C H A P T E R 08

Transfer Pricing Assessment

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Poet Kalidasa in his work Raghuvamsha – A King should extract tax the way sun absorbs moisture from Earth to give it back thousand times

Objective:
The most challenging part in complying with the transfer pricing law in India is undergoing a transfer pricing assessment. This chapter aims to simplify the transfer pricing assessment process to the reader and enable a smooth transfer pricing assessment process from the perspective of the client and the revenue authorities.

Introduction

They say representation before the assessing authority is an art and a science. In case of Transfer Pricing assessment this saying is further reinforced, due to the very nature of transfer pricing law, where one has to compare an assessee's related party transactions with independent transactions after various adjustments to ensure comparability and establishing such transactions satisfy the arm's length price (ALP) requirement. Since the introduction of transfer pricing law in India from AY 2002-03, the transfer pricing scrutiny process has grown in complexity with TPOs making varied adjustments using different techniques like bright line test method etc.

Transfer pricing cases are usually won and lost on the facts. The key in transfer pricing cases is to put together a compelling story of what drives the taxpayer's financial success, based on a thorough analysis of functions, assets, and risks, and an accurate understanding of the relevant financial information. An effective story explains the taxpayer's value chain, competitive position in its industry, and financial results, in a clear and compelling fashion.At any given point in time, one must not lose sight of the basic objective of transfer pricing process, being prevention of shifting of profits from the jurisdiction where value has been created. For instance, in the case of L'oreal India, the TPO rejected the ALP computation of the taxpayer contending that TNMM was the MAM, and not RPM. Though the taxpayer had incurred a loss, it was able to establish before the courts that the loss was on account of market penetration strategy adopted by the Company and that it had not shifted any profits to its AE outside India. The courts took cognizance of this and deleted the TP adjustment made by the TPO.

In summary, this chapter provides the transfer-pricing practitioner with a comprehensive toolkit to address the key themes underlying a transfer pricing assessment. As with every toolkit, not every tool, or audit step, will be necessary to get the job done in a particular case. You will need to use your judgment to apply the recommendations contained in the chapter to your specific case.

Reference to Transfer Pricing Officer

By virtue of the provisions of section 92CA(1), the Assessing Officer, with the previous approval of the Pr Commissioner / Commissioner is empowered to refer to the TPO the computation of the arm's length price of an international transaction or specified domestic transaction entered into by an assessee over whom the Assessing Officer exercises jurisdiction.

It is important to note that in order to make a reference to the TPO the assessment proceedings in relation to the relevant AY must be pending before the AO. Kaeser Compressors (India) Pvt Ltd [TS-406-ITAT-2015(PUN)-TP]

In XL India's case, AO made a reference to TPO even though assessment proceedings were not initiated and thereafter initiated reassessment proceedings to make TP adjustment proposed by TPO. It was held that the provisions *"do not envisage the AO making a reference to the TPO the issue of determination of ALP when there is no assessment proceedings pending before him"*; Accordingly, concludes that TPO's report could not be acted upon for issuance of the notice of reassessment u/s 148,XL India Business Services (P) Ltd [TS-438-HC-2015(DEL)-TP]

Approval before making the reference

The Assessing Officer is required to obtain prior approval of the Principal Commissioner or Commissioner before making the reference to the TPO. It has been held in various judicial pronouncements that it is not necessary for the Assessing Officer to provide a copy of such approval to the Assessee. In the case of ***Coca Cola India Inc. V. ACIT*** ***[TS-2-HC-2008(P & H)-TP]*** ***and Tally Solutions (P.) Ltd V. DCIT*** ***[TS-576-ITAT-2011(Bang)-TP],*** it was held that the Assessing Officer is not required to provide any opportunity of being heard to the assessee before making a reference to the TPO. However, if any of the 3 conditions provided in the CBDT Instruction No.3/2016 (dealt with later in this chapter) are satisfied,the AO must provide an opportunity of being heard to the taxpayer.

Prerequisites for making a reference to the TPO

The Assessing Officer may make a reference to the TPO where he considers it 'necessary or expedient' to do so. The use of the word 'may' in section 92CA suggests that the Assessing Officer can make a reference to the TPO at his discretion. The phrase 'necessary or expedient' has not been defined under the Act. The Hon'ble Supreme Court in the case of CIT v. Paharpur Cooling Towers (P) Ltd had an occasion to interpret this phrase appearing in sec. 245E of the Act and held that:

"Section 245E, which ... empowers the Commission to reopen any completed proceedings connected with the case before it but this power is circumscribed by the requirement expressly stated in the section that such reopening of completed proceedings should be necessary or expedient for the proper disposal of the case pending before it. There are two other limitations upon this power, viz., that this reopening of the completed proceedings can be done, even for the aforesaid limited purpose, only with the concurrence of the assessee and secondly that this power cannot extend to a period beyond eight years from the end of the assessment year to which such proceedings relates. These two features make it abundantly clear that the section contemplates reopening of the completed proceedings not for the benefit of the assessee but in the interests of the revenue. It contemplates a situation where the case before the Commission cannot be satisfactorily settled unless some previously concluded proceedings are reopened which would normally be to the prejudice of the assessee. It is precisely for this reason that the section says that it can be done only with the concurrence of the assessee and that too for a period within eight years. This section cannot be read as empowering the Commission to do indirectly what cannot be done directly ... The power conferred by the section 245E is thus a circumscribed and a conditional power. It can be exercised only in accordance with and subject to the conditions aforementioned and in no other manner."

