there appears to a conflict between the provisions of Section 92CA(4) and 92(3) of the Act. However, held that a harmonious construction of these sections would mean that in respect of a same transaction the Revenue can opt to determine total income on the basis of ALP determined in accordance with Section 92(1) of the Act, in the hands of one party to the said transaction, wherever there is a tax base erosion.
- With respect to the determination of the ALP of the transactions in the nature of royalty and management cross charge, the Tribunal opined that the TPO is required to examine the transaction in detail and the evidences in respect of the payments made and benefit received, prior to determining the ALP. Accordingly, the Tribunal remanded back to the TPO for further examination and computation of the ALP.

### Our comments

In general, the ALP accepted for a transaction holds good for both the limbs of the transaction viz. expense and income. However, the Indian transfer pricing provisions and the intent of the law expects the tax authorities to examine the transactions independently to ensure that the same does not lead to any tax base erosion. Therefore, mere acceptance of the ALP in case of one party to a transaction would not automatically lead to acceptance of the ALP in case of the other party.



<sup>2</sup> UE Development India Pvt. Ltd. v. DCIT [IT(TP)A No. 1104/Bang/2011 and IT(TP)A No. 284 to 286/Bang/2012]

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