MOOT PROPOSITION

DRAFT PROBLEM

The Assessee, Vulcantech India Pvt Ltd, Chennai has filed an appeal before the Hon'ble High Court of Madras under section 260A of the Income-tax Act, 1961 against the order of the Income-tax Appellate Tribunal (the "Tribunal") passed in the case of Vulcantech India Pvt Ltd. Vs. DCIT for the Assessment Year 2009-10 in ITA No.1027/Mds/2014 dated 4th July 2014. The assessee raised the following substantial questions of law which has been admitted by the Hon'ble High Court of Madras vide Tax Case Appeal (TCA) No. 352 of 2015 and fixed for final hearing.

"1. Whether on the facts and in the circumstances of the case the Tribunal was right in law in ***holding that corporate guarantee issued on behalf of subsidiary is an 'international transaction' u/s 92B****?*

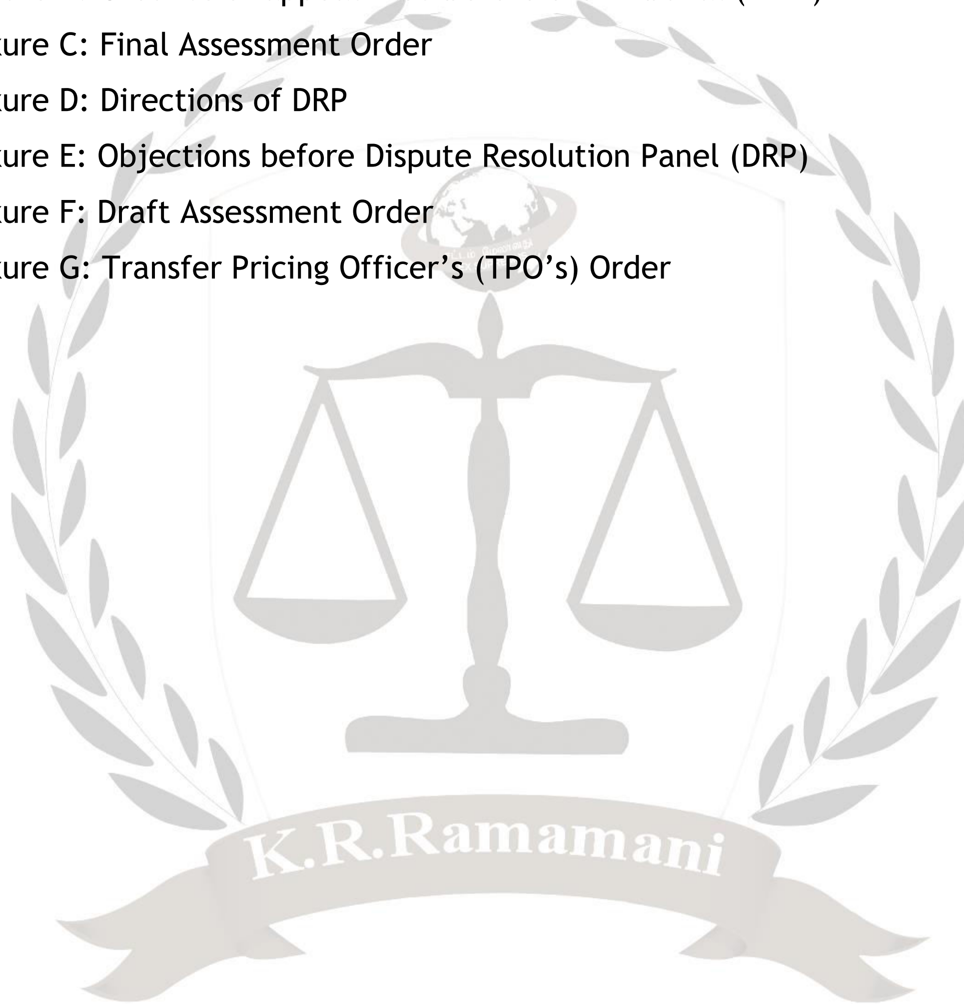
2. Whether on the facts and in the circumstances of the case the Tribunal was right in law in ***upholding the notional interest on the loan provided by assessee to its subsidiary Associated Enterprise****?*

3. Whether on the facts and in the circumstances of the case the Tribunal was right in law in ***holding that assessee is NOT entitled for balance 50% of additional depreciation in the current assessment year in respect of assets acquired in previous year and put to use for less than 180 days****.?*

K.K.Ramamani
Memorial Taxation
Moot Court Competition

In relation to the matter at hand, the following Annexures form part of the record of the case:

Annexure A: The impugned order of the Tribunal (ITAT)
Annexure B: Grounds of appeal filed before the Tribunal (ITAT)
Annexure C: Final Assessment Order
Annexure D: Directions of DRP
Annexure E: Objections before Dispute Resolution Panel (DRP)
Annexure F: Draft Assessment Order
Annexure G: Transfer Pricing Officer's (TPO's) Order



ANNEXURE A

IN THE INCOME-TAX APPELLATE TRIBUNAL, CHENNAI

BEFORE Mr. F.D.Legello, JUDICIAL MEMBER

AND Mr. Antony Vardon, ACCOUNTANT MEMBER (VICE-PRESIDENT)

ITA No. 1027/Mds/2014

AY 2009-10

Vulcantech India Pvt Ltd …………………… Appellant

- Vs -

The Deputy Commissioner of Income-Tax ………………….. Respondent

Assessee by : Mr.Aziz Alam

Department by : Mr. Raman Gopalakrishnan

Date of Hearing : May 6th 2014

Date of Pronouncement : July 4th 2014

Per Bench:

1. The present appeal arises out of the assessment order passed under Sec. 143(3) read with sections 92CA(4) and 144C(5) of the Income-Tax Act, 1961. The relevant Assessment Year is 2009-10.

2. The assessee has filed Return of Income for AY 2009-10 declaring Rs.55,55,90,132/- as Income. The Return was processed u/s 143(1) and subsequently the return was selected for scrutiny under CASS (Computer Aided Selection of Scrutiny) and notice u/s 143(2) was duly served on the assessee. Since there were international transactions for an amount in excess of Rs. 15 crores during the previous year relevant

to this assessment year, with the previous approval of the CIT reference was made by AO concerned to the Transfer Pricing Officer (TPO).

3. The issues involved in this appeal are:

a) **Transfer pricing issues:** The TPO, Chennai (being Joint Commissioner of Income Tax) vide Order dt 31.12.2012 has given a finding that an adjustment of **Rs. 1,29,60,020/-** has been proposed in the case of the assessee company. The adjustment consisted of two components namely:

a) Corporate Guarantee was provided free of charge to Standard Chartered Dubai for VulcanTech Gulf, the assessee's AE in order to enable said AE to obtain loan facilities from said Bank. The TPO held that corporate guarantee fees or commission was to be charged to the AE.

b) Interest-free loan which was given by assessee to its AE was considered under TP Provisions and a notional interest @ 11% p.a. was charged by the TPO

b) **Corporate tax issue**: In addition to the two TP adjustments made, the AO has also disallowed the balance additional depreciation to the tune of Rs.4,84,02,666/-

which could not be claimed in the previous year and which has been claimed in this financial year relevant to the impugned assessment year.

4. In short the matrix of additions/disallowances are as follows:

S.No	Issue	Amount Adjustment/disallowance
1	Corporate Guarantee adjustment **(TP issue)**	Rs. 1,12,58,030/-
2	Interest Free Loan adjustment **(TP issue)**	Rs. 17,01,990/-
3	Balance Additional Depreciation claimed & disallowed **(Corporate Tax issue)**	Rs. 4,84,02,666/-

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5. The Learned Counsel for the assessee before us has raised six grounds, with detailed sub-grounds, as listed below:

"Ground 1. The order of the DRP, AO and TPO are contrary to law, facts and circumstances of the case.

