Equity investments in AE can't be deemed as loans/advances; it's outside the ambit of international transaction

Summary – The Hyderabad ITAT in a recent case of Prithvi Information Solutions Ltd., (the Assessee) held that Investments in nature of equity, cannot be treated as loans and advances and hence cannot be brought within purview of 'international transactions' as defined under section 92B.

Facts

- The assessee, owner of a number of subsidiary companies overseas, was a global provider of customized information technology (IT) solutions and engineering services to a number of clients in USA.
- Assessee filed its return of income declaring total income under the normal provisions after claiming exemption under section 10A. Assessee also declared book profit under section 115JB.
- During the scrutiny assessment proceeding, the Assessing Officer noticing that assessee had entered into international transactions with its associated enterprises during the relevant previous year exceeding the threshold limit, made a reference to the TPO for determination of ALP.
- In course of proceeding before him, the TPO called upon the assessee to furnish various documents and informations. However, neither the assessee responded to the aforesaid letter nor the subsequent reminder sent through fax.
- Thus, in absence of required information and supporting evidence, the TPO rejected the TP study furnished by the assessee and proceeded to analyse the ALP of international transactions entered into by the assessee. The TPO noticed certain investments/loans/advances made by the assessee with its AEs/subsidiaries. However, he noticed that assessee had not charged any interest on such advances made to subsidiaries. TPO being of the view that loans to the subsidiaries should carry interest at arm's length determined the same by applying the rate of 17.2 per cent.
- Applying the aforesaid interest rate to the loan advance, the TPO worked out Arm's length interest, which was suggested towards transfer pricing adjustment on account of interest loans advanced to the subsidiaries.
- On appeal before the DRP, the assessee again objected to the arm's length price of interest charged on the alleged loans and advances to the subsidiaries. It was submitted by the assessee that so-called loans and advances were actually equity investment made by the assessee in its subsidiary as part of its business expansion programme, hence, TPO could not change the nature and classification of the asset from equity investment to loans and advances. Alternatively, it was also submitted by the assessee that even if the investments were treated as loans and advances, the risk basis rate adopted by the TPO would have no applicability; arm's length interest had to be considered by applying LIBOR + per cent point basis.
- The DRP came to the conclusion that interest rate of 17.26 per cent adopted by the TPO was not correct and directed the TPO to adopt rate of interest at LIBOR+2 per cent instead of domestic

interest rate. As a consequence of the order passed by the DRP, Assessing Officer finalized the assessment by determining the arm's length rate of interest and made the addition of the said amount to the income of the assessee.

- On further appeal to Tribunal, the assessee submitted that though initially the amount advanced to the subsidiaries, was treated as loan, but, subsequently, the subsidiary had allotted shares to the assessee, which the subsidiary could not inform assessee due to oversight. For that reason alone, the amount advanced was wrongly mentioned as loan in the auditors report in form No. 3CEB. However, that does not alter or change the nature and character of the investment made by the assessee in the subsidiaries.
- On the other hand the revenue submitted that along with return of income, assessee had furnished audited accounts with report in form 3CEB wherein the auditors had clearly mentioned that the amount advanced as loan. He submitted that though subsequently the assessee has furnished a revised audit report but nowhere he had explained why the earlier report was revised or what was the cause of mistake. It was submitted that as the AO/TPO has made the assessment on the basis of the original audit report submitted along with the return as well as books of account, addition made has to be sustained.

Held

- As can be seen from the facts on record, admittedly, assessee has not complied to the notice issued by the TPO calling for various informations and evidences, which led to the rejection of the TP study and ultimate determination of arm's length interest by applying the rate of 17.2 per cent. However, as can be seen from the order of the DRP, in course of proceeding before the DRP, assessee has not only furnished details with regard to investments made in the subsidiaries but has taken a specific stand that the investments are towards equity. It is also a fact on record that before the DRP assessee has produced share allotment certificates towards allotment of shares to the tune of Rs. 30.61 crores. Similarly, assessee claims to have submitted revised auditor's report before the departmental authorities. However, the revised audit report has not been referred to either by the DRP or by the TPO/AO. Further, assessee's claim that the investments are towards equity to a great extent is borne out from the fact that shares have actually been allotted to the assessee. If that is the case, investments made by the assessee cannot be treated as loan. Of course, it is a fact on record that in the auditor's report in form No. 3CEB submitted along with the return of income the amount of Rs. 29.985 crores was shown as loans to subsidiary. Therefore, it is the duty of the assessee to explain why investment was shown as loan and what is the true nature of the investment. Further, it is to be noted that the DRP has observed that loans stated in the auditor's report in form No. 3CEB and shares of Rs. 30.61 crores allotted to the assessee are not one and the same. What is the basis for such conclusion is not forthcoming from the order of the DRP. Unless there are evidences and material to show that assessee has made investment of Rs.30.61 crores in shares in addition to the amount mentioned as loan in form No. 3CEB, it cannot be presumed that loans stated in auditor's report in Form No. 3CEB and shares allotted are different. Unless this fact is verified properly by examining the books of account and final accounts of the assessee, no inference can be drawn merely on presumption and surmises. If the assessee's claim that the investment was towards equity is correct, then, it cannot be brought within the purview of 'international transactions' as defined under section 92B.

- Therefore, considering the facts of the assessee's case, in the light of the orders passed by the Hyderabad Bench in *Vijai Electricals Ltd.* v. *Addl. CIT* [2013] 60 SOT 77/36 taxmann.com 386 and the order of the ITAT, Ahmedabad Bench in case of *Micro Inks Ltd.* v. *Asstt. CIT* [2013] 36 taxmann.com 50/144 ITD 610, it is to be held that if the investments are in the nature of equity, then, they cannot be treated as loans and advances. However, for coming to a definite conclusion in this regard necessary details need to be examined from the books of account and other related documents. Since this aspect has not been properly examined either by the TPO or by the DRP, the matter is to be remitted back to the TPO/AO to examine afresh and take a decision in the matter. Further, while doing so, the AO/TPO must also consider assessee's claim that the entire investment was out of internal accruals and not borrowed funds. Only in the event the assessee advanced loans/advances then the question of T.P. analysis on the transactions may arise. In that event the TPO/AO is also directed to examine the issue as per the existing order of DRP to the extent of adoption of LIBOR+2 per cent rate and calculate the interest for the period of loan but not exceeding the period of 12 months. The calculation for more than 12 months by Assessing Officer has to be disapproved. Thus this ground of the assessee is allowed for statistical purposes.