Relying on the decision of the Apex Court, the Delhi Court in the case of Sony India (P) Ltd. v. CBDT[TS-3-HC-2006(DEL)]held that:

"There is no gainsaying that power conferred on an authority, particularly a discretionary power, cannot be exercised mechanically. What is 'necessary or expedient' will depend on the facts and circumstances of every case and the satisfaction of the Assessing Officer in this regard will have to be based on some objective criteria. On the other hand, the relatively insignificant value of the transaction may make it inexpedient

for the matter to be referred to the TPO. It is not possible to anticipate the instances that may necessitate the invoking of the discretion vested in the Assessing Officer in this regard. It is trite that any misuse of such exercise of discretion can be corrected by way of judicial review by statutory appellate authorities and ultimately the Courts … the exercise of the discretion by the Assessing Officer is required to be preceded by the formation of an opinion by the Assessing Officer of the necessity or expediency of making such a reference. However, what is not apparent is the nature of such opinion. Is this a prima facie opinion or a considered opinion after examining all available materials? … There is nothing in section 92CA itself that requires the Assessing Officer to first form a considered opinion in the manner indicated in section 92C(3) before he can make a reference to the TPO. In our view, it is not possible to read such a requirement into section 92CA (1) … It will suffice if the Assessing Officer forms a prima facie opinion that it is necessary and expedient to make such a reference."

While there is no doubt that making a reference for computation of the ALP to the TPO is at the discretion of the Assessing Officer, what emanates from the above is that the Assessing Officer has to form a prima facie opinion that it is necessary and expedient to make such a reference. Having some material on record and recording satisfaction thereof is essential before making a reference. Further, what is 'necessary and expedient' differs from one case to another.

CBDT instructions on reference to TPO

The transfer pricing provisions came into force from Assessment year ("AY") 2002-03. Since the inception, a reference was made to the TPO based on the value of international transactions relying on the instruction issued by the CBDTin 2003 wherein a reference was required to be made if the aggregate value of the international transactions exceeded Rs. 5 crores in the financial year, subsequently increased to Rs. 15 crores in the financial year. After completion of almost ten assessment cycles, CBDT issued Instruction no. 15 of 2015, in which the focus shifted to risk based TP assessment. Re-emphasizing the need for a risk based TP assessment, the CBDT issued Instruction no. 3 of 2016 providing the guidelines for making a reference to the TPO as follows:

No.	Situation	Action of the Assessing Officer
1	Where the case is	Reference to the TPO is mandatory

	selected for scrutiny either under CASS* or compulsory manual selection on the basis of transfer pricing risk parameter	
2	Where the case is selected for scrutiny on non-transfer pricing risk parameter	Reference shall be made to the TPO only in the following three cases: **a. Failure to report:** AO comes to know that the assesse has entered into international transaction and / or SDT but has not filed Form 3CEB or has not disclosed the same in the report; or **b. Quantum of previous adjustment:** If there has been a TP adjustment of Rs. 10 crore or more in any previous assessment years which is upheld by judicial authorities or pending in appeal; or **c. Search / seizure case:** Where search or survey operation has been carried out and findings on the TP issues are recorded by AO or the Investigation wing
3	Cases involving TP adjustment in earlier assessment years that has been set aside by the ITAT, High Court or Supreme Court on the issue of said adjustment	Reference to the TPO is mandatory

*CASS – Computer Assisted Scrutiny Selection

Before seeking the approval of the PCIT / CIT, the AO is required to record his satisfaction that there is an income or a potential of an income arising and / or being

affected on determination of ALP where the reference is made as a result of (except where it is falling under situation 3 above):

a. Where the taxpayer has not filed the report under section 92E but the international transaction or SDT undertaken by it comes to the notice of the AO;
b. Where the taxpayer has not declared one or more international transaction or SDT in the report under section 92E and the same comes to the notice of the AO;
c. Where the taxpayer has disclosed the transactions, but has made certain qualifying remarks that the said transaction is not an international transaction or SDT or does not affect the income of the taxpayer.

In the above three cases if no objection is raised by the taxpayer regarding the applicability of Chapter X of the Act, then the AO should refer the international transactions or specified domestic transaction to the TPO for determining the ALP after obtaining the approval of the Principal Commissioner or Commissioner of Income Tax.

If the taxpayer raises an objection regarding the applicability of chapter X in these three situations, the AO must consider the taxpayer's objections and pass a speaking order so as comply with the principle of natural justice.

In the case of Indorama Synthetics (India) Ltd. vs. the Additional Commissioner of Income-tax[TS-501-HC-2016(DEL)-TP], the Hon'ble Delhi High Court, relying on the decision of the Hon'ble Bombay High Court in the case of Vodafone India Services (P) Limited v. Union of India [TS-621-HC-2015(BOM)-TP] held that:

"Where the AO is of the view that a transaction reflected in the filed return partakes of the character of an international transaction, he will put the Assessee on notice of his proposal to make a reference to the TPO under Section 92CA (1) of the Act. Before making a reference to the TPO, the AO has to seek approval of the Commissioner/Director as contemplated under the Act. Therefore, all transactions have to be explicitly mentioned in the letter of reference. The very nature of this exercise is such that the AO will first put the Assessee on notice of his proposing to make a reference to the TPO and seek information and clarification from the Assessee. If at this stage, the Assessee raises an objection as to the very jurisdiction of the AO to make the reference, then it will be incumbent on the AO to deal with such objection on merits.

While Section 92CA (1) does not itself talk about a hearing having to be given to the Assessee upon the latter raising an objection as to the jurisdiction of the AO to make a reference, such requirement appears to be implicit in the very nature of the procedure

that is expected to be followed by the AO. As already noticed, the AO has to record that he considers it necessary and expedient to make a reference. The AO has to deal with the objections raised by the Assessee. It is only thereafter that the AO can come to the conclusion, even prime facie, that it is necessary and expedient to make the reference. This has to be done prior to making a reference."

The Hon'ble Delhi High Court also went on to hold that the CBDT Instruction No. 3 of 2016 clarifies the correct legal position and would apply retrospectively since it is a procedural aspect and is intended to the benefit to the Assessee.

Similarly, in the case of **Tata Consultancy Services [TS-521-ITAT-2015(Mum)-TP],** Mumbai ITAT held that, only after proper application of mind to all the facts and holding a prima facie belief, AO can make reference to theTPO or CIT can grant approval for such a reference, as it is primarily AO's duty to compute arm's length price and only where AO requires ALP to be computed by a specialist can a reference be made to TPO. ITAT stated that CBDT Instruction 3/2003 detracts AO/CIT from the above obligation in complete violation of the statutory provisions of the Act and necessary hearing is required to be given to the assessee in accordance with natural justice principles before a reference is made to AO after the 2007 amendment, relying on Bombay HC ruling in Vodafone India Services P. Ltd.