Ground 2. Adjustment towards Corporate Guarantee Fees:

2.a) The DRP/AO/TPO grossly erred in levying guarantee fees (also called guarantee commission) on the corporate guarantee issued to wholly owned subsidiary in Dubai

2.b) TPO erred in considering corporate guarantee as an international transaction as defined u/s 92B of the Act

2.c) TPO erred in taking suo moto cognizance of corporate guarantee transaction when such transaction was not an international transaction and was not reported in Form 3CEB or referred to TPO by the AO

2.d) TPO erred in assuming that there is an impact on the profit, income, losses or assets by assessee's corporate guarantee transaction

2.e) TPO erred in assuming that there was an accrued liability and ignored the reality that the corporate guarantee being invoked was a contingent event at best and could not be the subject of transfer pricing addition

2.f) TPO erred in overlooking the quasi-equity nature of the transaction i.e., return to the assessee in the form of dividends is the benefit arising to the assessee out of this transaction

2.g) TPO erred in overlooking the fundamental fact that this transaction is unique and integral to the parent-child (holding-subsidiary) relationship of "implicit support" and cannot be compared with external comparable thus fundamentally negating the possibility of arriving at ALP

2.h) TPO erred in applying Canadian court decisions to Indian law without jurisdiction

2.i) TPO erred in relying selectively on the OECD Transfer Pricing Guidelines which are not Indian law and do not apply to Indian TP assessments

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2.j) TPO applied external CUP on wholly uncomparable transactions without any basis in facts and circumstances of the instant case

2.k) TPO incorrectly referred bank guarantee rates publically available which are fundamentally different from corporate guarantees

2.l) TPO ought to have applied a proper methodology for arriving at corporate guarantee fees to be charged and instead summarily rejected arguments of assessee using interest saved approach without merit

2.m) TPO ought to have followed the ratio of various judicial forums which have set the guarantee rates as between 0.4 to 0.7% instead of the 1.5% that he has arrived at on ad-hoc basis.

Ground 3: Adjustment towards notional interest on loan given to AE:

3.a) The DRP/AO/TPO grossly erred in holding that notional interest should be charged on the loan given by assessee to its subsidiary

3.b) TPO erred in misunderstanding the nature of the transaction which was basically quasi-capital transaction as the loan was subsequently converted to equity in following year(s) and hence this capital transaction does not require any ALP adjustment.

3.c) TPO erred in interpreting a financing relationship between holding company and subsidiary as a lender and borrower simplicitor

3.d) Without prejudice to the above, TPO erred in adopting an ad-hoc interest rate of 11% calculated on weighted cost instead of adopting LIBOR rate

Ground 4: Disallowance of additional depreciation claimed in current year to extent not allowed in preceding year u/s 32(1)(iia)

4.a) The DRP/AO grossly erred in disallowing the additional depreciation claimed in the current year to the extent it was not allowed in the preceding year in respect of assets specified in Sec. 32(1)(iia)

4.b) The AO ought to have appreciated that sec 32(1)(iia) does not stipulate that additional depreciation is to be allowed only for the assets added during the year and only refers to any machinery or plant which has been acquired and installed after 31st day of March 2005

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4.c) The AO ought to have appreciated that the amended provision w.e.f 1-4-2006 does not prescribe the year and usage for allowability of additional depreciation.

4.d) The AO ought to have appreciated that grant of additional depreciation at the rate of 20% is a VESTED RIGHT as incentive for investments in new plant and machinery and assessee cannot be deprived of such vested rights as held by various judicial decisions of the Apex Court and High Courts across India

4.e) The AO ought to have appreciated that the assets for which additional depreciation is allowable, constitute a separate block by themselves and the rate of depreciation applicable to such assets are governed by both Appendix I of Rule 5 of IT Rules and depreciation rate as per clause(iia) of sec32(1) for additional depreciation.

4.f) The AO erred in not following the decisions of the Delhi Tribunal directly on this issue and decided in favour of the assessee

***Ground 5**. Without prejudice, the entire order of the DRP deserves to be set aside on the ground that it was not a speaking order and merely upheld the order of the AO/TPO without discussion or substantiation*

***Ground 6**. The Appellant craves leave to adduce additional grounds at the time of hearing"*

The issues relating to these Grounds are dealt with in subsequent paragraphs. **We do not feel the need to adjudicate the general grounds 1 and 6. We also at the outset dismiss summarily Ground 5 of the assessee** as we feel the DRP has given the assesse an opportunity to present its case by conducting the hearing and on consideration relied on the TPO order which is sufficient in our eyes.

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6. We note that the Learned Counsel for the assesse relied heavily on the assessee's submissions made before the lower authorities (AO/TPO). A few additional case laws which were not available at the time of passing of decision by the lower authorities but have since been pronounced by other Tribunals were produced for perusal before

us by the Learned Counsel of the assessee and we discuss the same in subsequent paragraphs.

7. The Learned Departmental Representative, on his part, strongly relied on the order of the lower authorities (AO/TPO). The Learned Departmental Representative also submitted few case laws in favour of Department decided by other Tribunals and which we have discussed below.

8. We have heard both Parties

9. **With respect to Ground #2**, the assessee has given what is known as a "corporate guarantee" for its Gulf AE to the bank in Dubai in order to enable the AE to avail of a loan and the assessee did not charge any guarantee commission or fees.

10. Before getting into the details, the Learned Counsel assailed the very basis by saying such a corporate guarantee transaction was not an international transaction at all as given in S.92B. He placed strong reliance on a very recent decision of ***Bharti Airtel Limited vs. ACIT (ITA No 5816/Del/2012 AY 2008-09)*** where in the Delhi Tribunal analyzed the S.92B threadbare and held that even with the insertion of the retrospective amendment via Explanation to S.92B such transactions are not corporate guarantee transactions. We quote from the judgment:

> *"30. It is, therefore, essential that in order to be covered by clause (c) and (e) of Explanation to Section 92 B, the transactions should be such as to have beating on profits, incomes, losses or assets of such enterprise. In other words, in a situation in which a transaction has no bearing on profits, incomes, losses or assets of such enterprise, the transaction will be outside the ambit of expression 'international transaction'. This aspect of the matter is further highlighted in clause (e) of the Explanation dealing with restructuring and reorganization, wherein it is acknowledged that such an impact could be*

immediate or in future as evident from the words "irrespective of the fact that it (i.e. restructuring or reorganization) has bearing on the profit, income, losses or assets of such enterprise at the time of transaction or on a future date". What is implicit in this statutory provision is that while impact on "profit, income, losses or assets" is sine qua non, the mere fact that impact is not immediate, but on a future date, would not take the transaction outside the ambit of 'international transaction'. It is also important to bear in mind that, as it appears on a plain reading of the provision, this exclusion clause is not for "contingent" impact on profit, income, losses or assets but on "future" impact on profit, income, losses or assets of the enterprise. The important distinction between these two categories is that while latter is a certainty, and only its crystallization may take place on a future date, there is no such certainty in the former case. In the case before us, it is an undisputed position that corporate guarantees issued by the assessee to the Deutsche Bank did not even have any such implication because no borrowings were resorted to by the subsidiary from this bank.

