Tenet Tax & Legal
Private Limited

Tenet Tax Daily
July 13, 2013

Entities incurring losses in odd circumstances excluded from list of comparables for TP study.

Summary – The Mumbai ITAT in a recent case of TCL Holdings (P.) Ltd., (the Assessee) held that companies which incurred losses due to extraordinary factors and not during normal course of business, could not be taken as comparables for computing Arms length pricing.

Facts

- The assessee engaged in the business of trading in consumer electronics products entered into international transactions with its AE for purchase of certain goods (CBUs).

- The TPO did not accept the TP study of assessee and conducted his own study based on new comparables and computed the transfer pricing adjustment.

- The assessee filed its objections before the DRP challenging the adjustments and comparables selected but the DRP upheld the decision of the TPO.

- On appeal before the Tribunal assessee contended that the TPO had rejected the comparables selected by it on ground that most of the comparables were loss making and that the comparables could not be rejected only on the ground of loss making without giving any specific reason. Also, comparables selected by TPO were manufacturing concerns which were functionally not comparable. It was also contended that the adjustment made by TPO was with respect to the entire sale which was not correct as the adjustment could be made only with respect to the international transactions.

- On the other hand, the revenue contended that assessee itself had bench marked the transactions at entity level. It further contended that the comparables selected by the assessee also included the manufacturing concerns. It was also pointed out that the functional profile of the assessee was also not clear since assessee had claimed to be engaged in trading as well as importing CBUs but Profit & Loss account did not show purchase any CBUs.

Held

- The ITAT held that the contention of the assessee that the comparables could not be rejected only on the ground of loss making is correct. The cases of loss making companies are required to be further examined to find out if the loss had occurred during the normal course of business or because of some extraordinary factors which have affected the comparability of the transaction. Only in the later case the loss cases have to be excluded. No such exercise has been done by the TPO.

- It was also found that both assessee and TPO have applied TNM method at entity level which is not correct. The adjustment is required to be computed only with respect to international transaction and not in respect of the entire business transactions. The argument given by TPO and DRP that they have made the adjustment at the entity level because the assessee had also made entity level adjustment, cannot be accepted. The ITAT held that merely because the assessee had made mistakes in computing the TP adjustment the authorities cannot follow the same.

- The assessee had also objected to the comparables selected by the TPO on the ground that the products dealt with by the companies were totally different. The case of the department is that they have selected only those companies which were dealing in consumer electronics products which were the products dealt in by the assessee. The objection raised by the assessee cannot be accepted if the products selected by the TPO are broadly similar as in TNM method it is not necessary that the product should be exactly the same as dealt in by the assessee.

- The objections were also raised by the assessee that the comparables selected by the TPO were manufacturing concerns. However, revenue has pointed out that the assessee has also selected manufacturing concerns. Therefore it is viewed that in TNM method, functions of the comparables selected should be similar. Therefore, it will not be appropriate to compare the margin of manufacturing companies to those of trading companies. The revenue also pointed out that business profile of the assessee itself was not very clear. The assessee has claimed that it was importing CBUs but the revenue pointed out that the Profit & Loss account placed does not show any purchase of CBUs. The revenue has also pointed out discrepancy in the figures of total income shown by the assessee.

- Considering the various discrepancies as well as infirmities in the approach adopted by both the parties the ITAT held that a fresh transfer pricing study should be undertaken for selecting proper comparables after careful study of functional profile of the assessee so as to arrive at proper TP adjustment. Therefore, the order of Assessing Officer was set aside and the matter was restored back to Assessing Officer /TPO for passing a fresh order after necessary examination in the light of observations made in the present order and after allowing an opportunity of hearing to the assessee.