Satisfaction of the AO vis-à-vis CBDT instruction

In the case of Sony India Pvt. Limited (supra), their Lordships of the Hon'ble Delhi High Court were considering CBDT Instruction No.3 dated 20.05.2003, which provides that a compulsory reference has to be made to the TPO to determine arm's length price, where the aggregate value of the international transactions exceeds Rs. 5 crores. The assessee in that case challenged the constitutional validity of the said Circular mainly on the ground that by issuance of the Circular, the AO's ultimate decision on computation of ALP is sought to be supplanted by the decision of the TPO for transactions of value over Rs. 5 crores and the TPO is not bound to follow the steps outlined u/s 92C of the Act, which are otherwise mandatory for the AO to follow. In this connection, the Hon'ble Delhi High Court held that that the Instruction in question is consistent with the statutory objective underlying section 92CA(1) of the Act and acts as guidance to the AO in the exercise of discretion in referring an international transaction to the TPO for determination of its ALP and it is neither arbitrary, nor unreasonable and is not ultravires the act.

Powers of the AO to compute the ALP

In the foregoing paragraphs, we have seen how the AO is empowered to make a reference to the TPO by virtue of the provisions of section 92CA(1). Independent of that, provisions of section 92C(3) empower the AO to determine the ALP of an international transaction or SDT where, on the basis of material or information or documents in his possession, the AO is of the opinion that:

a. the price charged or paid in an international transaction or SDT has not been determined in accordance section 92C (1) and (2); or
b. any information and document relating to an international transaction or SDT have not been kept and maintained by the assessee in accordance with the provisions of section 92D(1); or
c. the information or data used in computation of the ALP is not reliable or correct; or
d. the assessee has failed to furnish, within the specified time, any information or document which he was required to furnish by a notice issued under section 92D(3).

Prior to the issue of the CBDT Instruction No. 3 of 2016, the AO could have proceeded to determine the ALP of an international transaction or SDT in the above-mentioned instances. However, the CBDT has clarified that though the AO has the power under section 92C to determine the ALP of international transaction or SDT, determination of ALP should not be carried out at all by the AO in a case where reference is not made to the TPO. With the instruction of the CBDT, determination of ALP will necessarily have to be carried out by the TPO in all cases falling under the guidelines issued by the CBDT (supra).

It is pertinent to note that circulars issued by the board are binding in law on all tax authorities - ***Hindustan Aeronautics Ltd v. CIT [TS-11-SC-2000], CIT v. Hero Cycles Pvt Ltd [TS-33-SC-1997].***

Another question that arises is whether a reference to the TPO can be made under section 92CA(1) only upon satisfaction of one or more circumstances of 92C(3). The Hon'ble Delhi High Court in the case of Sony India (P) Ltd. v. CBDT has held that:

"There is nothing in section 92CA itself that requires the Assessing Officer to first form a considered opinion in the manner indicated in section 92C(3) before he can make a

reference to the Transfer Pricing Officer. In our view, it is not possible to read such a requirement into section 92CA(1). However, it will suffice if the Assessing Officer forms a prima facie opinion that it is necessary and expedient to make such a reference. One possible reason for the absence of such a requirement of formation of a prior considered opinion by the Assessing Officer is that the Transfer Pricing Officer is expected to perform the same exercise as envisaged under section 92C(1) to (3) while determining the ALP under section 92CA(3). The latter part of section 92CA(3) unambiguously states that the Assessing Officer shall "by order in writing, determine the arm's length price in relation to the international transaction in accordance3 with sub-section (3) of the section 92C. it will be pointless to have a duplication of this exercise at two stages one after the other." (Emphasis provided)

Following the above decision of the Hon'ble Delhi High Court, the Special Bench of the ITAT in the case of Aztec Software & Technology Services Ltd. v. ACIT **[TS-4-ITAT-2007(Bang)-TP]** held that the Assessing Officer is not required to demonstrate the existence of the circumstances set out in clause (a) to (d) of sub-section (3) of section 92C of the Act before referring the case of the assessee to the TPO for determining the ALP under section 92CA(1) of the Act for the reasons given under:

1. Proceedings in sections 92C and 92CA are quite independent of and distinct from each other and the proceedings under section 92CA(1) of the Act are not dependent on the proceedings under section 92C(3) of the Act. This is due to historical reasons as two provisions were introduced at different times.
2. The provisions of section 92C(3) of the Act confers powers on the Assessing Officer to determine the ALP himself where the circumstances mentioned in clause (a) to (d) of the sub-section exist. In such cases, the Assessing Officer is not bound to refer the case of the assessee to the TPO. On the other hand, the Assessing Officer may refer the case of the assessee to the TPO if he considers it necessary or expedient to do so.
3. The expression 'necessary' or 'expedient' is quite distinct from and independent of the circumstances mentioned in section 92C(3). The Assessing Officer may consider it necessary or expedient to make a reference to the TPO. No other condition is prescribed in the provision. Under what circumstances, Assessing Officer would consider it 'necessary' or 'expedient' would depend upon facts of each case.

4. No doubt, even in cases covered by section 92C(3) of the Act, the Assessing Officer may in appropriate cases consider it necessary or expedient to refer the case of the assessee to the TPO for determining the ALP but that does not mean that powers of the Assessing Officer to refer the case to the TPO is restricted to those cases which are covered by section 92C(3) of the Act.
5. Had the legislature contemplated to refer the case of the assessee to the TPO only in the circumstances mentioned in section 92C(3) then the legislature would have to provide such conditions in place of words 'necessary' or 'expedient' in sub-section (1) of section 92CA.
6. In section 92CA(1) there is no reference to section 92C(3). Moreover it is mandatory for TPO to determine ALP in accordance with sub-section (3) of section 92C. If the above section is to be applied by TPO under section 92CA(3) at the prescribed stage, there is no question of applying the same provision at the stage of making reference.
7. The words 'the said international transaction/SDT under section 92C' only refers to the transaction in respect of which reference can be made to the TPO and the same does not lead to the conclusion that the requirement of section 92C(3) can be read into section 92CA(1) of the Act.