31.In this light now, let us revert to the provisions of clause (c) of Explanation to Section 92 B which provides that the expression 'international transaction' shall include "capital financing, including any type of long-term or short-term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business". In view of the discussions above, the scope of these transactions, as could be covered under Explanation to Section 92 B read with Section 92B(1), is restricted to such capital financing transactions, including inter alia any guarantee, deferred payment or receivable or any other debt during the course of business, as will have "a bearing on the profits, income , losses or assets or such enterprise". This pre-condition about impact on profits, income, losses or assets of such enterprises is a pre-condition embedded in Section 92B(1) and the only relaxation from this condition precedent is set out in clause (e) of the Explanation which

provides that the bearing on profits, income, losses or assets could be immediate or on a future date. The contents of the Explanation fortifies, rather than mitigates, the significance of expression ' having a bearing on profits, income, losses or assets' appearing in Section 92 B(1).

32. There can be number of situations in which an item may fall within the description set out in clause (c) of Explanation to Section 92 B, and yet it may not constitute an international transaction as the condition precedent with regard to the 'bearing on profit, income, losses or assets' set out in Section 92B(1) may not be fulfilled. For example, an enterprise may extend guarantees for performance of financial obligations by its associated enterprises. These guarantees donot cost anything to the enterprise issuing the guarantees and yet they provide certain comfort levels to the parties doing dealings with the associated enterprise. These guarantees thus do not have any impact on income, profits, losses or assets of the assessee. There can be a hypothetical situation in which a guarantee default takes place and, therefore, the enterprise may have to pay the guarantee amounts but such a situation, even if that be so, is only a hypothetical situation, which are, as discussed above, excluded. One may have also have a situation in which there is a receivable or any other debt during the course of business and yet these receivables may not have any bearing on its profits, income, losses or assets, for example, when these receivables are out of cost free funds and these debit balances donot cost anything to the person allowing such use of funds. The situations can be endless, but the common thread is that when an assessee extends an assistance to the associated enterprise, which does not cost anything to the assessee and particularly for which the assessee could not have realized money by giving it to someone else during the course of its normal business, such an assistance or accommodation does not have any bearing on its profits, income, losses or assets, and, therefore, it is outside the ambit of international transaction under section 92B (1) of the Act.

33. In any event, the onus is on the revenue authorities to demonstrate that the transaction is of such a nature as to have "bearing on profits, income, losses or assets" of the enterprise, and there was not even an effort to discharge this onus. Such an impact on profits, income, losses or assets has to be on real basis, even if in present or in future, and not on contingent or hypothetical basis, and there has to be some material on record to indicate, even if not to establish it to hilt, that an intra AE international transaction has some impact on profits, income, losses or assets. Clearly, these conditions are not satisfied on the facts of this case.

34. There is one more aspect of the matter. The Explanation to Section 92 B has been brought on the statute by the Finance Act 2012. If one is to proceed on the basis that the provisions of Explanation to Section 92 B enlarge the scope of Section 92 B itself, even as it is modestly described as 'clarificatory' in nature, it is an issue to be examined whether an enhancement of scope of this anti avoidance provision can be implemented with retrospective effect. Undoubtedly, the scope of a charging provision can be enlarged with retrospective effect, but an anti-avoidance measure, that the transfer pricing legislation inherently is, is not primarily a source of revenue as it mainly seeks compliant behaviour from the assessee vis-à-vis certain norms, and these norms cannot be given effect from a date earlier than the date norms are being introduced. However, as we have decided the issue in favour of the assessee on merits and even after taking into account the amendments brought about by Finance Act 2012, we need not deal with this aspect of the matter in greater detail.

35. When it was put to the learned Departmental Representative that there could be a view that issuance of guarantees could be outside the ambit of scope of 'international transaction' itself, he submitted that there are large number of decisions in India and abroad, notably in Canada, dealing with the determination of arm's length price of guarantees. His argument seemed to be that even such a view is to be upheld, entire transfer pricing jurisprudence

K.K.Ramani Memorial Taxation Moot Court Competition

will be turned upside down. There does not seem to be any legally sustainable merits in this argument either. As for the decisions dealing with quantum of ALP adjustments in the guarantee charges, in none of these cases the scope of 'international transactions' under section 92B(1) has come up for examination. A judicial precedent cannot be an authority for dealing with a question which has not even come up for consideration in that case. It is only elementary that, as was also held by Hon'ble Bombay High Court in the case of CIT Vs Sudhir Jayantilal Mulji (214 ITR 154), that a judicial precedent is an authority for what it actually decides and not what may what come to follow from some observations made therein. As observed by Hon'ble Supreme Court in the case of CIT vs. Sun Engineering Works P. Ltd. (198 ITR 297) a " judgment must be read as a whole and the observations from the judgment have to be considered in the light of the question which were before ...... court" and that "a decision .... takes its colour from the questions involved in the case in which it is rendered and, while applying the decision to a later case, the courts must carefully try to ascertain the true principle laid down by the decision ....and not to pick out words or sentences from the judgment, divorced from the context of the questions under consideration by this court, to support their reasoning." It would, therefore, be wholly inappropriate to use those judicial precedents, dealing with ALP of guarantee commission, to decide a question which was not even before those judicial forums. Coming to the foreign decisions on the issue of ALP adjustments in guarantee commission, we have noted that in the case of GE Capital Canada Inc Vs The Queen (2009 TCC 563), the Tax Court of Canada has indeed dealt with ALP determination of the guarantee fees but then it was done in the light of their domestic law provisions which are quite at variance with the Indian transfer pricing legislation. Unlike elaborate wordings of Section 92 B of the Indian Income Tax Act, 1961 defining 'international transaction', Section 247 of the Canadian Income Tax Act only gives an inclusive definition which does not even really attempt to define the expression 'transaction'. It is nobody's case that

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the relevant legal provisions are in pari materia. We need not, therefore, deal with those foreign judicial precedents. Suffice to say that we have reached our conclusions on the basis of the legal provisions under section 92 B and no judicial precedent, contrary to our understanding of these legal provisions, has been cited before us. There is a decision of the co-ordinate bench in the case of Mahindra & Mahindra (supra), referred to in the DRP order, but that decision does not deal with the scope of amended section 92 B and leaves the issue open by stating that post insertion of Explanation to Section 92 B, the matter will have to be examined in the light of the amended law. We have held that even after the amendment in Section 92 B, by amending Explanation to Section 92 B, a corporate guarantee issued for the benefit of the AEs, which does not involve any costs to the assessee, does not have any bearing on profits, income, losses or assets of the enterprise and, therefore, it is outside the ambit of 'international transaction' to which ALP adjustment can be made.As we have decided the matter in favour of the assessee on this short issue, we see no need to address ourselves to other legal issues raised by the assessee and the judicial precedents cited before us.

36. For the reasons set out above, and as we have held that the issuance of corporate guarantees in question did not constitute 'international transaction' within meanings thereof under section 92B, we uphold the grievance of the assessee and direct the Assessing Officer to delete the impugned ALP adjustment of Rs 33,10,161. The assessee gets the relief accordingly."

