

## **Delegation of responsibility by Head Office to Project Office to be considered as international transaction**

**Summary – The Ahmedabad ITAT in a recent case of Shandong Tijun Electronic Power Engg. Company Ltd., (the Assessee) held that where HO of assessee entered into an agreement with Indian company to execute contract of power project since PO was executing project under delegation of responsibilities by HO, such delegation of responsibility by head office was required to be considered as an international transaction and since there existed a prior agreement in relation to transaction between HO and Indian company, transaction between assessee and Indian company was a deemed international transaction under section 92B(2)**

**Where total contract terms were similar between HO and PO as well as between HO and two Indian parties which were fit comparable uncontrolled transaction and there being no variation in rates charged as well as other terms of agreement, CUP method should have been followed by Assessing Officer to determine ALP**

**Where all conditions prescribed under section 44BBB(2) were fulfilled and assessee had followed one of recognized methods prescribed for determination of stage of completion of contract, Assessing Officer's action of rejecting books of account and assessing income under section 44BBB(1) on presumptive basis was not justified**

### **Facts**

- The assessee, a foreign company, was engaged in business of erection, testing and commissioning etc. of power plants. It entered into agreements with Indian companies APL and JPL. For the purpose of executing the contracts, a project office was opened in India.
- The Assessing Officer took a view that the transactions between the HO and Project Office came under the category of international transactions as per section 92B and he applied the TNMM for determining the Arm's Length Price (ALP) and Assessing Officer further analyzed various comparables and after considering the comparables accepted by the assessee, calculated the Arm's Length Price at the rate of 111.97 per cent of operating cost and made an upward adjustment under section 92C(3).
- The Commissioner (Appeals), however, set aside the findings of the Assessing Officer and particularly confirmed the plea of the assessee of application of CUP method and also holding that for the purpose of CUP method, the rates of contract between the APL as well as JPL with HO were the best comparables.

### **Held**

- So far as the issue that whether the transfer pricing provisions are applicable on the transactions between the HO and Project Office in India is concerned, there is no infirmity in the findings of the

Commissioner (Appeals) that the transactions between both the entities are deemed international transactions and the transfer pricing provisions are applicable between the foreign company, *i.e.*, HO and its PE.

- Project office of the assessee company and its head office were Associated Enterprises ('AEs') as per the provisions of section 92A(1)(a) for the simple reason that the PO was a separate taxable entity and the same was managed by HO, controlled by HO and even the capital contribution also came from HO. Moreover, article 9 of the India-China DTAA also stipulates that the HO and the PO of the assessee company are AEs because the head office participated directly in the management, control and capital of the project office.
- Since the AE (HO) entered into an agreement with APL and JPL to execute the contract of power project for APL and JPL, the assessee being the PO was executing the project under the delegation of responsibilities by the HO, such delegation of responsibility by the head office was required to be considered as an international transaction between Assessing Officer and HO of the assessee and since there existed a prior agreement in relation to the transaction between the HO and APL and JPL, the transaction between assessee and APL and JPL was a deemed international transaction under section 92B(2). Accordingly, the TPO is justified in holding the transactions between the assessee and its head office as international transaction.
- The Assessing Officer applied the TNMM whereas, the Commissioner (Appeals) has held that the CUP method is most appropriate method.
- CUP was the most appropriate method for determining ALP in view of availability of CUP of APL & JPL with HO. Further, transaction of APL & JPL with HO of the assessee could be treated as CUP being functionally comparable uncontrolled transactions in terms of rule 10B(2) & (3) and more particularly in view of the fact that entire income from the transaction was offered for tax in India.
- The Commissioner (Appeals) further observed that the transfer pricing addition was incorrectly made by selecting functionally incomparable transactions by observing that comparables selected by the Assessing Officer are not comparable in view of functional comparability of the said transactions, absence of segment information for individual line of business in case of those comparables which are engaged in various line of business and generalized filter applied for selection of comparables.
- Accordingly, the transfer pricing addition is incorrectly made by selecting functionally incomparable transactions and is therefore deleted.
- The transactions of awarding contract by APL and JPL - Indian parties to HO ought to have been taken as comparable uncontrolled transactions to benchmark the transactions of Shandong PO.
- In view of the above provisions and examining the facts of the instant appeal, there is no difference in the terms of functions performed, assets employed and risk undertaken, the price charged, incomparable uncontrolled transactions entered in the contracts between the parties APL & JPL to HO *vis-a-vis* the contract awarded to PO by the HO. Further, it is also not disputed at the end of the revenue that the price at which the contracts were awarded by APL and JPL- Indian parties -to HO -

Chinese entity - is a same price at which transactions price between PO, *i.e.* assessee in India and HO, a Chinese entity, as agreed upon. When the total value of the contract awarded to the Chinese HO has been offered as gross revenue by the PO, *i.e.* foreign entity incorporated in India, then how can there be any shifting of profits. This view further gets fortified in view of the fact that the action of the Assessing Officer in rejecting the books of account has already held to be invalid, which therefore, shows that the profits have been rightly shown by the assessee. For the purpose of computing Arm's Length Price, the basic thing which is to be examined that whether the assessee has shifted the profits to its Associate Enterprises either directly charging less revenue or showing excess cost to reduce the profits, but in the instant case where the total contract terms were similar between the Shandong HO and PO as well as between the Shandong HO and two Indian parties which was the fit comparable uncontrollable transaction and there being no variation in the rates charged as well as the other terms of the agreement, then there remained no room for the revenue authorities to make any upward adjustment to make addition in the hands of the assessee. In the given facts and circumstances of the case for the purpose of calculating Arm's Length Price, Comparable Uncontrollable Price (CUP) method should have been followed by the Assessing Officer to determine the ALP if the CUP method is applied, then no transfer pricing adjustment needs to be made in the given facts and circumstances of the case. There is no infirmity in the findings of the Commissioner (Appeals). In the result, this issue is also decided against the revenue and in favour of the assessee.