In both the foregoing decisions, it has been held that it is not necessary for the TPO to demonstrate the satisfaction of conditions enlisted in section 92C(3) before making a reference to the TPO under section 92CA(1).

Notice upon reference to a TPO

Once a reference is made to the TPO, similar to the notice under section 143(2), the TPO shall issue a notice requiring the taxpayer to produce any evidence on which the taxpayer wishes to rely in support of the computation of the ALP made by him. It is pertinent to note here that no responsibility is cast on the AO to issue a notice / communication to the taxpayer intimating reference made to the TPO. On the other hand, section 92CA(2) casts the responsibility on the TPO to issue the notice on the taxpayer.There is no specific limit for issue of notice by the TPO. While there is no prescribed / pre-printed format to issue this notice, it is necessary for the TPO to specify the date by which the evidence is to be furnished by the taxpayer.

Apart from the above notice, the TPO may also issue such other notice(s) upon the taxpayer directing him to furnish specific information / documents as called for by the TPO. This is similar to the notice issued by the AO under section 142(1). Generally, the TPO directs the taxpayer to furnish the following information / documents:

- Furnishing of TP study of the relevant previous year
- Segmental information or revenue allocation criteria based on the specific segment
- Annual financial statements, Form 3CEB and Form 3CD
- Agreements/Statement of Work between the assessee and associated enterprises(AE)
- Reason for selection of most appropriate method (MAM)
- Why particular profit level indicator PLI was chosen – (In case where Transaction Net Margin Method is adopted for determination of ALP)
- Any other specific matter

While responding to the notice issued by the TPO and furnishing the information/documents sought by the TPO, one should ensure thatthe following aspects are taken care of:

i. Ensuring the numbers appearing in the financial statements tie-up with those appearing in the TP documentation
ii. Ensuring the segmental financials are in sync with the financial statements
iii. Ensuring all the international transactions and SDTs reported in the Form 3CEB have been benchmarked in the TP documentation
iv. Ensuring there is no difference between the value of the international transactions / SDTs reported in Form 3CEB with the value reported in the TP documentation
v. If the international transactions / SDTs have found to be not within the arm's length price, the difference has been considered as income in the Return of Income of the taxpayer

Power of the TPO to determine ALP of transactions other than those referred to him

Another question that arises for consideration is whether the TPO has the power to determine the ALP in relation to international transactions which are not referred to him by the AO, but which comes to his notice during the course of the proceedings before him. Section 92CA(2A) provides that the TPO can determine the ALP of those international transactions which are not referred to him by the AO, it such transactions

come to his notice during the course of the TP proceedings. The position would remain the same irrespective of whether the taxpayer has furnished the report under section 92E or not - sec. 92CA(2B).

While 92CA(2A) was inserted with prospective effect from 1 June 2011, 92CA(2B) was inserted by Finance Act 2012 with retrospective effect from 1 June 2002. It is pertinent to note that these provisions have not been amended so as to apply to a SDT. Therefore, where the AO makes a reference to the TPO for computing the ALP of a SDT, the scope of his jurisdiction would be restricted to the SDT, which has been referred to him by the AO.

In the case of Atul Ltd. v. ACIT[TS-697-ITAT-2012(Ahd)-TP] and Amadeus India (P) Ltd v ACIT[TS-57-ITAT-2011(DEL)], it has been held that though the role of the TPO is restricted to the transaction referred to him, the AO is however empowered to determine the ALP of an international transaction that comes to his knowledge on the basis of findings of the TPO. These principles would not apply to the case of SDTs since the provisions of section 92CA (2A) and (2B) are not made applicable to SDTs and also in light of the CBDT Instruction no. 3 of 2016.

Issue of show cause notice

The TPO may either accept the computation of the ALP made by the taxpayer or reject it and proceed to make his own computation. Generally, the grounds for rejecting the taxpayers' computation are as follows:

i. Use of multiple year data

   The use of multiple year data has been a popular ground for the TPO to reject the TP study of an assessee. However, with the introduction of the range concept in the Indian Transfer Pricing Law from assessment year 2015-16 vide Rule 10CA of the Income-tax Rules, 1962, use of multiple year data should cease to be an issue from rejection of Transfer Pricing study.

ii. Use of inappropriate method to compute ALP

   Many a times, the TPO is in disagreement with the method used by the assessee to compute the Arm's Length Price,for Eg: The assessee would have used RPM method whereas the TPO is of the opinion TNMM should be the method used. Therefore, it is important for the assessee to have a sound reason for selection of any particular method and the same should be clearly stated in the TP study to avoid

rejection of the TP study on the grounds that an inappropriate method has been used to compute ALP.

iii. Use of inappropriate Profit Level Indicator(PLI)

Similar to using an inappropriate method to compute ALP, selection of inappropriate PLI for the purpose of benchmarking could also lead to rejection of a TP study, for eg: The assessee would have chosen Net Profit/Operating Cost as the PLI, whereas the TPO is of the opinion that the PLI should be Net Profit/Sales. Therefore, appropriate care must be taken while choosing a PLI to ensure that the base is not influenced by related party transactions.

iv. Disagreement on inclusion / exclusion of items in computation of margins

The TPO can proceed to reject a TP study on the basis that the margins of the comparables have not been computed appropriately, where the assessee could have excluded/included specific items in the computations such as amortization charges while computing the margins of the comparables. Therefore, for every exclusion/inclusion which deviates from the norm, it would be a good practice to a provide a note in the TP study.

