Transactions between Head office and foreign branch aren't international transactions under transfer pricing

Summary – The Delhi ITAT in a recent case of Aithent Technologies (P.) Ltd., (the Assessee) held that where TPO had computed transfer pricing adjustment qua all transactions carried out by assessee with AEs as well as non-AEs, matter should be remanded back

For treating any transaction as an international transaction, it is sine qua non that there should be two or more separate AEs

Facts

- The assessee, an Indian company, was engaged in development of software. It had a branch office in Canada. The assessee and its branch office also rendered certain services to its AE at US.
- The assessee used certain comparables and showed that these transactions were at arm's length price.
- The TPO altered some of the comparables chosen by the assessee and computed the arm's length margin of his final set of comparables at 23.56 per cent of the operating cost. This arm's length margin was applied on total revenues earned by the assessee (inclusive of revenues from non-AEs). Accordingly, he proposed transfer pricing adjustment.
- The assessee remained unsuccessful before the DRP on various issues including the selection of comparables made by the TPO.
- On appeal:

Held

- The assessee has a branch office in Canada and there are some transactions between the head office in India and the branch office in Canada. These transactions have also been taken into sweep for the purposes of making the transfer pricing adjustment. There is no dispute on the fact that the assessee has offered its total income for taxation, which also comprises of the revenues from its Canada branch. In other words, the figures of expenses and incomes, assets and liabilities of branch office in Canada have been merged with such figures of head office in India. It is the merged figures of both the head office and branch office taken together as one unit, that have been taken into consideration for all practical purposes including the computation of total income and the transfer pricing analysis.
- The first question for consideration is whether the transactions between the head office in India and branch office in Canada can be considered as international transactions, even though the assessee inadvertently reported the same so as a matter of abundant caution. The answer is obviously in negative. A bare perusal of the definition of 'international transaction' in section 92B brings to light that for treating any transaction as an international transaction, it is *sine qua non* that there should

be two or more separate AEs. When one considers the definition of 'International transaction' given in section 92B alongwith the meaning of the AE given in section 92A, it clearly transpires that in order to describe a transaction as an 'international transaction', there must be two or more separate entities.

- It is simple and plain that no person can transact with self in common parlance. As such, one cannot earn any profit or suffer loss from self. The same is true in the context of business as well. Neither any person can earn income nor suffer loss from self. It is called the principle of mutuality. When expanded commercially, the proposition which follows is that there can be no profit from trade with self. This has been fairly settled through a catena of judgments from the Apex Court.
- Even if for a moment, the contention of the revenue is accepted as correct that the head office earned profit from its branch office, then such profit earned would constitute additional cost of the Branch office. On the aggregation of the accounts of the Head office and branch office, such income of the head office would be set off with the equal amount of expense of the branch office, leaving thereby no separately identifiable income on account of this transaction.
- Reverting to the extant context, when the assessee is only one entity, then such *inter se* dealings between the head and the branch office cease to be commercial transactions in the primary sense, what to talk of an 'international transaction', whose pre-requisite is a transaction between two or more associated enterprises. Since the office in Canada was only a branch office and not a separate entity distinct from the assessee, the transactions between the head office in India and branch office in Canada cannot be considered as international transaction.
- There is hardly any need to accentuate that there can be no estoppel against law. Merely because the assessee took an inadvertent appreciation of the transactions with self as international transactions, that cannot prevent it from claiming before the authorities that the correct legal position should prevail. In view of the fact that the assessee's office in Canada is its branch office, the transactions between the head office and the branch office, under the provisions of the Act, cannot be considered as international transactions. Therefore, the TPO was not justified in determining the ALP of the international transaction of 'Software Product Development/Software Consultancy Services' by applying the average operating profit margin of the comparables to the cost base of transactions with its AE, which also included the transactions with the branch office in Canada. Such cost base is directed to be considered as exclusive of transactions with the Canada branch. Therefore, the impugned order was set aside to this extent.
- It is uncontroverted, as is also apparent from the TPO's order, that the transfer pricing adjustment has been made by considering the total costs incurred by the assessee in respect of both the controlled and uncontrolled transactions with the associated enterprises (AE) and non-AEs. An addition towards transfer pricing adjustment can be made by comparing the assessee's profit rate from the international transaction with that of comparable uncontrolled transactions. Under the TNMM, the process is simple in initially finding out the operating profit margin of the assessee and then the average adjusted operating profit margin of comparable cases. Such adjusted profit margin

of the comparables constitutes benchmark margin, which is then compared with the operating profit margin from the assessee's international transactions with its AE. It is not permissible to make transfer pricing adjustment by applying the average operating profit margin of the comparables on the assessee's universal transactions entered into with both the AE and non-AEs. As the entire exercise under Chapter-X is confined to computing total income of the assessee *from international transactions* having regard to the arm's length price, there is no scope for computing the income even from non-international transactions having regard to the ALP. As the TPO had computed the transfer pricing adjustment *qua* all the transactions carried out by the assessee with reference to the base of 'total costs', also inclusive of costs relevant for transactions with non-AEs, the impugned order on issue was vacated and the matter was restored to the file of Assessing Officer/TPO for recalculating the amount of addition of transfer pricing adjustment by taking into consideration the international transactions only under this segment to the exclusion of transactions with branch affirmed and non-AEs.