

Share application money paid to AE couldn't be held as international transaction by deeming it as lending/borrowing

Summary – The Pune ITAT in a recent case of Tooltech Global Engineering (P.) Ltd., (the Assessee) held that where assessee company made payment to its AE towards share application money thereby reflecting a capital investment and same not having been disputed by TPO, such a transaction cannot be subject to an arm's length price adjustment under plea of it being a transaction of lending or borrowing

Facts

- The assessee company was engaged in the business of engineering design and development services.
- During relevant year, assessee entered into international transactions on account of loans and advances given to its associated enterprises.
- In transfer pricing proceedings, the TPO made certain adjustment to assessee's ALP on account of interest charged on loans and advances given to AEs.
- The DRP set aside objections raised by the assessee.
- On appeal:

Held

- The question came up for consideration is relating to determination of income arising from an 'international transaction', which is required to be computed having regard to the arm's length price, as per the mandate of section 92(1) of the Act. The case of the Assessing Officer is that the impugned international transactions are in the nature of lending or borrowing between associated enterprises, and are, thus subject to transfer pricing assessment. Undisputedly, if the transactions are treated in the nature of lending or borrowing, the same fall within the meaning of 'international transaction' defined in section 92B of the Act, their arm's length price has to be determined as per section 92C of the Act. The plea of the assessee to the effect that it has not actually earned any interest from impugned advances, is of no consequence while determining the arm's length price of the international transaction. Thus, in-principle, there is enough justification on the part of the TPO for having rejected the plea of the assessee.
- Apart from the aforesaid, assessee has made two-fold arguments. Firstly, as per the assessee, all the advances made to the associated enterprises in question are not in the nature of loans; and, secondly, it is canvassed that even if an adjustment for non-charging of interest is to be made the same ought to be made with reference to the LIBOR rate and not in the manner made by the TPO.

- Firstly, the plea of the assessee is that the amount of Rs.1.87 crore represented outstanding balance in sundry debtor's account against sales made, which was converted into loan on 31-03-2009 by way of a book entry. It was contended that the amount outstanding from the associated enterprise on account of sales, has been converted into a loan only at the year-end and, therefore, even if interest is liable to be charged for the purposes of arm's length price, as the amount was converted into loan only at the year end, no adjustment was required to be made for the period under consideration. Further, with regard to the advances of Rs.66,87,000 and Rs.9,24,52,000 made during the year, it is explained that the same have been advanced for making investment in the equity capital of a new company, namely, MBT, and the same are not loans but share application money pending allotment. The said amount along with interest element has been reflected as 'Investment' in the Balance-Sheet.
- As regards share application money the TPO has treated such transaction in the nature of interest-free loan primarily for the reason that till the close of the previous year under consideration no shares have been actually allotted to the assessee. Accordingly, arm's length price adjustment has been made on account of interest element on such amount. The action of the TPO in changing the characteristic of the transaction of payment of share application money as an interest-free loan is unwarranted and beyond his jurisdiction which carrying out the transfer pricing proceedings. There is no provision of law which enables the TPO to change the character of a transaction while subjecting it to the process of determination of arm's length price. The TPO was required to benchmark such transactions against a similarly placed transaction and not deem the transaction to be a lending or borrowing transaction. No doubt, a transaction of advancing loans is within the purview of transfer pricing mechanism and the arm's length price computed thereof is includible in the assessable income of the assessee. So however, where the character of payment is towards share application money, thereby reflecting a capital investment, and the same not having been disputed by the TPO, such a transaction cannot be subject to an arm's length price adjustment under the plea of it being a transaction of lending or borrowing. Therefore, the TPO was not justified in treating the aforesaid transaction as being an interest-free lending transaction entered with the associated enterprise. Moreover, it is also not the case of the TPO that in a comparable transaction of share application money amongst unrelated parties, the transaction would have entailed charging of interest for the period between payment of share application and the date of allotment of shares. Therefore, the approach of the authorities below in the context of the aforesaid amount by treating it to be a transaction in the nature of interest-free lending transaction *per se*, and subjecting it to an arm's length price adjustment is erroneous and unwarranted. Accordingly, the Assessing Officer is directed to delete the addition to the said extent.
- In so far as the amount of Rs.1,87,61,274 is concerned, no doubt as on 31-3-2009 the same stood converted into an interest-free loan, but initially the said amount reflected unrealized consideration of sales made by the assessee to its associated enterprise. The addition on this count has been computed by the lower authorities by considering that the amount represented a loan transaction

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for the complete period of 12 months comprised in the year under consideration. In-fact, as per the appellant, the outstanding amount was converted into loan only on the last day of the previous year under consideration. No doubt, a transaction of interest free lending is liable to be subject to arm's length price adjustment, so however, where the lending has occurred on the last day of the previous year under consideration, no adjustment would be necessary for the relevant year. However, in this context, there was no determination by the TPO or the Assessing Officer regarding assessee's plea that outstanding debtor's balance has been converted into loan on the last day of previous year under consideration. As the same involves a factual appreciation, it is fit and proper to restore the matter back to the file of the Assessing Officer.