v. Use of inappropriate filters

The assessee could have chosen comparables based on turnover criteria and further subjected such comparables to quantum of related party transactons (RPT) test (RPT filter). Now, the TPO can reject the TP study, if s/he disagrees with the filters/criteria based on which comparables have been chosen. It is upto the assessee to defend the selection of criteria which has to be done on based on sound reasoning.

vi. Adoption of inappropriate comparables

The TPO can reject the TP study if s/he is in disagreement with the comparables chosen by the assessee.Therefore, the process of choosing comparables should be well documented in the TP study, and the comparables should withstand the test of functionality and reasonability.

vii. Disagreement on economic adjustments

Many a times in a TP study which establishing the ALP, economic adjustments such as risk adjustment, working capital adjustment, capacity utilizationadjustment are given effect to by the assessee. The TPO may disagree with such adjustments and may proceed with rejecting the TP study. Therefore, every economic adjustment should be backed with strong documentation and reasoning.

viii. Identifying transactions other than those referred by the AO and determiningthe ALP thereof

As per Sec. 92CA(2) of the Act, the TPO has the powers to examine international transactions other than those reported by the AO, on identification of such transactions.

ix. Identifying transactions other than those reported by the taxpayer and determining the ALP thereof

As per Sec. 92CA(3) of the Act, the TPO has the powers to examine international transactions other than those reported by the assessee, on identification of such transactions. Therefore, great care must be taken to report all the International transactions as inadvertently some of the transactions might be missed out from reporting in the Form-3CEB or in the TP documentation. This will even lead to attraction of the penalty provisions.

Where as a result of the above, the ALP computed by the TPO has the effect of increasing the income chargeable to tax or decreasing the loss of the taxpayer, the TPO shall issue a show-cause notice to the taxpayer giving reasons for rejecting the approach adopted by the taxpayer and detailing the approach he wishes to adopt.

In the case of Maruti Suzuki India Limited v. Addl. CIT[TS-43-HC-2010(DEL)], it was held that the purpose of a show-cause notice is to enable the assesse to meet the grounds on which the ALP paid by him is sought to be rejected and adjustment is proposed to be made to its income. The reasons conveyed to the assesse need to be clear, cogent, specific and unambiguous. Unless the assesse knows where the grounds are which could impel the TPO to discard the price disclosed by it and to propose an adjustment in its income, while determining ALP in relation to the international transaction made by it, it is not possible for it to meet those grounds and satisfy the TPO that the price agreed by it for the transaction in question is the right ALP and that there is no justification to make any adjustment in its income. The assesse can produce the relevant information and documents before the TPO only if it knows the precise case which it is expected to meet before the TPO. It is meaningless to give opportunities of leading evidence to the assesse, without first letting it know, what it is expected to meet. In case the TPO feels the necessity of making adjustments to the income of the assesse only after he has considered the evidence produced before him by the assesse in support of the price agreed by it for transaction in question, he needs to disclose to the assessee at that very stage, the ground

on which he wants to make the adjustment to its income, and then give it an adequate opportunity to reply to those grounds and lead evidence in support thereof.

In the show cause notice, the TPO should quantify the amount by which the taxpayer falls short of the ALP and the quantum of adjustment he proposes to make.

On receipt of the show-cause notice, the taxpayer may either accept the modifications proposed by the TPO or furnish a detailed response to the TPO within the stipulated time.

It is pertinent to note that after receiving the response to the show cause notice from the taxpayer, if the TPO makes adjustments on grounds other than those mentioned in the first show-cause notice, then it is incumbent upon the TPO to issue a fresh show-cause notice specifying the modified grounds on which the TPO proposes to compute the ALP. Further, where the TPO does not indicate that he had abandoned the show-cause notice issued to the taxpayer and intends to proceed on a different set of grounds for making the adjustment, merely seeking information without conveying the grounds for making the adjustment will not satisfy the requirements of issuing the show cause notice.

Time limit for passing of Order by TPO under section 92CA

Sl. No.	**Proceedings under section**	**Time for completion**	**Time limit for passing of Order by TPO**
	(A)	(B)	(C)
1	143(3) or 144, where reference is made to the TPO under section 92CA(1)	33 months from the end of the AY in which the income was first assessable	60 days prior to (B)
2	147, where reference is made to the TPO under section 92CA(1)	21 months from the end of the FY in which the notice under section 148 was served	60 days prior to (B)
3	143(3)/144/147 where the original assessment is set aside under section 254/263/264 and where reference is made to the	21 months from the end of the FY in which the said order under section 254 is received by Pr. CCIT/ CCIT/ Pr. CIT/ CIT or the	60 days prior to (B)

	TPO under section 92CA(1)	order under section 263/264 is passed by the CIT or Pr. CIT	

TPO's Order is binding on the AO

Section 92CA(4) provides that on receipt of the order under section 92CA(3), the Assessing Officer shall proceed to compute the total income of the assessee under section 92C(4) 'in conformity' with the ALP as determined by the TPO. CBDT Circular No. 3/2008, dt. 12th March, 2008, clarifies that the arm's length price determined by the TPO would be binding on the Assessing Officer. The Special Bench, in the case of Aztec Software & Technology Services Lts. Vs. ACIT**[TS-4-ITAT-2007(Bang)-TP]** observed that:

