

Tax Flash News

21 April 2023

The Supreme Court of India overturns various High Court decisions on the transfer pricing issues and remits the matter back to examine any perversity in the relevant Tribunal orders

Executive Summary

The Supreme Court of India¹ has recently dealt with the admissibility of an appeal with the High Court under Section 260A of the Income-tax Act, 1961 (the Act), involving the transfer pricing issue of comparable data. In a batch of appeals², the Supreme Court has reversed the decision of the Karnataka High Court in the case of Softbrands India (P) Ltd³, which dismissed the revenue's appeals challenging the findings of the relevant Tribunal decision⁴. The Supreme Court has quashed and set aside various High Court orders involved in the batch of appeals and remanded the cases back to High Courts for fresh adjudication and to examine whether the findings recorded by the Tribunal while determining the Arm's Length Price (ALP) are perverse or not. The Supreme Court decision is likely to result in increased litigation at the High Court level as both taxpayers and revenue authorities may prefer an appeal with the High Court against adverse Tribunal orders on various transfer pricing issues.

To set the context, selection and rejection of comparable companies' data and application of filters constitute a significant part of the overall transfer pricing litigation in India. In this regard, the Karnataka High Court in the case of Softbrands India (P) Ltd noted that the existence of a substantial question of law is *sine qua non* for maintaining an appeal before High Court. It was noted that unless the findings of the Tribunal

are ex-facie perverse and unsustainable and exhibit a total non-application of mind by the Tribunal to the relevant facts of the case and evidence placed on record before the Tribunal, the High Court cannot interfere or disturb the findings of the Tribunal. The High Court had further noted that if it took the path of making such a comparative analysis, it will drag the High Courts into a whirlpool of data analysis defeating the very purpose of Section 260A i.e., to adjudicate on the substantial question of law. The said decision had a bearing on numerous appeals before various High Courts on similar transfer pricing issues and a consistent view was taken by the High Courts whereby appeals challenging the findings of the Tribunal were dismissed on the ground that the issues decided by the Tribunal are the question of facts and as perversity is neither pleaded nor argued nor demonstrated, no substantial question of law arises for consideration under Section 260A.

Revenue's contentions

- The ALP is to be determined in accordance with the provisions related to transfer pricing in Chapter X of the Act read with Income Tax Rules, 1962 (the 'Rules'). Thus, it is always open for the High Court to consider and/or examine, whether the guidelines stipulated under the Act and the Rules, while determining the ALP have been followed by the Tribunal or not.
- If the determination of the ALP by the Tribunal is de hors of the guidelines stipulated under the Act and the Rules, the said ALP determination can be said to be perverse and is open for adjudication by the High Court.

¹ SAP Labs India Pvt. Ltd. & Others Civil Appeal No. 8463 OF 2022 [Arising from S.L.P.(Civil) No.28652/2018] – Taxsutra.com

² Batch of 143 appeals

³ PCIT v. Softbrands India (P) Ltd. [2018] 406 ITR 513 (Kar)

⁴ Softbrands India P Ltd [TS-206-ITAT-2015(Bang)-TP]

- The Karnataka High Court, in the case of Softbrands India (P) Ltd. erroneously held that the Tribunal is the final fact-finding authority on determining the ALP.
- There cannot be an absolute proposition of law that the High Court shall not interfere against the decision of the Tribunal in an appeal under Section 260A.

