Tax Flash News

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Mumbai Tribunal upheld "at-cost" TP method for Shell India's provision of technical services in oil & gas domain; validates industry practice, OECD alignment and use of independent expert opinion

Executive summary

The Mumbai Bench of the Income-tax Appellate Tribunal ('the Tribunal') delivered a landmark ruling in the case of *Shell India Markets Pvt. Ltd.* ('SIMPL' or 'the taxpayer')[1], upholding the taxpayer's "at-cost" (no mark-up) transfer pricing ('TP') model for rendering technical services to its associated enterprise ('AE') relating to oil & gas operations.

In reaching this conclusion, the Tribunal considered the typical consortium framework related to upstream oil and gas sector operating under Production Sharing Contracts ('PSCs'), which often include restrictions prohibiting profit margins on such technical services. Amongst other factors, the Tribunal also took into consideration an independent expert opinion obtained by the taxpayer which after analysing Indian TP provisions, OECD guidelines along with industry practice concluded that "at-cost" model adopted satisfies the arm's length principle ('ALP').

[1] *Shell India Markets Private Limited* v. *NFAC/ DCIT* (ITA No. 4828/ Mum/ 2024)

Also, it was noted by the Tribunal that the evidence on record, which includes sample and identical PSCs, that other consortium members render and receive similar technical services on “at-cost” basis, demonstrates that “at-cost” model is the industry norm and meet the requirement of the ‘Other Method’ as contemplated by Rule 10AB of the Income-tax Rules, 1962.

In relation to the other international transactions of the taxpayer that formed part of an aggregate TP adjustment of more than INR 5,000 million in this case, the Tribunal disregarded the Transfer Pricing Officer’s (‘TPO’) approach using non-contemporaneous data, application of arbitrary turnover filter and non-examination of the cost allocation documentation. In this respect, the Tribunal remanded the matter to the TPO for fresh analysis with specific direction on conducting contemporaneous comparable search, provide cogent reasons of applying any filters, analysing the functional analysis of comparable companies and record clear findings on inclusion and exclusion of such comparables. For cost allocation, the Tribunal directed the TPO to examine the evidence, verify services and benefits, and apply a recognised TP method under section 92C of the Income-tax Act, 1961 (‘the Act’) and Rule 10B/10AB.

Facts of the case

SIMPL’s international transactions primarily involved the rendering of specialised technical services in relation to Exploration and Production (‘E&P’) in the oil and gas sector. Further, the taxpayer entered into other international transactions in the nature of technical non-E&P services, IT and IT-enabled services, recovery against employees seconded to AE and payment to AEs against certain cost allocations.

The technical services include upstream E&P activities such as geological and reservoir engineering charged strictly at cost, without any profit element, in compliance with PSC terms that prohibit mark-up on services covered under PSC. TPO made an adjustment adding a margin of 16.52 per cent on the cost. The Dispute Resolution Panel (‘the DRP’) confirmed the adjustment, citing consistency with prior years and Revenue’s stand.

For the non-E&P services, IT and ITeS services, the taxpayer *suo-moto* offered mark-up of 16 per cent, 12 per cent and 8 per cent respectively, that were considered to be at arm’s length. The TPO rejected SIMPL’s benchmarking and applied modified filters while importing comparable from earlier years. The DRP upheld TPO’s approach.

The taxpayer was charged a cost allocation with respect to certain centralised strategic and support services it received from the AE. The TPO accepted the charge as much as it related to the cost-plus IT/ITeS services *(considering it already formed part of the cost base which was offered to taxes)*. However, for the remaining charges, the ALP of the cost allocation was considered by the TPO at *nil* citing lack of evidence of need, service, and benefit.

Lastly, the taxpayer seconded employees to AEs for training and global exposure, recovering actual costs without mark-up. The TPO treated recoveries as support service fees, applied Transactional Net Margin Method ('TNMM') without Functions, Assets and Risks ('FAR') analysis or transparent comparables.

Tribunal's decision

E&P services – "At-cost" policy accepted and entire adjustment deleted

The Tribunal upheld that technical services rendered under PSCs for upstream oil & gas operations should be benchmarked strictly at cost under the Indian TP regulations. In reaching this conclusion, the Tribunal considered the PSC framework, the conduct of other consortium members, expert opinion on record, and absence of any true comparable third-party uncontrolled transactions for such specialised services to uphold the arm's length nature of "at-cost" recharges to the AE.

The Tribunal's observations for forming the above view are summarised hereunder:

- The Tribunal struck down the TPO's approach for benchmarking upstream technical services using ITeS comparables, without analysing the functional, risk and market differences, given that remuneration is already embedded in the PSC framework.
- Other consortium members render and receive similar upstream technical services strictly on an "at-cost" basis under identical PSCs. This is

precisely the type of situation contemplated by Rule 10AB (other method) and, in substance, aligns with the principles of the Comparable Uncontrolled Price ('CUP') method.

- Independent expert opinion confirming that cost-only pricing under PSCs is consistent with OECD guidelines, industry practices and the Indian TP provisions which the TPO and DRP failed to appreciate.
- The Tribunal stated that the Revenue must strive for degree of coherence and consistency as similar facts have been considered at arm's length in the hands of other consortium members.
- The Tribunal concluded that TP provisions cannot ignore the commercial and legal framework of PSCs.