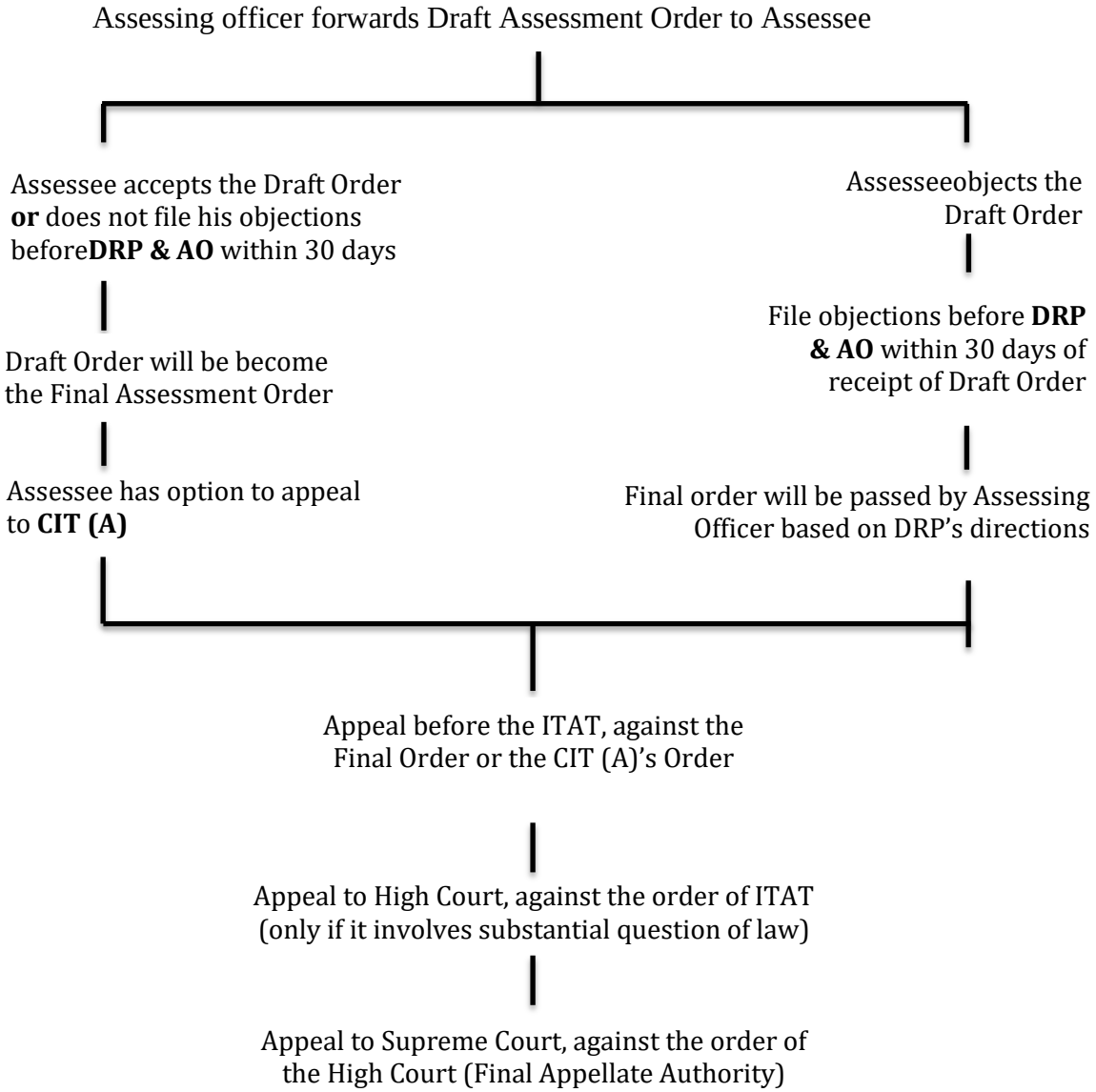
"Now words 'having regard to' have been replaced by 'in conformity with'. So now AO after introduction of sub-section (4) above is required to pass assessment order in conformity with the order of the TPO determining ALP. Now the order of the TPO has been expressly made binding on the AO. From the above, it is clear that there was a lacunae in the Act as appropriate language was not used earlier. This has been modified and w.e.f. 1.6.2007, the order of TPO is binding on the AO who now has no choice but to pass an Order in conformity with the order of the TPO. The word "having regard to" did not convey the same meaning. For all the aforesaid reasons, we hold that prior to substitution sub-section (4) by a new section, the order of the TPO was not binding on the AO."

Application to the Dispute Resolution Panel (DRP)

Dispute Resolution Panel is a collegium comprising of three Commissioners of Income-tax constituted by the Board. DRP was created with a view to bring about speedy resolutions of disputes in the case of international transactions, particularly involving transfer-pricing issues.

The AO shall, on receipt of the Order passed by the TPO, compute the total income of the assessee and pass the Draft Assessment Order. The assessee then has the option to either file an application before the DRP under section 144C or file an appeal before the Commissioner of Income-tax (Appeals) against the final assessment order.

The options available to the taxpayer are elucidated below:



An application can be made before the DRP only where a transfer-pricing adjustment has been recommended by the TPO and the same is incorporated in the Draft Assessment

Order. Where a reference was made to the TPO, but no variation arises **as a consequence of** the order of the TPO passed under section 92CA(3) of the Act. To put it differently, only when there is a transfer pricing adjustment in the order under section 92CA(3) will the AO pass a Draft Assessment Order against which an application may be filed before the DRP. Where there is no transfer pricing adjustment despite a reference being made to the TPO, the AO will straight away pass the final assessment order.

One should also note that where a TP adjustment has been made by the AO in exercise of powers vested in section 92C(3) without making a reference to the TPO, the option of filing an application before the DRP is not available to the taxpayer.

The application filed before the DRP should consist of the following:

Sl. No	Particulars
1	Form 35A
2	Background of the Assessee
3	Grounds of Objections
4	Detailed Grounds of Objection
5	Draft Assessment Order
6	TP Order u/s 92CA
7	Reply to Show Cause Notice
8	Show Cause Notice
9	Transfer Pricing Study
10	Original Power of Attorney

The above should be filed **in quadruplet** before the DRP and a copy should be filed before the AO within 30 days of receipt of the draft assessment order.

While filing an application before the DRP, caution should be exercised that the requisite steps have been duly followed. Sometimes the important step of filing a copy of the DRP application with the concerned AO within the due date is missed as this is not the practice while filing an appeal before the CIT(A), and man is a creature of habit. This may entail wide range of consequences, as the AO may proceed with passing the final order of assessment. In such a situation, the assessee is compelled to file an appeal before the CIT(A) even though an application is made before the DRP. The assesse may also file a petition for rectification under sec 154 of the Act as passing the assessment order is a mistake apprarent on record when the valid proceedings are pending before the DRP.

