



Adjustment allowed to import price on account of extra credit period availed by the taxpayer from its AE; Accepts LIBOR plus 200 basis points as arm's length interest rate on ECB loan

Background

Recently, the Chennai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of XYZ Pvt Ltd¹ (the taxpayer), allowed adjustment to import price on account of extra credit period availed by the taxpayer from its Associated Enterprise (AE); and also accepted LIBOR plus 200 basis points as arm's length interest rate for the External Commercial Borrowing (ECB) availed by the taxpayer.

Facts of the case

- The taxpayer engaged in manufacturing of chargers, purchases critical raw materials from its AE, namely XYZ Inc. The AE acts as a sourcing hub, responsible for internal and external sourcing of components used by its group companies in manufacturing of chargers.
- The AE applied a mark-up of 5 per cent on the third party purchase price for the supply chain management services rendered. Further, the AE allowed an extended credit period of 180 days to 270 days to the taxpayer while the credit period allowed to the AE from its vendors was only 30 days to 60 days.
- The taxpayer carried out economic adjustments on account of excess credit period allowed by the AE to the extent of 210 days (270 days minus 60 days) and adopted Comparable Uncontrolled Price (CUP) method as the most appropriate method to benchmark the aforementioned import transaction.
- However, during the assessment proceedings, the Transfer Pricing Officer (TPO) restricted the adjustment on account of excess credit period to 120 days (180 days - 60 days) instead of 210 days (270 days - 60 days) as claimed by the taxpayer.
- TPO noted that the invoices raised by the AE indicate that interest at the rate of 11 per cent was levied in case of delay in payment beyond 180 days. Therefore, TPO applied 11 per cent interest rate to carry out the impugned adjustment.
- Further, the TPO rejected the benefit of +/- 5 per cent variation, claimed by the taxpayer, stating that the benefit under the second proviso to Section 92C(2) of the Income-tax Act, 1961 (the Act) is available only in cases where more than one Arm's Length Price (ALP) is determined whereas, in case of the taxpayer, only one price is taken as ALP for comparison.
- Secondly, in respect of the ECBs availed from AE, the taxpayer paid interest at LIBOR plus 200 basis points, and the TPO used average implicit interest rate as provided in 'Status Report on India's External Debt 2008' as the benchmark to determine the arm's length interest rate.

¹ XYZ Pvt. Ltd v. ACIT (ITA No. 2201/Mds/2012) – Taxsutra.com

- Based on the above, the TPO proposed downward adjustment in respect of the taxpayer's import transaction and the interest paid on ECB. Aggrieved by the adjustments, the taxpayer approached the Dispute Resolution Panel (DRP) which upheld the impugned adjustment.
- Aggrieved by the order of DRP, the taxpayer was in appeal before the Tribunal.

Taxpayer's contentions

Import transaction

- The taxpayer highlighted the fact that, being the first year of operations, the AE provided extended credit period of up to 270 days (as against 180 days mentioned on the invoice).
- Such additional period of 90 days (270 days - 180 days) should also be considered for determining the price charged on imports by the taxpayer.
- Further, the taxpayer contended that no adjustments were made for similar import purchases made from the same AE in the immediately succeeding assessment year i.e. 2008-09. Therefore, the Assessing Officer (AO)/TPO cannot disregard the rule of consistency where there is no change in facts of the case.

Interest on ECB Loan Transaction

- In respect of the interest paid on ECB loan, the taxpayer contended that the TPO arbitrarily proceeded to make an adjustment based on an unadjusted industry average from the 'Status Report on India's External Debt 2008'.
- Reliance was placed on the ruling of Special Bench of the Bangalore Tribunal in the case of Aztec Software & Technology Services Ltd.² wherein it was held that unadjusted industry averages cannot be taken to represent arm's length conditions. The Tribunal, in that case, had further mentioned that even the Organisation for Economic Co-operation and Development Transfer Pricing Guidelines (OECD TP Guidelines) allow the use of inexact comparables that are 'similar' to the controlled transaction but does not allow the use of 'unadjusted industry average returns'.
- Further, the taxpayer contended that the TPO did not provide an opportunity of being heard before making an adjustment on the ALP of interest on ECB.

Tax department's contentions

Import transaction

- The TPO contended that the taxpayer enjoyed the benefit of additional credit period and hence the price charged by the AE would include a markup for the additional benefit.
- Further, the import invoices indicate that interest at the rate of 11 per cent is payable in case of overdue payments. The TPO contended that the invoice price is already loaded with the interest up to the due date mentioned in the invoice (180 days), and any interest on delayed payment is over and above the invoice price.
- Accordingly, TPO contended that the ALP to be re-determined taking credit period of 180 days (as indicated on the invoice) instead of 270 days (actual credit period) as considered by the taxpayer and attributed interest at 11 per cent for 120 days (180 days - 60 days).

Interest on ECB loan transaction

- The DRP, in its order, contended that the taxpayer did not mention what was the impediment in the 'Status Report on India's External Debt 2008' adopted by the TPO.
- The DRP further contended that the taxpayer did not clearly substantiate which critical factor impacted the interest rate and in what manner.
- Further, DRP held that there is no merit in the taxpayer's objection that no opportunity of being heard was given. The DRP also held that the notice under Section 92CA(2) was duly served upon the taxpayer, and the taxpayer, in fact, attended the hearings and filed necessary submissions. It also mentioned that even the AO discussed the TP order with the taxpayer before drawing any inference.

Tribunal's ruling

After hearing both the parties, the Tribunal held the following:

Import transaction

- The Tribunal acknowledged the fact that the taxpayer enjoyed larger credit period over and above the credit period mentioned on the invoice and held that it is appropriate to consider the additional credit period, over and above what is mentioned on the invoice while determining the ALP.

² Aztec Software & Technology Services Ltd. v. ACIT [2007] 107 ITD 141 (Bang)

- Further, following the principle of consistency, adjustment on ALP of imports deleted.

Interest on ECB Loan Transaction

- The AO cannot apply the implicit interest rate on India's External Debt since it is an unadjusted industrial average.
- Placing reliance on OECD TP Guidelines and various judicial precedents³, the tribunal opined that the taxpayer's interest payment to its AE at LIBOR plus 200 basis points is appropriate and, accordingly, no adjustment was called for on account of interest paid on ECB loan.

Our comments

This ruling pronounced by the Hon'ble Chennai Tribunal has allowed the benefit of adjusting for extended credit period (on payables) over and above the period mentioned on the invoice (i.e. actual credit period) while computing the adjusted CUP. ALP of the import price can be determined, applying the CUP method, after adjusting for interest differential for the actual credit period.

In line with the other judicial precedents, the Tribunal ruled that LIBOR is an appropriate indicator to benchmark interest rate on ECB loans. Further, the Tribunal also opined that unadjusted industry average interest rates from 'Status Report on India's External Debt 2008' cannot be applied.



³ (i) Aztec Software & Technology Services Ltd v. ACIT [2007] 107 ITD 141 (Bang)
(ii) Tata Autocomp Systems Ltd. v ACIT (ITA No. 7354/Mum/11)
(iii) Siva Industries & Holdings v. ACIT [2012] 145 TTJ 497 (Chen)
(iv) Aurionpro Solution Ltd v. ACIT [2013] 27 ITR(T) 276 (Mum)
(v) Cotton Naturals (I) (P) Ltd. v. DCIT [2014] 146 ITD 662 (Del)

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