11. The Learned DR while strongly relying on the TPO order argued that a plain reading of the retrospective amendment makes it very clear that guarantees fall under the ambit of the international transaction. The Learned DR submitted a number of decisions which upheld the guarantee fees to be charged on guarantee transactions provided to AE:

Everest Kanto Cylinder Ltd. v DCIT [TS-714-ITAT-2012(Mum)-TP]

Glenmark Pharmaceuticals Ltd v. Addl. CIT [TS-329-ITAT-2013(Mum)-TP]

K.R.Ramamani Memorial Taxation Moot Court Competition

Asian Paints Ltd. [ITA No. 408/Mum/2010 and ITA No. 1937/Mum/2010, AY 2005-06, ITAT Mumbai]

Reliance Industries Ltd v.ACIT (ITA No.4475/ M/ 2007 & Others AY 2003 - 04 to 2005-06)

12. The Learned Counsel of the assessee also assailed the suo moto cognizance by the TPO of such a guarantee transaction which he said was not reported in Form 3CEB nor referred to by AO. This argument has no merit – just because the assessee fails to report and it fails to get referred, can the assessee escape the law? Furthermore, to address this issue once and for all, S.92CA(2B) was inserted with retrospective effect and the ***LG Electronics Pvt. Ltd. vs. ACIT (140 ITD 41 Delhi Special Bench***) has upheld the retrospective operation of the same. **We thus dismiss sub-ground 2.c of the assessee.**

13. We find that a specific retrospective amendment was introduced which clearly covers the instant case. We disagree with the decision of the non-jurisdictional tribunal and hold that the retrospective amendment clearly covers corporate guarantees and further reject the assumption that there is no bearing whatsoever *'on the profits, income, losses, assets of such enterprises'* and hence it will not apply. **We therefore dismiss sub-ground 2.b and 2.d of the assessee.**

14. We note that the corporate guarantee may or may not be invoked. However that is not the subject matter of consideration; the crux of the issue is whether a benefit given to the AE for free would be given to a non-AE i.e., third party for free? The answer is clearly that corporate guarantee allowed the AE to avail at lesser interest rates loans from the bank; if the AE were to go on its own wouldn't any bank or lender charge higher interest rates? Would not the credit rating of the AE be completely different from that of the assessee, its parent and by lending guarantee the credit rating of the AE is in essence replaced by the credit rating of its parent – in such a scenario there is clearly a benefit flowing to the AE for which the assessee has not charged.

K.R Ramamani Memorial Taxation Moot Court Competition

15. In similar vein, we do not see merit in the quasi-equity argument as the simple fact is that the dividends may or may not flow irrespective of which a benefit has been extended in financial year previous to the impugned AY. Hence the point of adjustment is at this point of time.

16. The arguments about reliance on Canadian court decisions and OECD is misplaced. These are sources of jurisprudence and many decisions of the Hon'ble Tribunal and Hon'ble High Courts and Apex Court have relied on such jurisprudence.

17. **We therefore dismiss sub-Grounds 2.d to 2.i of the assessee. Therefore, by dismissal of sub-grounds 2.b to 2.i of the assesse it follows that we dismiss the ground 2.a of the assessee which is the basic issue of corporate guarantee fees adjustment by TPO. We hold that the assessee has to charge & receive corporate guarantee fees/commission for the guarantee issued by it.**

18. Now, with respect to sub-grounds 2.j to 2.m which relates to the ***computation*** of said corporate guarantee fees, we see merit in the assessee's grievance. Taking some external comparable without analysis does no justice to the assessee, relying on *naked* bank guarantee rates is incorrect as these are different from corporate guarantees as brought out in the decision of the Mumbai Tribunal in ***Glenmark Pharmaceuticals (supra)***

19. We therefore set aside these specific sub-grounds 2.j to 2.m to the TPO to compute the corporate guarantee fees afresh after giving opportunity of hearing to the assessee as well as after considering the above quoted judicial decisions which are directly on this issue.

20. **With respect to Ground #3,** the Learned Counsel for the assessee relied on the recent decision of ***Micro Inks Ltd. vs. ACIT (ITA No.1068, 1442, 3453, 1669, 1762,***

940, 2447, 2583, 3143/Ahd./2006 dated August 6th 2013) by the ITAT Ahmedabad wherein it was held that such quasi-capital transactions were not liable to ALP adjustment under Indian TP Provisions.

21. The Learned DR relied on the decisions of ***VVF Ltd Vs DCIT (2010 TIOL 55 ITAT MUM TP)*** and ***Perot Systems TSI India Ltd Vs DCIT (2010 TII 3 ITAT TEL TP)*** which are directly on this issue and were distinguished on factual grounds by the *Micro Inks* decision *(supra)*

22. We do not find merit in the assessee's case. It is clear that when a loan is given to a third party interest would be charged; such a logical conclusion cannot be escaped by mere technicalities. A loan has to be treated as such in the year it is given; merely because it changes character later cannot change its treatment this year. It might become a gift later, converted into equity etc. This is not of relevance and what is clear here is that no interest was charged to the AE thus helping the AE get *free* money. In this regard, we do not agree with the decision of the Tribunal quoted by the assessee. We believe this is clearly covered under definition of international transaction especially with the retrospective amendment of Finance Act 2012 vide Explanation to S.92B which specifically talks about capital transactions. **We therefore dismiss sub-Grounds 3.a, 3.b and 3.c of the assese.**

23. With respect to Ground 3.d, we find merit in the grievance of the assessee that weighted cost is not an appropriate measure and that the standard rate is the LIBOR rate. **We therefore set aside this Ground #3.d** to the TPO to adopt LIBOR rate as the base rate in computing the notional interest for the loan given by assessee to its AE.

K.R.Ramamani Memorial Taxation Moot Court Competition

24. **With respect to Ground 4**, Learned Counsel of assessee submitted that in the earlier AY the asset was put to use for less than 180 days. Therefore, the assessee had claimed 50% of the additional depreciation i.e., 10% additional depreciation in the relevant AY. The assessee is claiming remaining 50% of the depreciation in the AY

under consideration in accordance with the decision of the Tribunal in the case of ***DCIT Vs. Cosmo Films Ltd.*****, reported as** ***13 ITR (Trib) 340 (Del); ACIT Vs. Sil Investment Ltd.*****, reported as** ***148 TTJ (Del) 213; and M/s.MITC Rolling Mills P. Ltd. Vs. ACIT (ITA No.2789/Mum/2012)*** **decided on 13-05-2013**. In all the cases relied upon, the Tribunal has held that the assessee is entitled to claim remaining 50% additional depreciation in case the assessee has claimed 50% additional depreciation on new asset in the preceding AY.

25. It was also submitted that there is no restriction that the new assets should be added during that financial year only. Such a restriction, if any, was done away with the amendment w.e.f 1-4-2006. Hence the assessee was clearly entitled to get its balance additional depreciation according to the Learned Counsel for the assessee.

26. It was also submitted that there was a *vested right* endowed on the assessee which came into play once the machinery was bought and installed and the assessee cannot be deprived of this vested right. A number of High Court and Apex Court decisions were cited in the Draft Assessment Order in this regard.

27. The Learned Counsel for assessee further submitted that the ***M.M.Forgings vs. ACIT (TCA No 1130 of 2010, 11th January 2010)*** was completely misinterpreted by the Department and that it spoke about only restricting the additional depreciation similar to normal depreciation to 50% in the year where it was used for less than 180 days but the issue of whether the balance additional depreciation can be claimed next year was never an issue before the Hon'ble High Court. It was submitted that the Department's stand that restriction stopped with 50% in the first year implicitly flowed was fundamentally flawed.

