

Bank guarantee given for foreign AE couldn't be benchmarked on basis of bonds to be raised in Indian market

Summary – The Mumbai ITAT in a recent case of Grindwell Norton Ltd., (the Assessee) held that where assessee provided corporate guarantee to foreign bank in connection with borrowing by AE, and had charged fee @ 1% but ALP of such transaction was determined at 3.35% on basis of respective abilities of assessee and AE in Indian domestic market, exercise carried out by TPO suffered from an inherent misconception as benchmarking had been done between two incomparable situations

Facts

- AE of the assessee, which was based in Bhutan, raised a term loan from bank. The assessee-company provided Corporate Guarantee to the bank in connection with the said borrowing on behalf of its AE.
- The assessee-company had charged corporate Guarantee fee at the rate of 1 per cent from its AE.
- The TPO noted the difference between the credit rating of assessee (and the corresponding interest rate payable to raise bonds in Indian market) and the credit rating of the AE (and the corresponding interest rate payable for raising bonds in Indian market) and such difference, according to him, reflected the benefit in the form of Corporate Guarantee given by the assessee.
- Accordingly, the arm's length price of such transaction had been determined by the TPO at 3.35 per cent, which had resulted in enhancement of assessee's income.
- The Commissioner (Appeals) confirmed said adjustment.
- On appeal:

Held

- Notably, the TPO has benchmarked the instant transaction of provision of Corporate Guarantee on the basis of respective abilities of the assessee and AE to raise Bonds in the Indian domestic market. The TPO asserted that based on the debt-equity ratio the credit rating of the assessee-company was higher in comparison to that of the AE and, therefore, the rate of interest payable by the AE to raise Bonds in the Indian market would be higher than the rate payable by the assessee-company. Such differential has been used to determine the corporate Guarantee fee that should have been charged by the assessee-company from its AE so as to determine the arm's length price of the instant transaction. The aforesaid approach of the TPO is clearly inconsistent with the ratio laid down by the Bombay High Court in the case of *CIT v. Everest Kanto Cylinder Ltd.* [\[2015\] 378 ITR 57/232 Taxman 307/58 taxmann.com 254](#). Notably, in the case of *Everest Kanto Cylinder Ltd. (supra)*, the dispute was relating to the adjustment made by the TPO in the matter of Guarantee commission earned for

providing a Corporate Guarantee to the Bank in connection with the borrowings made by the AE of the assessee therein. The TPO determined the arm's length price of such transaction based on the instances of commercial banks providing Guarantee on behalf of their clients. The High Court held that the considerations which apply for issuance of Corporate Guarantee were distinct and separate from that of Guarantee provided by the banks and, therefore, the two transactions were incomparable. Similar parity of reasoning is applicable in the present case too because the considerations which weigh for raising of Bonds, that too in Indian market, are quite distinct and incomparable with the instance of providing of Corporate Guarantee to a bank abroad in connection with raising of loan from such bank by the AE of assessee outside India. The exercise carried out by the TPO to arrive at the arm's length rate of 3.35% suffered from an inherent misconception as the benchmarking had been done between two incomparable situations. Therefore, the said stand of the income-tax authorities could not be upheld.

- In the present case, a point which has been consistently made by assessee is to the effect that there is no concept of credit rating in Bhutan and that the banks charge a uniform rate of interest on the term loans, which is 12 per cent. Secondly, it is pointed out with reference to the balance-sheet of AE that it has adequate debt-equity ratio to raise such loan from the Bank of Bhutan. In fact, it has also been pointed out, and which is reflected from the notes in the balance-sheet of AE, that the Corporate Guarantee had been advanced by the assessee-company only for 35 per cent of the sanctioned loan. Under these circumstances, it can be safely inferred that providing of Corporate Guarantee was not a 'critical mass', which enabled the AE to raise term loan from Bank. Moreover, the savings to the assessee-company in the shape of lower production costs on procurement of material from the AE is also a relevant factor. Thus, considering the entirety of the facts and circumstances of the case, Corporate Guarantee fee charged by the assessee at the rate of 1 per cent is well-founded and did not require any Transfer Pricing adjustment. Thus, the order of the Commissioner (Appeals) is set aside and the Assessing Officer is directed to delete the addition of Rs. 2,12,937/-.