

## “Umbrella” of combined entity level TNMM can’t be used to benchmark separate transactions on combined basis

**Summary – The Delhi ITAT in a recent case of LG Electronics India (P.) Ltd., (the Assessee) held that Separate transactions such as sales and royalty payments under the combined umbrella of TNMM on an entity level is not permissible as it may result in "cross-subsidization", i.e., a probable addition on account of transfer pricing adjustment arising from one international transaction may be usurped by the income from the other international transaction giving higher income on transacted value. As the international transaction of royalty payment is a separate transaction and not closely linked with the other transactions (import of raw materials, import of service spares, export of finished goods, export of service spares, commission, design and development fee) with which the assessee has merged it, such merger for the purposes of the determination of its ALP on entity level under TNMM cannot be allowed**

- Transfer pricing legislation contemplates determination of arm's length price of an international transaction, which means for each transaction separately. The term 'transaction' has been defined in Rule 10A(d) to mean 'a number of closely linked transactions.'
- ALP is required to be determined in respect of each international transaction separately. If, however, there are a number of closely linked transactions, then, such closely linked plural transactions can be considered as a singular transaction for the purposes of benchmarking.
- In other words, a number of closely linked transactions can be categorized as one transaction for the purposes of determination of ALP. To put it conversely, the transactions which are not closely linked, should be processed under the transfer pricing regime independently and not on a consolidated basis.
- Clubbing of royalty payment with other international transactions for processing them jointly in a combined TNMM approach, it would defeat the mandate of the transfer pricing legislation.
- It is simple and plain that cross subsidization of the international transactions in a combined approach is impermissible.
- The net effect of section 92(3) is that if transacted value income from an international transaction is more than its arm's length price income, then, the ALP income should be discarded and the actual income should be considered.
- To sum up, it is the higher of actual income or the ALP income from an international transaction, which should be taken into consideration for computing the total income. It does not mean that the actual more income from one international transaction vis-a-vis its ALP income should be combined with

another transaction which gives actual income less than the ALP income and then both be processed together under this Chapter so as to set off the income (Transacted income minus ALP income) from the first transaction with the potential income arising from the second transaction (ALP income minus transacted value income).

- When we consider more than one separate transaction under the combined umbrella of TNMM on an entity level, it is quite possible that a probable addition on account of transfer pricing adjustment arising from one international transaction may be usurped by the income from the other international transaction giving higher income on transacted value. That is the reason for which the legislature has provided for determining the ALP of each international transaction separate from the others.
- As the international transaction of royalty payment is a separate transaction and not closely linked with the other transactions(import of raw materials, import of service spares, export of finished goods, export of service spares, commission, design and development fee) with which the assessee has merged it, such merger cant be allowed for the purposes of the determination of its ALP on entity level under TNMM.

***Related case***

See however, *Canada v Glaxo Smithkline Inc*[2012]SCC 52 decided by the Supreme Court of Canada where License agreement was found by the Court to be closely linked to Supply Agreement and Court held that both should be evaluated together.