Since the law has not provided any remedy for a situation where application is filed before the DRP on or before the due date whereas copy of the application is not filed or filed belatedly before the AO and the AO has passed the final assessment order, the assesse may approach the High Court under writ jurisdiction.

DRP vs. CIT-(A)

While both the options are available to the taxpayer, the following points should be taken into consideration before opting for either the CIT(A) route or DRP route:

Particulars	DRP	CIT-(A)
Tax Demand	AO can enforce the tax demand once the final assessment order is passed after incorporating the directions of the DRP	AO can enforce the tax determined on assessment once the final assessment order is passed
Revenue's right of appeal	While the taxpayer can prefer an appeal against the order of the DRP, the Department cannot challenge the directions of the DRP	The Department has the right to prefer an appeal against the order of the CIT(A)
Time limit to pass the order	The DRP is obliged to issue directions within nine months from the end of the month in which the taxpayer receives the draft order	Time limit for disposal of the appeal has not been prescribed under the Act
Issues not raised before the AO	The tax payer can raise any issue before the DRP though such issues were not raised before the AO	The taxpayer cannot raise any fresh issues before the CIT A which were not raised before the AO unless the CIT A accepts the petition for admission of additional grounds filed by the taxpayer.

Income escaping assessment – [Section – 147(ba)]

If the AO has ‘reason to believe’ that any income chargeable to tax has escaped assessment for any AY, he may assesss or reassesss such income for that AY. Where the assessee has failed to furnish a report in respect of international transactionswhich he was so required u/s 92E, then in such a situation,income chargeable to tax shall be deemed to have escaped assessment.Therefore, if an assessee fails to report any international transaction then assessment can be initiated under section 147.

.In the case of Greenland Exports Private Ltd [TS-778-ITAT-2012(CHNY)-TP], the ITAT opined that AO's view that turnover exceeding Rs.15Crores required compulsory scrutiny, *"cannot in any way be deemed as a reason to believe that there was escapement of income"*. Relying on SC decisions in Rajesh Jhaveri and Kelvinator, noted that even after substitution of S.147, AO must have reason to believe that income chargeable to tax had escaped assessment, and concludes that "the re-opening suffered from a fundamental flaw, going to the roots and vitiating the re-assessment process";

In order to reopen an assessment beyond the period of four years of the assessment order,the income chargeable to tax having escaped assessment must be relateable to the failure on the part of the assessee to disclose truly and fully all material facts necessary for assessment.

In the case of Mastek Ltd’s [TS-612-HC-2016(GUJ)-TP]the AO had reopened the assessment on the ground that TP-addition made would not qualify for Sec 10A deduction in terms of Sec 92C(4), despite which such deduction was granted during original assessment; The Gujarat HC while quashing the notice udner sec 148 observed that *“Even if that be so, nowhere the Assessing Officer had recorded that excess deduction was granted to the petitioner due to failure on the part of the assessee to disclose truly and fully all necessary material facts, a prime requirement under the provisions of section 147 of the Act which enables the Assessing Officer to reopen an assessment previously framed after scrutiny beyond the period of four years of the assessment order…If at all it was an error on the part of the Assessing Officer to grant larger relief than what was justified under the legal provisions”*;

Where there is no material indicating incorrectness of ALP determination shown by AO; Reassessment to merely determine arm's length price ('ALP') of international transactions reported in Form 3CEB invalid; Cheil Communications India P. Ltd. [TS-101-HC-2013(DEL)-TP]. Hwoever, **Non-filing of Form 3CEB tantamounts to material non-**

disclosure, reassessment in such cases would be valid. Sitara Diamond Pvt. Ltd. [TS-264-HC-2013(BOM)-TP]

Earlier year's TP adjustment is a valid ground for initiating re-assessment. Sysarris Soft P Ltd [TS-43-HC-2013(KAR)-TP]. Whereas **Re-assessment for earlier FY, in view of TP assessment in subsequent FYs is held to be invalidin the case of** SGS India P Ltd [TS-6-HC-2007(BOM)]

Revisionary powers u/sc. 263

The Principal Commissioner or Commissioner may call for and examine the record of any proceedings under the Act and if he considers that any order passed therein by the AO is erroneous and prejudicial to the interest of the revenue, pass such order enhancing or modifying the assessment or cancelling the assessment or directing a fresh assessment.

Explanation 2 to Sec. 263 inserted vide Finance Act, 2015 provides instances where an order of the assessing authority can be considered to be erroneous and prejudicial to the revenue. One of the grounds for jurisdiction under Sec. 263 being the order is passed without making inquiries or verification which should have been made. Therefore, if an AO does not make a reference to the TPO can it be held that, the order is erroneous and prejudicial to the revenue?

The Hyderabad ITAT in the case of Quislex observed that issue is squarely covered by Delhi HC decision in Ranbaxy Laboratories Ltd vs CIT wherein it was held that failure by AO to make reference to TPO wherever aggregate value of international transaction exceeded the prescribed limit would result in AO's order being erroneous and prejudicial to Revenue's interest calling for revision u/s 263.Quislex Legal Services P Ltd [TS-248-ITAT-2015(HYD)-TP]

