
**PRINCIPLE OF CONSISTENCY TO BE TAKEN INTO CONSIDERATION WHILE
SELECTING THE MOST APPROPRIATE METHOD; ‘OTHER METHOD’ TO BE
APPLIED ONLY IF NONE OF THE OTHER PRESCRIBED METHODS ARE
APPLICABLE**

The Delhi High Court in a recent decision¹ has laid down important principles with regard to selection and application of the most appropriate method for the purpose of computation of arm’s length price under Chapter X of the Act.

Factual background

The assessee, a part of the Sabic group, during the relevant previous year was engaged in provision of marketing support services to the associated enterprise. During the relevant year, the assessee received consideration from associated enterprises for provision of marketing support services. The said transaction was benchmarked applying Transactional Net Margin Method (‘TNMM’) as the most appropriate method, using Operating Profit / Value added expenses (‘OP/VAE’) as the Profit Level Indicator (‘PLI’). The assessee also undertook an alternate benchmarking analysis. There was no dispute regarding the functional profile of the assessee and it was accepted by the TPO that the assessee was only a marketing support service provider and not a trader or a buy-sell entity.

The TPO, however, discarded TNMM applied by the assessee and instead, applied Other Method for the purpose of benchmarking analysis. For applying the Other Method, the TPO selected 7 uncontrolled agreements and held that median rate of commission charged / paid under the said agreements represents the arm’s length price for the marketing support services provided by the assessee. The TPO, thereafter, applied the said commission rate on the sales made by the associated enterprises in India and arrived at the arm’s length compensation for the services provided by the assessee to the associated enterprises. Accordingly, transfer pricing adjustment was made by the TPO in respect of the international transaction of provision of marketing support services.

Decision of the Tribunal

The Delhi Bench of the Income Tax Appellate Tribunal (‘the Tribunal’) deleted the adjustment made by the TPO on the basis that (i) the TPO had not provided any cogent reasons for rejection of the TNMM and (ii) TNMM was accepted as the most appropriate method in the earlier years and without any change in the facts of the case, the TPO was not justified in rejecting the said method. The Tribunal relied upon the decision of the Delhi High Court in the case of *Sumitomo Corporation India Private Limited vs CIT 387 ITR 611 (Delhi)* and *Li & Fung India Pvt. Ltd. vs CIT 361 ITR 85 (Delhi)* to hold that TNMM applied by the assessee using OP/VAE expenses as the PLI was the most appropriate method for the purpose of benchmarking in the case of the assessee.

¹ Pr. CIT - 7 vs Sabic India Pvt. Ltd., order dated 14.10.2024 in ITA No.514/2024

Decision of the High Court

The Revenue challenged the order of the Tribunal before the Delhi High Court. The High Court noted that TNMM had consistently been accepted by the Revenue as the most appropriate method from assessment year 2009-10 to 2014-15. The High Court held that even though the principle of *res judicata* does not strictly apply to tax matters, inconsistencies in the approach in assessment of tax on annual basis, would be debilitating to a conducive commercial environment. It was further held by the High Court that *“A change in the approach of assessment of tax, absent any statutory change, leads to uncertainty as to the cash flow/fund flow, which are the lifelines of commercial enterprises. Thus, unless there are cogent reasons to discard the method for transfer pricing adopted in the earlier assessment years, the TPO was required to follow the method consistently adopted for determining the ALP in prior years”*

The High Court, accordingly, upheld the order of the Tribunal holding that the TPO was not justified in rejecting TNMM which was consistently applied by the assessee and accepted by the Revenue in the preceding years. The High Court further approved the finding of the Tribunal that the TPO was not justified in rejecting TNMM and applying the Other Method without providing any justification or sound reasons.

It was held by the High Court that even though Rule 10AB of the Income Tax Rules, 1962 (“the Rules”) permit determination of arm’s length price by simulating the price that would have been charged in similar uncontrolled transactions under similar circumstances, recourse to the said method was available only if none of the Other Methods are considered as the most appropriate method.

The High Court further went on to hold that in terms of Rule 10AB of the Rules, even for the purpose of undertaking benchmarking analysis applying the Other Method, the TPO was required to place on record data in respect of comparable uncontrolled transactions. The High Court noted that uncontrolled agreements selected by the TPO were not similar / comparable to the transactions undertaken by the assessee and therefore, application of the Other Method by the TPO was not in accordance with the provisions of Rule 10AB of the Rules.

VA Comments

The High Court has emphasized the importance of principle of consistency in matters relating to selection of the most appropriate method. The finding of the High Court, that unless there are cogent reasons, the TPO is required to follow the method consistently adopted in the earlier years, is expected to bring considerable clarity in matters wherein the dispute revolves around selection of most appropriate method.

This is the first time that the High Court has undertaken a detailed analysis of the provisions of Rule 10AB and on that basis, held that (i) recourse to the ‘Other Method’ is available only if none of the Other Methods are considered as the most appropriate method and (ii) Rule 10AB of the Rules expressly contemplates adoption of a method which takes into account price that has been charged or paid, or would have been charged or paid, for the same or similar uncontrolled transaction, under similar circumstances. Accordingly, even for the purpose of application of the ‘Other Method’, it is necessary to place on record data with respect to comparable uncontrolled transactions.

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