

TAX FLASH NEWS

Assessing Officer erred in adding back transfer pricing adjustment to book profits under Section 115JB of the Income-tax Act

Background

Recently, the Delhi bench of the Income Tax Appellate Tribunal (the Tribunal) in the case of Cash Edge India Private Limited¹ (the taxpayer), held that the Assessing Officer (AO) had erred in adding back the Transfer Pricing (TP) adjustment to book profits under Section 115JB of the Income-tax Act, 1961 (the Act) [Minimum Alternate Tax (MAT)] and directed the AO to exclude the TP adjustment from the book profits computed under Section 115JB of the Act.

Facts of the case

- The taxpayer rendered software development and business support services to its associated enterprise (AE) i.e. Cash Edge Inc., USA for which it was compensated on a cost plus basis (as per terms of the Professional Services Agreement entered into between both the entities). The arm's length price (ALP) of the international transaction of software development services was determined by applying transactional net margin method (TNMM) and taking operating profit to the total cost (OP/TC) ratio as the profit level indicator (PLI). The PLI of the taxpayer was determined at 11.16 per cent whereas the average PLI of 14 comparables selected by the taxpayer was 6.90 per cent.
- The Transfer Pricing Officer (TPO) rejected the TP study of the taxpayer and carried out a fresh benchmarking analysis. The TPO selected 10 comparables and proposed an adjustment by computing the mean PLI of the comparable companies at 23.68 per cent as against PLI of 11.16 per cent of the taxpayer. The Dispute Resolution Panel (DRP) upheld the adjustment made by the

TPO, subject to: a) exclusion of the two comparables, b) granting working capital adjustment as per the OECD Methodology c) furnishing the annual report of Wipro Technology Services Ltd. to the taxpayer and d) re-computing the operating margin of the taxpayer as well as comparable companies as per the guidelines provided by Safe Harbor Notification dated 18 September 2013.

- The final assessment of the total income of the taxpayer was made by the AO at INR 25,661,736 under MAT after adding the TP addition of INR 11,893,468.

Taxpayer's contentions

Dispute on comparables

- The taxpayer primarily contended the inclusion of the following companies by the TPO, stating that these are not fit to be considered as comparables for reasons such as: they are functionally different, non-availability of segment information or audited (signed) financials, rejection of these companies by other judicial pronouncements, existence of related party transactions etc.
 - Persistent Systems Limited (Persistent)
 - Zylog Systems Limited (Zylog)
 - Wipro Technology Services (WTS)

Addition of TP adjustment by the AO, to the income assessed under Section 115JB (MAT)

- The taxpayer contended that the book profits of the company cannot be adjusted except as provided in Explanation 1 to Section 115JB(2) of the Act and that TP adjustment is not one of the adjustments contemplated under that Explanation.

¹ Cash Edge India Private Limited v. ITO [ITA No. 64/Del/2015 – Assessment Year 2010-11]

- The taxpayer placed reliance on various decisions².

Tax department's contention

Addition of TP adjustment by the AO, to the income assessed under Section 115JB (MAT)

- The tax department relied on the decision of the Special Bench of the Tribunal in the case of Rain Commodities³ for adding back the TP adjustment to the taxpayer's income computed under Section 115JB of the Act.

Tribunal's ruling

Dispute on comparables

- After evaluating the contentions presented by both, the taxpayer and the Revenue, the Tribunal directed to exclude these companies from the comparables set except Zylog, for which it directed to set-aside the issue back to the file of the TPO for reconsideration, subject to the availability of the audited segment data of Zylog's software development services segment and it qualifying all the filters applied by the TPO.

Nature of foreign exchange gain/loss (operating or not)

- Relying on the decisions in the case of Westfalia Separator India Pvt. Ltd.⁴ and Fiserv India Pvt. Ltd.⁵ (Supra), the Tribunal directed the AO/TPO to treat foreign exchange gain/loss as an operating item.

Addition of TP adjustment by the AO, to the income assessed under Section 115JB (MAT)