Other transactions

The Tribunal noted w.r.t. SBO[2] IT/ ITeS services that while the fresh analysis submitted by the taxpayer appears robust, remanded the matter to the TPO/ Assessing officer ('AO') for de novo determination with clear directions to:

- Conduct a fresh current-year search by applying Rule 10B(5) and Rule 10CA.
- Consider taxpayer's updated analysis and supporting documents.
- Avoid arbitrary filters like the 1/10–10 times turnover band unless justified.

The Tribunal further noted w.r.t. the cost allocations considered to be *nil*, the TPO himself has accepted the cost allocation in respect of shared service segment and has only rejected the cost allocation pertaining to downstream segment, even though both emanate from the same centralised cost pools and agreements. The Tribunal admitted additional evidence, noted inconsistent treatment, and remitted downstream cost allocation to AO/ TPO for fresh determination. The Tribunal has held that determining ALP at *nil* without applying any prescribed method is contrary to law. It also observed that questioning commercial expediency falls outside the scope of TP provisions. Once a taxpayer maintains and produces evidence of receipt of intra-group services, allocation keys, and benefits derived, the same cannot be considered to be *nil* even under the 'Other method'.

For '*Recoveries'*, the Tribunal held that the matter needs fresh examination on taxpayer's role, nature of cost recoveries, and proper benchmarking if characterised as service, and remitted it to AO/ TPO for re-adjudication.

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[2] Shell Business Operations

Our comments

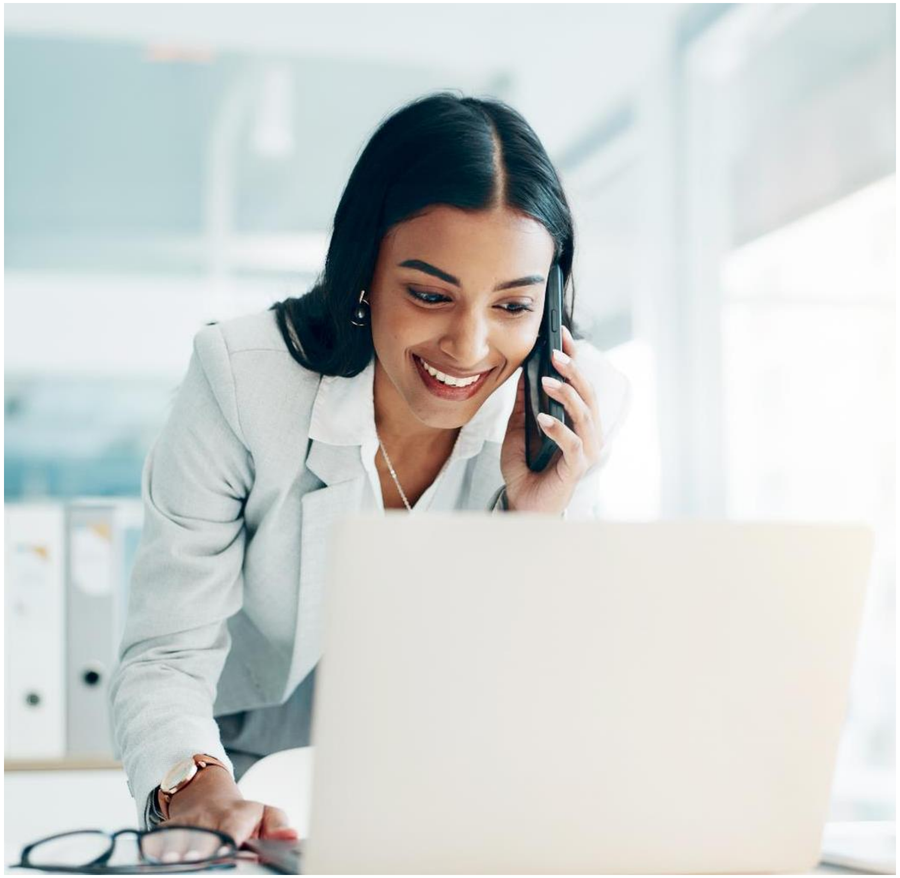
This ruling is relevant not only for the oil & gas sector but also for taxpayers in other sectors as it emphasises on certain fundamental TP issues as well as on due considerations of unique facts.

Key takeaways

<u>‘Other Method’ gains traction</u>: Where standard comparables are unavailable, documentary evidence and industry practice can justify arm’s length pricing.

<u>Practical implication</u>: Taxpayers should maintain comprehensive and contemporaneous documentation, including methodical benchmarking analyses, to substantiate industry-specific practices. This should encompass third-party contracts, intercompany agreements, and, where appropriate, independent expert opinions. Overall, there should be due consideration of unique facts, contractual constraints and industry norms in the ALP determination.

<u>Re-affirmation of core TP principles</u>: The TP regulations require careful selection of comparables, application of logical filters, and alignment with the underlying business rationale. The Tribunal also noted due consideration of commercial expediency in cost allocations transactions.



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