28. On the other hand, the Learned Departmental Representative strongly relied on the orders of the lower authorities (DRP/AO) and submitted that the issue in appeal has been adjudicated against the assessee by the co-ordinate Chennai Bench of the

K.K.Lamani Memorial Taxation Moot Court Competition

Tribunal in the case of ***DCIT Vs. Brakes India Ltd., decided on 06-01-2012 by Chennai ITA*** and subsequently, followed in the case of ***M/s.CRI Pumps (P) Ltd., Vs. ACIT*** **(ITA No.1824/Mds/2010 A.Y.2007-08) decided on 04-04-2013.**

29. We have heard the submissions made by the representatives of both the sides. We have also perused the orders of the authorities below as well as the decisions relied on by the representatives in support of their contentions. The additional depreciation on new Plant & Machinery u/s.32(1)(iia) has been allowed with a view to give boost to the manufacturing sector. Benefit of such additional depreciation is in addition to the normal depreciation which is allowed to all the assessees. However, the benefit of additional depreciation is given subject to certain conditions. Though the Delhi Bench of the Tribunal in the case of ***DCIT Vs. Cosmo Films Ltd., (supra) and ACIT Vs. Sil Investment Ltd., (supra)*** has allowed the claim of assessee for 50% of additional depreciation u/s.32(1)(iia) in respect of new Plant & Machinery installed at the new eligible industrial undertaking where Plant & Machinery were put to use for less than 180 days in the year of installation and the assessee had claimed only 50% of the additional depreciation and the balance amount was claimed in the next year, the coordinate Chennai Bench of the Tribunal in the case of ***DCIT Vs. Brakes India Ltd., (supra) and M/s.CRI Pumps (P) Ltd., Vs. ACIT (supra)*** has taken a contrary view. We have to follow said view of the Coordinate Bench and **hence dismiss this ground of the assessee**.

30. In any case, even on merits, we do NOT find a vested right endowed to the assessee; such a fiction cannot be created from the provisions of depreciation. We also believe the restriction of additional depreciation to assets added in previous year is the correct interpretation of the section as it stands today. We also feel that this issue is implicitly covered by the decision of the Hon’ble Madras High Court in *M.M.Forgings (supra)* however reliance cannot be placed on the same as this specific question of law was not before the Hon’ble High Court.

K.R.Ramamani Memorial Taxation Moot Court Competition

31. In the result, the appeal of the assessee is partly allowed for statistical purpose.

Sd/-	Sd/-
(______________)	(______________________)
VICE PRESIDENT	JUDICIAL MEMBER
ACCOUNTANT MEMBER	

Chennai

Dated: July 4th 2014

Copies to:

(1) Appellant

(2) Respondent (DR), DRP, AO, TPO

(3) *Guard File*

By order:

Assistant Registrar

Income Tax Appellate Tribunal, Chennai

Memorial Taxation
Moot Court Competition

ANNEXURE- B

Vulcantech India Pvt Ltd

Assessment Year 2009-10

PAN : RRRRA1234B

APPEAL BEFORE THE INCOME-TAX APPELLATE TRIBUNAL AGAINST THE ORDER PASSED UNDER SECTION 143(3) READ WITH SECTION 144C(13) IN PURSUANCE OF THE DIRECTIONS GIVEN BY THE DISPUTE RESOLUTION PANEL (DRP) CHENNAI

GROUNDS OF APPEAL

Ground 1. The order of the DRP, AO and TPO are contrary to law, facts and circumstances of the case.

Ground 2. Adjustment towards Corporate Guarantee Fees:

2.a) The DRP/AO/TPO grossly erred in levying guarantee fees (also called guarantee commission) on the corporate guarantee issued to wholly owned subsidiary in Dubai

2.b) TPO erred in considering corporate guarantee as an international transaction as defined u/s 92B of the Act

2.c) TPO erred in taking suo moto cognizance of corporate guarantee transaction when such transaction was not an international transaction and was not reported in Form 3CEB or referred to TPO by the AO

2.d) TPO erred in assuming that there is an impact on the profit, income, losses or assets by assessee's corporate guarantee transaction

2.e) TPO erred in assuming that there was a accrued liability and ignored the reality that the corporate guarantee being invoked was a contingent event at best and could not be the subject of transfer pricing addition

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2.f) TPO erred in overlooking the quasi-equity nature of the transaction i.e., return to the assessee in the form of dividends is the benefit arising to the assessee out of this transaction

2.g) TPO erred in overlooking the fundamental fact that this transaction is unique and integral to the parent-child (holding-subsidiary) relationship of "implicit support" and cannot be compared with external comparable thus fundamentally negating the possibility of arriving at ALP

2.h) TPO erred in applying Canadian court decisions to Indian law without jurisdiction

2.i) TPO erred in relying selectively on the OECD Transfer Pricing Guidelines which are not Indian law and do not apply to Indian TP assessments

2.j) TPO applied external CUP on wholly uncomparable transactions without any basis in facts and circumstances of the instant case

2.k) TPO incorrectly referred bank guarantee rates publically available which are fundamentally different from corporate guarantees

2.l) TPO ought to have applied a proper methodology for arriving at corporate guarantee fees to be charged and instead summarily rejected arguments of assessee using "interest saved" approach without merit

2.m) TPO ought to have followed the ratio of various judicial forums which have set the guarantee rates as between 0.4 to 0.7% instead of the 1.5% that he has arrived at on ad-hoc basis.

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Ground 3: Adjustment towards notional interest on loan given to AE:

3.a) The DRP/AO/TPO grossly erred in holding that notional interest should be charged on the loan given by assessee to its subsidiary

3.b) TPO erred in misunderstanding the nature of the transaction which was basically quasi-capital transaction as the loan was subsequently converted to equity in following year(s) and hence this capital transaction does not require any ALP adjustment.

3.c) TPO erred in interpreting a financing relationship between holding company and subsidiary as a lender and borrower simplicitor

3.d) Without prejudice to the above, TPO erred in adopting an ad-hoc interest rate of 11% calculated on weighted cost instead of adopting LIBOR rate

Ground 4: Disallowance of additional depreciation claimed in current year to extent not allowed in preceding year u/s 32(1)(iia)

4.a) The DRP/AO grossly erred in disallowing the additional depreciation claimed in the current year to the extent it was not allowed in the preceding year in respect of assets specified in Sec. 32(1)(iia)

4.b) The AO ought to have appreciated that sec 32(1)(iia) does not stipulate that additional depreciation is to be allowed only for the assets added during the year and only refers to any machinery or plant which has been acquired and installed after 31st day of March 2005

4.c) The AO ought to have appreciated that the amended provision w.e.f 1-4-2006 does not prescribe the year and usage for allowability of additional depreciation.

4.d) The AO ought to have appreciated that grant of additional depreciation at the rate of 20% is a VESTED RIGHT as incentive for investments in new plant and machinery and assessee cannot be deprived of such vested rights as held by various judicial decisions of the Apex Court and High Courts across India.

4.e) The AO ought to have appreciated that the assets for which additional depreciation is allowable, constitute a separate block by themselves and the rate of depreciation applicable to such assets are governed by both Appendix I of Rule 5 of IT Rules and depreciation rate as per clause(iia) of sec32(1) for additional depreciation.

4.f) The AO erred in not following the decisions of the Delhi Tribunal directly on this issue and decided in favour of the assessee

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Ground 5. Without prejudice, the entire order of the DRP deserves to be set aside on the ground that it was not a speaking order and merely upheld the order of the AO/TPO without discussion or substantiation

Ground 6. The Appellant craves leave to adduce additional grounds at the time of hearing.