Taxpayer's contention

- Once the ALP is determined by the Tribunal taking into account the relevant provisions of the law, a challenge to the same cannot be said to be a substantial question of law.
- Jurisdiction under Section 260A cannot be invoked unless there arises a substantial question of law. A substantial question of law can arise in a case only when a question of law is fairly arguable, where there is room for a difference of opinion on it. Section 260A also provides that the High Court may determine any issue which (a) has not been determined by the Tribunal; or (b) has been wrongly determined by the Tribunal.
- The fact-finding may give rise to a substantial question of law, inter alia, in the event the findings are based on (i) no evidence; and/or (ii) while arriving at the said finding, relevant admissible evidence has not been taken into consideration or inadmissible evidence has been taken into consideration; or (iii) legal principles have not been applied in appreciating the evidence; or (iv) when the evidence has been misread.
- Placing reliance on various decisions, it was emphasized that, the Tribunal, being a final fact-finding authority, in the absence of demonstrated perversity in its finding, interference therewith by the High Court is not warranted.
- The revenue's submission, seeking High Court's examination in each case, as to whether the guidelines laid down in the Act and the Rules are followed to determine the ALP, is not correct and is too farfetched, as the High Court can only decide the substantial question of law raised and arising before it.
- The Tribunal and various High Courts have indeed applied the guidelines laid down in the Act and the Rules, over the last two decades, which has contributed to the evolution of a process. An intervention in the present batch of appeals and/or laying down any guidelines

ignoring this background could potentially disturb the well-settled principles. Moreover, it would cast an unjust and onerous burden on the High Court to undertake a suo-moto exploration of facts not placed before it.

- Transfer pricing provisions are essentially a valuation exercise involving the determination of a statistical sample of comparables. It is not a science, but it is an art. Placing reliance on the Supreme Court decision in the case of G.L. Sutania and Anr v SEBI and Ors.⁵, it was contented that valuation is a question of fact.

Supreme Court decision

- The Supreme Court held that the Tribunal has to follow the guidelines stipulated under Chapter X of the Act read with the Rules. Any ALP determination de hors the relevant provisions can be considered as perverse and it may be considered a substantial question of law, as perversity itself can be said to be a substantial question of law.
- The Supreme Court agreed with revenue's contention that there cannot be any absolute proposition of law that in all cases where the Tribunal has determined the ALP, the same is final and cannot be the subject matter of scrutiny by the High Court.
- Further, when ALP determination is challenged before the High Court, it is open for the High Court to consider and examine whether such ALP has been determined taking into consideration the relevant provisions under the Act and the Rules. The Supreme Court further noted that the High Court can also examine the question of comparability of two companies or selection of filters and examine whether the same is done judiciously and on the basis of the relevant material/evidence on record.
- Accordingly, the Supreme Court quashed and set aside the High Court orders. The matters are remitted back to the concerned High Courts to decide and dispose of the respective appeals afresh and examine in each case whether the guidelines laid down under the Act and the Rules are followed while determining the ALP by the Tribunal and whether the findings recorded by the Tribunal while determining the ALP are perverse or not. The Supreme Court has also noted a timeline of nine months from the date of receipt of the present order to the respective High Courts to complete the exercise.

⁵ G.L. Sutania and Anr v SEBI and Ors. reported in 2007 (5) SCC 133

Our comments

Transfer Pricing ('TP') issues are very subjective and prone to protracted litigation. The need for a separate Transfer Pricing wing for assessment purposes, the constitution of a collegium of three Commissioners as part of the Dispute Resolution Panel set-up, and a separate bench in certain Tribunals for TP and international tax matters indicate the tax department's consideration of TP matters as a specialized and fact-intensive domain. Tribunals de facto have been considered the final fact-finding authority in India. Only legal issues or in other words 'substantial questions of law' go up to the High Courts and Supreme Court in India for further adjudication. However, with this landmark Supreme Court decision, the India TP litigation landscape is likely to change significantly.

The Tribunal has long been considered the final fact-finding authority deciding the TP issues around comparability analysis. However, with this Supreme Court decision, the existing tax litigation process in India, which is already considered time-consuming, may seem to add greater uncertainty and litigation costs. Efforts of taxpayers relating to transfer pricing matters may increase significantly as more of revenue's appeals may potentially get admitted for the hearing at the High Court level. This is also likely to add to the existing significant backlog of cases at the High Court level. The recent amendment introduced by the Finance Act 2023 enabling the revenue to file cross-objections in response to the appeals filed by the taxpayers against the DRP directions is another such development that may add to the litigation timelines and process.

