Royalty paid on inter-company sales not at Arm's Length?

Payment of royalty on the sales made to the associated enterprise has always been disputed by the Indian Transfer Pricing department as not satisfying the arm's length test. In a recent ruling[1], the Hon'ble Delhi Bench of Tribunal was pleased to delete the transfer pricing adjustment made in respect of payment of royalty on invoices raised by CRM Services India Private Limited ('TP India' or 'the Company') on its AE, Teleperformance USA ('TP USA').

The dispute raised in the various years cantered around the royalty paid by the company pursuant to Licensing Agreement dated 02.01.2002 read with Foreign Collaboration Agreement with TP USA of even date, whereby the Company paid royalties on the 'accumulated gross revenue' from sale of voice-based call center services by TP India to third parties, including in respect of invoices raised on TP USA for the services to the clients of TP USA. In the unique business of TP India being a voice-based call center service provider, the services were rendered to third party customers of TP USA, as calls were made by third party customers who were attended to by the company in India.

DRP concluded that TP India is obliged to make payment of royalty to TP USA only on the sales made to third parties as royalty paid to TP USA qua revenues received from TP USA does not mean sale of services to third parties and therefore, did not form part of "accumulated gross revenues".

Thereafter, the Company entered into the addendum to the Licensing Agreement on 22.08.2014 which clarified that 'third parties', for the purpose of payment royalty to TP USA in terms of the Licensing Agreement, shall mean entity or entities to which TP India has rendered services either directly or indirectly or through an affiliate.

Nevertheless, it was submitted that Section 62 of the Indian Contract Act, 1872 provides for alteration in the original contract upon consent of the parties to the contract, meaning thereby, that as such, alteration in a contract is not prohibited under the law.

The ITAT rejecting the contention of the TPO that the addendum to the Licensing Agreement executed by the company on 22.08.2014 clarifying the terms of the Licensing Agreement so as to enable payment of royalty on invoices raised on TP USA as also on the invoices raised on third parties, was a post facto exercise for avoiding tax liability and therefore, is to be disregarded. Thus, the ITAT while approving payment of royalty by CRM on its entire sales, i.e. on direct sales made to third parties as well as on sales made to TP USA for services rendered to its customers, held as under:

(i) Payment of royalty in terms of licensing agreement dated 02.01.2002 was accepted upto at arm's length price before AY 2007-08. Consistency in the conduct of parties to the

[1] CRM Services India Private Ltd. v. DCIT: ITA No. 1518 & 1519/Del/2022

transaction is relevant to interpreted or construed the transaction, agreement and addendum.

(ii) There is no requirement under the provisions of the Act to have an underlying agreement, much less a registered or notarized agreement for undertaking an international transaction with the group companies. The mutual conduct of parties over time is often determinative of actual intentions.

(iii) When clauses of Collaboration Agreement dated 02.01.2002 between TP USA and the Company are read along with the licensing agreement dated 2nd January, 2002, the only conclusion that can be drawn is that there was consensus ad idem between parties that royalty is to be paid with respect to the entire sales revenue of the assessee in regard to overseas clients of TP USA, including sales to third party customers for TP USA for which Revenue is received from TP USA. The addendum was entered upon to just bring more clarity to this understanding and it cannot be said that this post facto addendum was made with intention to undo the findings of DRP.

Comments –

Clause (v) of section 92F of the Act defines the term "transaction" to include ***an arrangement, understanding or action in concert, whether or not such arrangement, understanding or action is formal or in writing***. Rule 10B(2) of the Rules, providing for comparability of a transaction with uncontrolled price, suggests that the contractual terms of the inter-company agreement are the one ***which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions***. Thus, the Tribunal has rightly looked in the real intention of the parties and their conduct over period of time, to determine the arm's length price of the transaction.

The appeal was successfully argued by Shri Ajay Vohra, Sr. Advocate, along with Vaish team - Neeraj K. Jain and Abhishek Agarwal.

For any details and clarifications, please feel free to write to:

Mr. Neeraj Jain : neeraj@vaishlaw.com
Mr. Abhishek Agarwal : abhisheka@vaishlaw.com

Corporate, Tax and Business Advisory Law Firm

DELHI

1st, 9th, 11th Floor,
Mohan Dev Building, 13, Tolstoy Marg,
New Delhi, 110001 (India)

+91-11-42492525
delhi@vaishlaw.com

MUMBAI

106, Peninsula Centre,
Dr. S.S. Rao Road, Parel,
Mumbai, 400012 (India)

+91 22 42134101
mumbai@vaishlaw.com

BENGALURU

105 -106, Raheja Chambers,
#12, Museum Road,
Bengaluru, 560001 (India)

+91 80 40903588/89
bangalore@vaishlaw.com