TP norms would not put fetters on selection of foreign comparables if Indian Cos didn't satisfy test of comparability

Summary – The Delhi ITAT in a recent case of Tata Motors European Technical Centre Plc., (the Assessee) held that Indian Transfer Pricing Regulation does not put any fetters on selection of foreign comparables, if conditions are as such that the Indian comparables do not stand the test of comparability with the tested party.

Facts

(a) TMETC ('assessee') was a UK based company. It was wholly owned subsidiary of Tata Motors Ltd ('TML'), India. It was providing design and engineering services for automobiles to the TML.

(b) For rendering these services, assessee sent its employees to India by deputing engineers and technical personnel at TML's factory/establishment. Thus, the assessee had a service PE in India.

(c) Assessee selected four overseas comparables located in UK to benchmark ALP of transactions with TML (i.e., AE). TPO disagreed with selection of foreign comparables based in UK on the ground that since PE of assessee was located in India and carrying out its business within the Indian territory, assessee had to be treated as a business entity in India. Thus, it made transfer-pricing adjustment by selecting Indian comparables.

(d) The issue that arose before the Tribunal was as under:
Whether assessee was justified in carrying out comparative analysis on the basis of UK based comparables, rather than by selecting Indian comparables?

The Tribunal held in favour of assessee as under:

(1) Indian Transfer Pricing Regulation does not put any fetters on selection of foreign comparables, if conditions are as such that the Indian comparables do not stand the test of comparability with the tested party.

(2) If the tested party itself was a foreign-based entity and the services rendered by it were very specific, for which the Indian comparables were not available or functionally not comparable then, it could not be held that foreign comparables could not be selected for benchmarking the arm's length price or margin.

(3) OECD transfer pricing guidelines also provided that non-domestic comparables should not be automatically rejected and it has to be seen on case by case basis by the reference to the extent to which they satisfy the comparability factors.

(4) UN Manual on Transfer Pricing also states that Indian Transfer Pricing Regulation have accepted the foreign comparable in cases where the foreign AE is the least complex entity and the requisite information about the tested party and comparables are available. So, the blanket assumption by the TPO and DRP that foreign comparables could not be accepted at all was not correct.

(5) The assessee, for the purpose of rendering services in India, was incurring all cost in UK like direct costs, employee costs, etc., then for the purpose of computation of PLI, these costs had to be taken into consideration for determining the profit margin.

(6) Since main costs attributable to the PE were based on cost incurred in UK, it could be said that PE was influenced by the economic and financial conditions in UK, as against the Indian economic factors.

(7) The Indian economic factors were not at all influencing the cost or margin of the assessee, hence, it could not be held that Indian comparable could be used to benchmark the transactions of assessee.