A cost-effective mechanism to resolve complex transfer pricing disputes in a conducive taxation environment and in a time-bound manner is the need of the hour. Given the potential impact of this decision, taxpayers need to evaluate their overall TP dispute resolution strategy using a multi-pronged approach - starting from the preparation of robust TP documentation which includes detailed processes and data for comparability analysis, strengthening the submissions filed during the assessment proceedings and before the Tribunal, and consideration of alternate dispute resolution mechanisms including the Advance Pricing Agreement (Unilateral / Bilateral), Mutual Agreement Procedure (MAP)⁶ and safe harbor mechanism.

⁶ Regarding MAP, it is important to note that the regulations (Rule 44G) now provide that Competent Authorities shall endeavor to arrive at a mutually agreeable resolution of the tax disputes, within an average time period of twenty-four months.



KPMG in India addresses:

Ahmedabad

Commerce House V, 9th Floor,
902, Near Vodafone House, Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051.
Tel: +91 79 4040 2200

Bengaluru

Embassy Golf Links Business Park,
Pebble Beach, 'B' Block,
1st & 2nd Floor,
Off Intermediate Ring Road, Bengaluru – 560071
Tel: +91 80 6833 5000

Chandigarh

SCO 22-23 (1st Floor),
Sector 8C, Madhya Marg,
Chandigarh – 160 009.
Tel: +91 172 664 4000

Chennai

KRM Towers, Ground Floor,
1, 2 & 3 Floor, Harrington Road,
Chetpet, Chennai – 600 031.
Tel: +91 44 3914 5000

Gurugram

Building No.10, 8th Floor,
DLF Cyber City, Phase II,
Gurugram, Haryana – 122 002.
Tel: +91 124 307 4000

Hyderabad

Salarpuria Knowledge City,
6th Floor, Unit 3, Phase III,
Sy No. 83/1, Plot No 2, Serilingampally
Mandal,
Ranga Reddy District,
Hyderabad – 500 081.
Tel: +91 40 6111 6000

Jaipur

Regus Radiant Centre Pvt Ltd.,
Level 6, Jaipur Centre Mall,
B2 By pass Tonk Road,
Jaipur – 302 018.
Tel: +91 141 - 7103224

Kochi

Syama Business Centre,
3rd Floor, NH By Pass Road,
Vytila, Kochi – 682 019.
Tel: +91 484 302 5600

Kolkata

Unit No. 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata – 700 091.
Tel: +91 33 4403 4000

Mumbai

2nd Floor, Block T2 (B Wing),
Lodha Excelus, Apollo Mills Compound, N M
Joshi Marg, Mahalaxmi, Mumbai- 400011
Tel: +91 22 3989 6000

Noida

Unit No. 501, 5th Floor,
Advant Navis Business Park,
Tower-A, Plot# 7, Sector 142,
Expressway Noida,
Gautam Budh Nagar,
Noida – 201 305.
Tel: +91 0120 386 8000

Pune

9th floor, Business Plaza,
Westin Hotel Campus, 36/3-B,
Koregaon Park Annex,
Mundhwa Road, Ghorpadi,
Pune – 411 001.
Tel: +91 20 6747 7000

Vadodara

Ocean Building, 303, 3rd Floor,
Beside Center Square Mall,
Opp. Vadodara Central Mall,
Dr. Vikram Sarabhai Marg,
Vadodara – 390 023.
Tel: +91 265 619 4200

Vijayawada

Door No. 54-15-18E,
Sai Odyssey,
Gurunanak Nagar Road, NH 5,
Opp. Executive Club, Vijayawada,
Krishna District,
Andhra Pradesh – 520 008.
Tel: +91 0866 669 1000

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KPMG Assurance and Consulting Services LLP, Lodha Excelus, Apollo Mills Compound, NM Joshi Marg, Mahalaxmi, Mumbai - 400 011 Phone: +91 22 3989 6000, Fax: +91 22 3983 6000

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