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TP provisions aren't applicable on transactions between Indian head office and foreign branch

Summary – The Delhi ITAT in a recent case of Aithent Technologies (P.) Ltd., (the Assessee) held that Transfer pricing provisions would not be applicable in respect of transactions between assessee having head office in India and branch office in Canada as branch office was not a separate enterprise

Section 92B, read with section 92C of the Income-tax Act, 1961 - Transfer pricing - International transaction, meaning of (Transaction with branch office) - Assessment year 2008-09 - Assessee was an Indian company having branch office in Canada - Whether since branch office was not a separate enterprise, there could be no question of treating transaction between head office and branch office as an international transaction - Held, yes -Whether it is only Indian income of a non-resident, which is chargeable to tax in India and hence over or under invoicing between Indian head office and foreign branch office is always income-tax neutral in case of an Indian enterprise having a permanent establishment outside India - Held, yes - Whether thus where assessee had offered for taxation not only income earned by Indian head office, but also whole of income earned by Canada branch office, transfer pricing provisions would be inapplicable - Held, yes [Para 8] [In favour of assessee]

Facts

- The assessee was an Indian company having branch office in Canada. In addition to that, it had a 100 per cent subsidiary in USA.
- There were certain transactions between the assessee and its branch office in Canada, which were treated by the Transfer Pricing Officer (TPO)/Assessing Officer as international transactions and their ALP was determined.

Issue to be decided

- Whether a separate determination of ALP of the transactions of assessee between Indian head office and branch office, Canada should be made so as to make an addition on account of transfer pricing adjustment?

Held

- It is simple and plain that no person can transact with self in common parlance. As such, one can neither earn any profit nor 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 dealings with 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 wherein it has been held that there cannot be a valid transaction of sale between branch office and head office and hence profit on such sales is not includible in assessee's computation of total income.

- Coming to the context of transfer pricing provisions, it is noticed that section 92B(1) defines 'International transaction' to mean a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale . . . . or provision of services. Going by this definition, there can be an international transaction only between two or more associated enterprises (AEs). Since branch office is not a separate enterprise, there can be no question of treating transaction between head office and branch office as an international transaction. At this juncture, it is pertinent to note that section 92F(iii) defines 'enterprise' to mean 'a person (including a permanent establishment of such person) who is. . . . . engaged in any activity, relating to the production, storage, supply, distribution, acquisition or control of articles or goods. . . . of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights. . . . . whether such activity or business is carried on, directly or through one or more of its units or divisions or subsidiaries, or whether such unit or division or subsidiary is located at the same place where the enterprise is located or at a different place or places.' On consideration of definition of 'international transaction' under section 92B(1) in juxtaposition to the definition of 'enterprise' under section 92F(iii), the position which *prima facie* appears is that since a branch office which is selling goods or providing services is an 'enterprise' as a permanent establishment of the general enterprise, all the transactions between the branch office and the general enterprise be subjected to the transfer pricing provisions. However, this *prima facie* impression loses its substance when the general enterprise is an Indian entity and the branch office is located outside India. It is so for the reason that section 5 defining scope of total income provides through sub-section (1) that 'subject to the provisions of this Act, the total income of any previous year of a person who is a resident includes all income from whatever source derived which (a) is received or is deemed to be received in India in such year by or on behalf of such person; or (b) accrues or arises or is deemed to accrue or arise to him in India during such year; or (c) accrues or arises to him outside India during such year'. Thus it is apparent that a resident assessee is liable to tax for its world income, which not only comprises of Indian income but also the income which 'accrues or arises to him outside India during such year'. The final accounts of foreign branch office, including all the items of income, expenses, assets and liabilities are merged with the accounts of head office and the accumulated income so determined is liable to tax in India. When the sale made by the Indian Head office is considered as purchase of the foreign branch office and the figures of head office and branch office are consolidated, any under or over invoicing becomes tax neutral. 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 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. So the over or under invoicing between the Indian head office and foreign branch office is always income-tax neutral in the case of an Indian enterprise having a permanent establishment outside India. Making a transfer pricing adjustment in

respect of the international transactions between the Indian head office and the foreign branch office will result into charging tax on income which is more than legitimately due to the exchequer. Obviously, this is impermissible.

- The rationale in not applying the provisions of Chapter-X on transactions between the head office and branch office is limited only on an Indian enterprise having branch office abroad. It is not the other way around. If a foreign general enterprise has a branch office in India, such Indian branch office will be considered as an 'enterprise' under section 92F(iii) and the transactions between the foreign head office and the Indian branch office will be 'International transactions' in terms of section 92B. This is for the reason that the total income of a non-resident in terms of section 5(2) includes all income from whatever source derived which (a) is received or is deemed to be received in India in such year by or on behalf of such person; or (b) accrues or arises or is deemed to accrue or arise to him in India during such year. Thus it is only the Indian income of a non-resident, which is chargeable to tax in India. In such circumstances, there can be an allurement to some non-resident assessees to resort to under or over-invoicing so as to mitigate the tax burden in India. It is with this background in mind that the legislature introduced Chapter X with the caption 'Special provision relating to avoidance of tax' so to ensure that the international transactions are reported at ALP. Some foreign associated enterprise instead of having an Indian enterprise may opt to have a branch office in India and then claim that since the Indian branch office is not a separate enterprise, the transfer pricing provisions should not be applied. Section 92F(iii) has been incorporated to ensure that not only the transactions between the foreign enterprise and its Indian associated enterprise but also the transactions between the foreign enterprise and its branch office in India are also determined at ALP so that the Indian tax kitty is not deprived of the rightful amount of tax due to it. Thus, the definition of 'enterprise' as per section 92F(iii) as also including its permanent establishment for the transfer pricing provisions is confined only in respect of a foreign general enterprise having a branch office in India and not *vice versa*.
- The extant assessee is also an Indian resident and as such is liable for tax in respect of the income earned in India (through its Head office in India) and also the income accruing from outside India (through its Branch office in Canada). The assessee has rightly offered income for taxation not only the amount earned by the Indian head office, but also whole of the income earned by Canada branch office. This position can be ascertained from the Annual accounts of the assessee. Not only the income but, also the expenses and all the items of balance sheet of branch office, Canada have also been merged with the figures of head office. It is the total income as also including the total revenue earned by branch office Canada, which has been offered for taxation. Under such circumstances and in the backdrop of the foregoing discussion, the transfer pricing provisions cannot apply in respect of transactions between the Indian head office and branch office in Canada. The impugned order is set aside *pro tanto*.