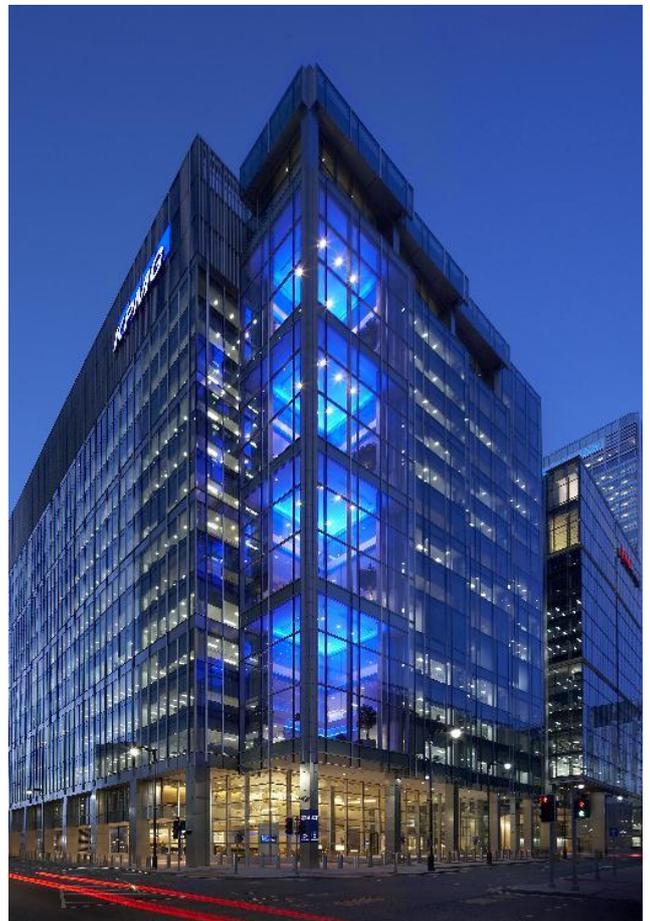
- The Tribunal, specifying that except for adjustments provided in Explanation 1 Section 115JB(2) of the Act, no other adjustment can be made to book profits under Section 115JB of the Act, held that the TP adjustment could not have been added back to the book profits under Section 115JB.
- The case law relied upon by Revenue is not applicable in the present case as the Special Bench, following the decision the Apex Court in Apollo Tyres and HCL Comnet (supra), held that the AO cannot travel beyond the net profits declared by the taxpayer unless (a) it is discovered that profit and loss (P&L) account is not drawn up in accordance with Part II and Part III of Schedule VI of the Companies Act or (b) incorrect accounting policies,

accounting standards have been adopted for preparing such accounts and the method/rate of depreciation has been adopted incorrectly. In the present case there is no such allegation or any such finding by the AO in the assessment order.

Our comments

By duly considering and dealing with the contentions from both sides (taxpayer and Revenue), the Tribunal has once again given due importance to performing an in-depth comparability analysis for selection/rejection of comparable companies.

The issue of addition of TP adjustment to the income computed under Section 115JB (MAT) seems more factual rather than being subjected to interpretation. The Tribunal has accordingly struck down the AO's action, bringing in much-required clarity to the entire dispute.



² Apollo Tyres Ltd v. CIT [2002] 255 ITR 273 (SC), Malayala Manorama Co. Ltd. v. CIT [2008] 300 ITR 251(SC), CIT v. HCL Comnet Systems and Services Ltd.[2008] 305 ITR 409 (SC), DCIT v. Bisleri Sales Ltd [2013] 151 TTJ 285 (Mum)

³ Rain Commodities v. DCIT [2010] 40 SOT 265 (Hyd)

⁴ Westfalia Separator India Pvt. Ltd. v. ACIT (ITA No. 4446/D/02)

⁵ Fiserv India Pvt. Ltd. (ITA No.6737/Del/2014)

www.kpmg.com/in

Ahmedabad

Commerce House V, 9th Floor,
902 & 903, Near Vodafone House,
Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru

Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala, Bangalore 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh

SCO 22-23 (1st Floor)
Sector 8C, Madhya Marg
Chandigarh 160 009
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai

No.10, Mahatma Gandhi Road
Nungambakkam
Chennai 600 034
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Delhi

Building No.10, 8th Floor
DLF Cyber City, Phase II
Gurgaon, Haryana 122 002
Tel: +91 124 307 4000
Fax: +91 124 254 9101

Hyderabad

8-2-618/2
Reliance Humsafar, 4th Floor
Road No.11, Banjara Hills
Hyderabad 500 034
Tel: +91 40 3046 5000
Fax: +91 40 3046 5299

Kochi

Syama Business Center
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682019
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata

Unit No. 603 – 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata 700 091
Tel: +91 33 44034000
Fax: +91 33 44034199

Mumbai

Lodha Excelus, Apollo Mills
N. M. Joshi Marg
Mahalaxmi, Mumbai 400 011
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

Noida

6th Floor, Tower A
Advant Navis Business Park
Plot No. 07, Sector 142
Noida Express Way
Noida 201 305
Tel: +91 0120 386 8000
Fax: +91 0120 386 8999

Pune

703, Godrej Castlemaine
Bund Garden
Pune 411 001
Tel: +91 20 3050 4000
Fax: +91 20 3050 4010

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