However, in Obulapuram Mining Company Pvt Ltd [TS-512-ITAT-2016(Bang)-TP], the Bangalore ITAT quashed CIT’s order u/s 263 for AY 2008-09 since assessment order could not be established to be erroneous and prejudicial to the interest of revenue. In this case the CIT invoked revisionary powers u/s 263 for the reason that AO had not referred ALP determination of international transactions to TPO as required under CBDT Instruction No. 3/2003. Relying on Bombay HC decision in Vodafone India, ITAT

concluded that CIT's reliance on Delhi HC decision in Sony India and ITAT Special Bench decision in Aztec was misplaced as these judgments were rendered in the context of Sec 92CA(4) as existing prior to the amendment in 2007. Further relying on ITAT decision in Tata Consultancy Services wherein it was held that CBDT Instruction No. 3/2003 was not binding on AO, and held that, "In this view of the matter, the assessment order cannot be said to be erroneous because the view taken by the A.O. of not referring the matter to the TPO is a possible view as per this tribunal order"; Also the ITAT noted that Revenue had been unable to point out any other basis for holding assessment order to be erroneous, accordingly concluded that order of CIT u/s 263 was unsustainable. , the ITAT upheld Currently the CBDT CircularNo. 3/2003 has been withdrawn andas per the CBDT instruction no. 15 of 2015, the focus has shifted to risk based assessment and therefore, if in accordancewith such latest circular the AO does not refer the matter to TPO, then the Bangalore ITAT view in [TS-512-ITAT-2016(Bang)-TP] should prevail.
In the case of Essar Steel Ltd. [TS-698-ITAT-2012(Mum)-TP], it was held that, CIT hasno jurisdiction to revise order of TPO passed u/s 92CA,as TPO functions separately under DIT. CIT's order u/s 263 to revise 'assessment order' based on TPO's proposal not valid. The TPO proposal was for revision of his order. The ITAT held thatthere is no clarity in provisions as to authority who can revise TPO's order. DIT should have initiated revision proceedings instead of forwarding proposal to CIT. Assessment order not erroneous or prejudicial to interest of Revenue, as it was in conformity with TPO's order.

Conclusion

One could agree that the stand of the department in having adopted a risk based approach to identify international trasactions prone to tax evasion, will benefit both the department, in as much as providing respite to overburdened officers and also the taxpayers, as the focus has shifted from quantity investigation to quality investigation. On the flip side, entities which are being subject to a transfer pricing scrutiny must be prepared to undergo a thorough and detailed investigation into their international transactions which calls for tremendous preparedness by strengthening their documentation in order to be able to manage compliance. In this chapter, an attempt has been made to highlight certain key aspects that we professionals need to bear in mind while handling scrutiny assessments for our clients given the quality oriented approach the revenue has resorted to off late.

Test your understanding

Q1 Assessing officer can make reference to TPO with the approval of

(a) Additional Commissioner of Income Tax
(b) Joint Commissioner of Income Tax
(c) Principal Commissioner or Commissioner of Income Tax
(d) None of the above

Q2 Which of the following case shall be compulsorily referred to TPO by the assessing officer?

(a) Case selected for scrutiny under Computerised Assisted Scrutiny Selection (CASS) on transfer pricing risk parameters.
(b) If there has been a TP adjustments of Rs 10 Crores or more in any previous assessment years which is upheld by the judicial authorities or is pending in appeal
(c) Assessing officer comes to know that the assessee has entered into international transaction and/or specified domestic transactions and has failed to report such transactions in Form 3CEB.
(d) All of the above

Q3 Upon reference being made by assessing officer to TPO for determination of arm's length price(ALP), TPO is empowered to

(a) Determine arm's length price
(b) Determine validity of reference made by AO
(c) Question commercial expediency of international transactions entered into by the assessee
(d) None of the above

Q4 With reference to TP proceedings, which of the following statements is true

(a) The TPO must serve a notice to assessee requiring him to produce any evidence for explanation of ALP determined by him
(b) The TPO must provide an opportunity of being heard to the assessee
(c) The TPO need not issue a show cause notice before carrying out a TP adjustment
(d) (a) and (b) above

Q5 TPO is empowered to determine ALP of:

(a) International transactions referred to him by AO
(b) International transactions which are not referred to him by the AO, but which come to the notice of TPO during the transfer pricing proceedings
(c) Specified domestic transactions not referred by AO, but which come to the notice of TPO during the transfer pricing proceedings
(d) Both (a) and (b)

Q6 After receiving the order of TPO, AO shall:

(a) Compute the total Income of the assessee in conformity with the ALP as determined by TPO
(b) Reject the ALP as determined by the TPO
(c) Alter the ALP as determined by the TPO
(d) None of the above

Q7 Assessee aggrieved by the TP adjustment, can file his objection before:

(a) Dispute resolution panel (DRP)
(b) CIT (Appeals)
(c) ITAT
(d) Either of (a) or (b)

Q8 Who is an eligible assessee for appealing to an DRP?

(a) Any person in whose case a TP adjustment has been carried out under Section 92CA;
(b) Any foreign company
(c) Both (a) and (b)
(d) None of the above

Q9 Objection can be filed before the DRP upon:

(a) Passing of final assessment order
(b) Passing of Transfer Pricing order

(c) Passing of draft assessment order by assessing officer
(d) None of the above

Q10 State which of the following statement is false in respect of transfer pricing assessment proceedings?

(a) Taxpayer can prefer an appeal against the order of DRP
(b) Department can challenge the directions given by DRP
(c) Department has the right to prefer an appeal against the final order of the CIT(A)
(d) None of the above

Q11 What is the time limit for passing an order by DRP?

(a) 21 months from the end of the month in which the taxpayers receive the draft order
(b) 9 months from the end of the month in which the taxpayer receives the draft order
(c) No time limit specified
(d) None of the above

Q12 TPO rejects the comparable companies adopted by the assessee and the DRP agrees with TPO. Even ITAT upheld the view of DRP. In this situation, what can assessee do?

(a) Appeal to high court
(b) Appeal to supreme court
(c) Accept the decision of ITAT
(d) None of the above

Q13 In respect of scrutiny under Section 143, the TPO, for AY 2014-15 has to pass an order on or before

(a) 31.10.2017
(b) 31.12.2017
(c) 31.03.2018
(d) 31.01.2018

Q14 In respect of a reassessment under Section 147, if the notice under Section 148 has been served during FY 2014-15, the TPO has to pass an order on or before

(a) 31.10.2016
(b) 31.12.2016

(c) 31.03.2017
(d) 31.01.2017

Q15 What are the pre-requisites for CIT to exercise revisionary powers under Sec. 263

(a) The order is prejudicial to the revenue
(b) The order is erroneous
(c) Both (a) and (b)
(d) Neither (a) and (b)