Sd/-
Director
For Vulcantech India Pvt Ltd
Location: Chennai
Date: 31.03.2014

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ANNEXURE C

Income Tax Department

No. 121, M.G.Road, Nungambakkam, Chennai – 34

1	Name of the Assessee	M/s.Vulcantech India Private Limited
2	Address	No. 105A, Dr. Radhakrishnan Salai, Mylapore, Chennai
3	PAN/G.I.R. No.	RRRRA1234B
4	Status (Domestic/Public/Private, If Applicable)	Private Company
5	Assessment Year	2009-10
6	Whether Resident/Resident But Not Ordinarily Resident/Non-Resident	Resident
7	Method of Accounting	Mercantile
8	Previous Year	2008-09
9	Nature of Business	Trading, Reselling & Distribution of IT/business automation products
10	Date of Order	31.01.2014
11	Section under which assessment order is passed	143(3) r.w.s 144C(13)

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FINAL ASSESSMENT ORDER

The assessee is engaged in the business of Trading, Reselling & Distribution of IT/business automation products. The assessee company had e-filed its Return of Income for the AY 2009-10 declaring Rs.55,55,90,132/- as income. The Return was processed under sub-section (1) of section 143 of the Income Tax Act, 1961.

The case was selected for scrutiny and notice u/s 143(2) of the Act was issued to the assessee. Subsequently, the case was assigned by the Commissioner of

Income Tax to the Additional Commissioner of Income Tax (LTU) –II, for completion of assessment u/s 143(3) of the Act.

The case was referred to the Transfer Pricing Officer (TPO) for computation of Arms Length Price as the assessee has made international transactions exceeding Rs. 15 crores. The TPO passed an order u/s 92CA(3) on 31.12.2011, making a total upward adjustment of **Rs. 1,29,60,020/- .** The ACIT, Large Taxpayer Unit-II, Chennai issued a Draft Assessment Order u/s 143(3) r.w.s 144C dt 31.03.2013, incorporating the adjustment suggested by the TPO as well as disallowing claim of balance additional depreciation (not granted in the earlier year) to the tune of **Rs.4,84,02,666/-**

The assessee preferred an appeal before the Dispute Resolution Panel (DRP) on 23.04.2013. The DRP passed an order u/s 144C(5) r.w.s 144C(8) on 31.12.2013 upholding the order of the TPO.

In accordance with the directions given by the DRP, the final assessment order is as given under:

Income from Business:	**Rs.55,55,90,132/-**
Add: TP Adjustments:	**Rs. 1,29,60,020/-**
Add: Additional Depreciation claim disallowed	**Rs. 4,84,02,666/-**
Assessed Income:	**Rs. 61,69,52,818/-**

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Sd/-

(Sri. Arvind Hazare)

Deputy Commissioner of Income Tax

Large Taxpayer Unit - II

Copy to:

1. The assessee (Registered Office address)
2. The AO
3. The TPO
4. The Dispute Resolution Panel
5. The Registry

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ANNEXURE D

Income Tax Department

Dispute Resolution Panel (DRP)

No. 121, M.G.Road, Nungambakkam, Chennai – 34

Proceedings to issue directions under sub-section 5 of section 144C read with sub-section 8 of Sec 144C of the Income Tax Act 1961		
1	F. No. DRP/CHE/98/2013-14	Date of Directions: 31.12.2013
2	Name of the Assessee & Address	M/s. Vulcantech India Private Limited No. 105A, Dr. Radhakrishnan Salai, Mylapore, Chennai
3	PAN	RRRRA1234B
4	Assessment Year	2009-10
5	Date of Filing of Objections by the Assessee before the DRP	23.04.2013
6	Date of Direction	31.12.2013
7	Section & Sub-section under which the directions are given	144C(5) r.w 144C(8)

Directions issued under sub section (5) of 144C read with sub section (8) of 144C of IT Act, 1961

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The assessee company is engaged primarily in trading, reselling and distribution in India of all categories of Information Technology (IT) and office automation products such as Personal Computers (PC), Peripherals, PC building blocks, networking products, software products and enterprise solution products. The assessee filed objections in the prescribed Form 35A on 23.04.2013 to the Draft Assessment Order

u/s 143(3) r.w.s 144C of the Act forwarded by the AO (being the Additional Commissioner of Income Tax, Large Taxpayer Unit, Chennai). This Draft Assessment Order was received by the assessee on 07.04.2013. Thus, the objection filed by the assessee before the Dispute Resolution Panel (hereinafter referred to as the DRP) is in time.

Grounds of Objection raised by assessee before this Panel:

The assessee has raised the following detailed Grounds of Objections before this Panel:

"Objection 1. The order of the AO/TPO is contrary to law, facts and circumstances of the case

Objection 2. Adjustment towards Corporate Guarantee Fees:

2.a) The AO/TPO grossly erred in levying guarantee fees (also called guarantee commission) on the corporate guarantee issued to wholly owned subsidiary in Dubai

2.b) TPO erred in considering corporate guarantee as an international transaction as defined u/s 92B of the Act

2.c) TPO erred in taking suo moto cognizance of corporate guarantee transaction when such transaction was not an international transaction and was not reported in Form 3CEB or referred to TPO by the AO

2.d) TPO erred in assuming that there is an impact on the profit, income, losses or assets by assessee's corporate guarantee transaction

2.e) TPO erred in assuming that there was a accrued liability and ignored the reality that the corporate guarantee being invoked was a contingent event at best and could not be the subject of transfer pricing addition

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2.f) TPO erred in overlooking the quasi-equity nature of the transaction i.e., return to the assessee in the form of dividends is the benefit arising to the assessee out of this transaction

2.g) TPO erred in overlooking the fundamental fact that this transaction is unique and integral to the parent-child (holding-subsidiary) relationship of "implicit support" and cannot be compared with external comparable thus fundamentally negating the possibility of arriving at ALP

2.h) TPO erred in applying Canadian court decisions to Indian law without jurisdiction

2.i) TPO erred in relying selectively on the OECD Transfer Pricing Guidelines which are not Indian law and do not apply to Indian TP assessments

2.j) TPO applied external CUP on wholly uncomparable transactions without any basis in facts and circumstances of the instant case

2.k) TPO incorrectly referred bank guarantee rates publically available which are fundamentally different from corporate guarantees

2.l) TPO ought to have applied a proper methodology for arriving at corporate guarantee fees to be charged and instead summarily rejected arguments of assessee using "interest saved" approach without merit

2.m) TPO ought to have followed the ratio of various judicial forums which have set the guarantee rates as between 0.4 to 0.7% instead of the 1.5% that he has arrived at on ad-hoc basis.

Objection 3. Adjustment towards notional interest on loan given to AE:

3.a) The AO/TPO grossly erred in holding that notional interest should be charged on the loan given by assessee to its subsidiary

3.b) TPO erred in misunderstanding the nature of the transaction which was basically quasi-capital transaction as the loan was subsequently

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converted to equity in following year(s) and hence this capital transaction does not require any ALP adjustment.

3.c) TPO erred in interpreting a financing relationship between holding company and subsidiary as a lender and borrower simplicitor

3.d) Without prejudice to the above, TPO erred in adopting an ad-hoc interest rate of 11% calculated on weighted cost instead of adopting LIBOR rate

Objection 4. Disallowance of additional depreciation:

4.a) The AO grossly erred in disallowing the additional depreciation claimed in the current year to the extent it was not allowed in the preceding year in respect of assets specified in Sec. 32(1)(iia)

4.b) The AO ought to have appreciated that sec 32(1)(iia) does not stipulate that additional depreciation is to be allowed only for the assets added during the year and only refers to any machinery or plant which has been acquired and installed after 31st day of March 2005

4.c) The AO ought to have appreciated that the amended provision w.e.f 1-4-2006 does not prescribe the year and usage for allowability of additional depreciation.

4.d) The AO ought to have appreciated that grant of additional depreciation at the rate of 20% is a VESTED RIGHT as incentive for investments in new plant and machinery and assessee cannot be deprived of such vested rights as held by various judicial decisions of the Apex Court and High Courts across India.

4.e) The AO ought to have appreciated that the assets for which additional depreciation is allowable, constitute a separate block by themselves and the rate of depreciation applicable to such assets are governed by both Appendix I of Rule 5 of IT Rules and depreciation rate as per clause(iia) of sec. 32(1) for additional depreciation.

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4.f) The AO erred in not following the decisions of the Delhi Tribunal directly on this issue and decided in favour of the assessee"

An opportunity for hearing was given by the DRP on November 20th 2013 for the assessee where in the counsel for the assessee reiterated all their arguments made by the assessee's authorized representatives before the AO/TPO and submitted a copy of the submissions made before the AO/TPO.

We have heard the assessee and considered its submissions in detail.

We have perused the TPO order as well as the Draft Assessment Order by the AO and find them to be very detailed discussing the various angles involved including discussing the assessee's submissions.

We thus find all the Objections of the assessee have been covered by the AO/TPO and do not find reason to disturb the adjustments made by the AO/TPO.

We therefore uphold the two transfer pricing adjustments towards notional interest to be charged and corporate guarantee fees to be charged which were made by the TPO and the disallowance of additional depreciation made by the AO. The appeal filed by the assessee are accordingly disposed off.

Sd/-	Sd/-	Sd/-
Sri. John D'Souza	Smt. Indira Rani	Sri. V.Vijayaraghavan
(Member)	(Member)	(Member)

Copy to:-

1. AO, Chennai
2. TPO, Chennai
3. The Assessee
4. The Guard File

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ANNEXURE E

Vulcantech India Private Limited

Assessment Year 2009-10

Summary of Objections before the DRP

Objection 1: The order of the AO/TPO is contrary to laws, facts and circumstances of the case

Objection 2: Adjustment towards Corporate Guarantee Fees:

2.a) The AO/TPO grossly erred in levying guarantee fees (also called guarantee commission) on the corporate guarantee issued to wholly owned subsidiary in Dubai

2.b) TPO erred in considering corporate guarantee as an international transaction as defined u/s 92B of the Act

2.c) TPO erred in taking suo moto cognizance of corporate guarantee transaction when such transaction was not an international transaction and was not reported in Form 3CEB or referred to TPO by the AO

2.d) TPO erred in assuming that there is an impact on the profit, income, losses or assets by assessee's corporate guarantee transaction

2.e) TPO erred in assuming that there was a accrued liability and ignored the reality that the corporate guarantee being invoked was a contingent event at best and could not be the subject of transfer pricing addition

2.f) TPO erred in overlooking the quasi-equity nature of the transaction i.e., return to the assessee in the form of dividends is the benefit arising to the assessee out of this transaction

2.g) TPO erred in overlooking the fundamental fact that this transaction is unique and integral to the parent-child (holding-subsidiary) relationship of "implicit support" and cannot be compared with external comparable thus fundamentally negating the possibility of arriving at ALP

K.K.Ramamani Memorial Taxation Moot Court Competition

2.h) TPO erred in applying Canadian court decisions to Indian law without jurisdiction

2.i) TPO erred in relying selectively on the OECD Transfer Pricing Guidelines which are not Indian law and do not apply to Indian TP assessments

2.j) TPO applied external CUP on wholly uncomparable transactions without any basis in facts and circumstances of the instant case

2.k) TPO incorrectly referred bank guarantee rates publically available which are fundamentally different from corporate guarantees

2.l) TPO ought to have applied a proper methodology for arriving at corporate guarantee fees to be charged and instead summarily rejected arguments of assessee using interest saved approach without merit

2.m) TPO ought to have followed the ratio of various judicial forums which have set the guarantee rates as between 0.4 to 0.7% instead of the 1.5% that he has arrived at on ad-hoc basis.

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3.a) The AO/TPO grossly erred in holding that notional interest should be charged on the loan given by assessee to its subsidiary

3.b) TPO erred in misunderstanding the nature of the transaction which was basically quasi-capital transaction as the loan was subsequently converted to equity in following year(s) and hence this capital transaction does not require any ALP adjustment.

3.c) TPO erred in interpreting a financing relationship between holding company and subsidiary as a lender and borrower simplicitor

3.d) Without prejudice to the above, TPO erred in adopting an ad-hoc interest rate of 11% calculated on weighted cost instead of adopting LIBOR rate

K.K.Ramamani Memorial Taxation Moot Court Competition

Objection 4: Disallowance of additional depreciation claimed in current year to extent not allowed in preceding year u/s 32(1)(iia)

4.a) The AO grossly erred in disallowing the additional depreciation claimed in the current year to the extent it was not allowed in the preceding year in respect of assets specified in Sec. 32(1)(iia)

4.b) The AO ought to have appreciated that sec 32(1)(iia) does not stipulate that additional depreciation is to be allowed only for the assets added during the year and only refers to any machinery or plant which has been acquired and installed after 31st day of March 2005

4.c) The AO ought to have appreciated that the amended provision w.e.f 1-4-2006 does not prescribe the year and usage for allowability of additional depreciation.

4.d) The AO ought to have appreciated that grant of additional depreciation at the rate of 20% is a VESTED RIGHT as incentive for investments in new plant and machinery and assessee cannot be deprived of such vested rights as held by various judicial decisions of the Apex Court and High Courts across India.

4.e) The AO ought to have appreciated that the assets for which additional depreciation is allowable, constitute a separate block by themselves and the rate of depreciation applicable to such assets are governed by both Appendix I of Rule 5 of IT Rules and depreciation rate as per clause(iia) of sec32(1) for additional depreciation.

4.f) The AO erred in not following the decisions of the Delhi Tribunal directly on this issue and decided in favour of the assessee

K.K.Ramani Memorial Taxation Moot Court Competition

Sd/-

Authorized Signatory

For Vulcantech India Pvt Ltd

Dated: 23.04.2013, Place: Chennai

ANNEXURE F

Income Tax Department

No. 121, M.G.Road, Nungambakkam, Chennai – 34

1	Name of the assessee	M/s.Vulcantech India Private Limited
2	Address	No. 105A, Dr. Radhakrishnan Salai, Mylapore, Chennai
3	PAN/G.I.R. No.	RRRRA1234B
4	Status (Domestic/Public/ Private, If Applicable)	Company
5	Assessment Year	2009-10
6	Whether Resident/Resident But Not Ordinarily Resident/Non-Resident	Resident
7	Method of Accounting	Mercantile
8	Previous Year	2008-09
9	Nature of Business	Trading, reselling and distribution in India of Information Technology (IT) and office automation products
10	Date of Order	31.03.2013
11	Section under which Assessment Order is passed	143(3) r.w.s 144C (1)

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DRAFT ASSESSMENT ORDER

The assessee has filed Return of Income for AY 2009-10 declaring Rs.55,55,90,132/- as Income. The Return was processed u/s 143(1) and subsequently the return was selected for scrutiny under CASS (Computer Aided Selection of Scrutiny) and notice u/s 143(2) was duly served on the assessee. Since there were international transactions for an amount in excess of Rs. 15 crores during the previous year relevant to this assessment year, with the previous approval of the CIT reference was made to the Transfer Pricing Officer. The TPO – I, Chennai, namely Joint Commissioner of Income Tax vide Order dt 31.12.2012 has given a finding that an adjustment of **Rs. 1,29,60,020/-** has been proposed in the case of the assessee company.

Accordingly, the assessment of the assessee company has been concluded as per this order.

1. Computation of Arms Length Price (ALP):

During the current year, the case was referred to the Transfer Pricing Officer, in order to determine the Arms Length transaction of the assessee with its Associated Enterprise u/s 92CA of the Act. On the above reference, the Transfer Pricing Officer has passed an order vide F.No. F -282/TPO-I/A.Y/2009-10 dt 31.12.2012 wherein an amount of **Rs. 1,29,60,020/-** has been determined as ALP adjustment required.

Accordingly, in view of provisions of Sec 92CA(4) of the Act, an adjustment of **Rs. 1,29,60,020/-** is made on the above issue as determined by the Transfer Pricing Officer and added to the total income of the current year. Proceedings for penalty u/s 271(1)(c) read with Explanation 7 to that section will be initiated for this purpose as specifically requested by the TPO with respect to issues of corporate guarantee.

K R Ramamani Memorial Taxation Moot Court Competition

Add: **Rs. 1,29,60,020/-**

2. Claim of Additional Depreciation u/s 32(1)(iia)

The assessee has claimed "additional depreciation" **u/s.32(1)(iia)** amounting to Rs. 4,84,02,666/- during the year at the rate of 10% (50% to 20%) in respect of second half additions made to plant and machinery during the preceding assessment year, viz., assessment year 2008-09. Since the additions to fixed assets were made in the second half during that year i.e., AY 2008-09, 50% of the additional depreciation has been implicitly carried forward and claimed during this assessment year.

As per the provisions of section 32(1)(iia), the additional depreciation shall be available only for the new assets added during the year. Further, there is no provision in the Act permitting the balance depreciation to be allowed in the succeeding year. Therefore, the assessee was asked to explain why its claim of additional depreciation should not be disallowed.

The assessee in response, made an elaborate submission justifying its claim. The relevant extract of its submission is as under:

> *"It should relate to an industrial undertaking commencing manufacture or production after 1st April, 2005 or those existing undertakings who achieved substantial expansion by way of increased installed capacity. Further conditions are that, the plant and machinery*
> *(a) Before its installation by the assessee were not used within or outside India by any other person or*
> *(b) Were not installed in any office premises or any residential accommodation including accommodation in the nature of guest house or*
> *(c) Should not be any office appliances or road transport vehicles or*

K R Ramamani Memorial Taxation Moot Court Competition

(d) Should not be any machinery or plant, the whole of the actual cost of which is allowed as a deduction (by way of depreciation or otherwise) in computing the income chargeable under the head "Profits and gains of business or profession" of any one previous year.

(e) The assessee should furnish the details of machinery and plant and increase in the installed capacity of production in such form as may be prescribed along with the Return of Income and the Report of an Accountant as defined in explanation below sub-section 2 of section 288 certifying that the deduction has been correctly claimed in accordance with this clause.

The above provisions clearly show that the assets eligible for additional depreciation are to be treated as "Separate block" since they are eligible as a class for granting further depreciation.

In respect of assets eligible for additional depreciation is to be granted both under sub-clause (ii) and (iia). As per clause (ii) "in the case of any block of assets, such % on the written down value thereof as may be prescribed". The rates referred to are rates prescribed under Rule 5 of the Income Tax Rules viz rates as per table in Appendix 1. Further as additional depreciation rate is given as per clause (iia). Therefore even though in the year of installation, proviso restricts additional depreciation percentage by 50% it would not deprive of the balance since the restriction is for that year only. Restricting the additional depreciation in the following year would mean not granting the depreciation as per the prescribed rate. This procedure is followed by the Income Tax Department also in respect of cases when an asset for which rate is 100% of the cost of acquisition is prescribed. If for the first year only 50% was allowable due to the restriction clause, then for the following year, the balance was granted even though the asset was acquired in the preceding year. ***This additional benefit in the form of additional allowance u/s. 32(1)(iia) is one lime benefit to encourage the industrialization and in view of the decision of the Honourable Supreme Court in the case of Bajaj Tempo Ltd v CIT (1992) 196***

K R Ramamani Memorial Taxation Moot Court Competition

*ITR 188 (SC), **the provisions related to it have to be constructed reasonably, liberally and purposive to make the provision meaningful while granting the additional allowance**. This additional benefit is to give impetus to industrialization and the basic intention and purpose of these provisions can be reasonably and liberally held that the assessee deserves to get the benefit in full when there is no restriction in the statute to deny the benefit of balance of 50% when the new plant and machinery were acquired and used for less than 180 days. One time benefit extended to the assessee has been earned in the year of acquisition of new plant and machinery. It has been calculated at 15%, but restricted to 50% only on account of usage of these plant and machinery in the year of acquisition. In Sec. 32(1)(iia), the expression used is "shall be allowed". **Thus the assessee had earned the benefit as soon as he had purchased the new plant and machinery in full but it is restricted to 50% in that particular year on account of period of usage. Such restrictions cannot divest the statutory right. Law does not prohibit that balance 50% will not be allowed in succeeding year.***

In view of the above the benefit of balance 50% depreciation cannot therefore be denied to the Assessee in the immediately succeeding year". (emphasis supplied by Assessee in its submission)

The assessee also relied on and filed an article published in the **South India Regional Council Newsletter, ICAI in May 2011** titled *"Deductibility of Additional Depreciation in a year succeeding the year in which eligible assets were acquired and installed – an analysis"* from which the following extracts are reproduced under fair-use clause:

"Section 32(1)(iia) was introduced into the Act by Finance Act, 2002 with effect from 01-04-2003. It was introduced as an incentive for fresh investments in the industrial sector. The following extract from Finance Minister's Speech at the

K P Ramamani Memorial Taxation Moot Court Competition

time of presenting Finance Bill 2002 at the floor of the Parliament fortifies this proposition:

> *"I have already mentioned the need to provide incentives for fresh investments in the industrial sector. To give impetus to such investment, I propose to allow additional depreciation at the rate of 15% on new plant and machinery acquired on or after 1st April, 2002 for setting up a new industrial unit, or for expanding the installed capacity of existing units by at least 25%."*

Additional depreciation under section 32(1)(iia) is different from normal depreciation under section 32(1) (ii). Both are independent deductions. These deductions are separately available to an assessee. Clause (iia) to section 32(1) was introduced in the Act with a specific purpose / object of providing relief to assessees who make investment in the new plant and machinery.

The section therefore has to be interpreted keeping in view the intent and purpose for which it was introduced. It is a cardinal rule of interpretation that a beneficial provision should be given a liberal and purposive interpretation so as to fulfill the object of the legislation and comply with the legislative intent. It has to be interpreted in favour of assessee. [See among others ***S. Appukuttan v. T. Janaki Amma AIR 1988 SC 587, Bajaj Tempo Ltd v. CIT [1992] 196 ITR 188 (SC), Union of India and others v. M/s. Wood Papers Ltd. and another, AIR 1991 SC 2049, Chairman, Board of Mining Examination and Chief Inspector of Mines v. Ramjee AIR 1977 SC 965]****.*

K R Ramamani Memorial Taxation Moot Court Competition

The applicability of this rule can be challenged only where the result of liberal interpretation would be as good as re-legislation of a provision by addition, subtraction or alteration of words and violence would be done to the spirit of the provision or where there is no ambiguity. The Supreme Court in ***Tirath Singh v. Bachittar Singh, AIR 1955 SC 830; CIT v. National Taj Traders, AIR 1980 SC 485 and K P Varghese v. ITO, AIR 1981 SC 1922*** *held that purposive*

interpretation / construction is to be adopted where the literal meaning of the language used in the provision leads a result which would defeat the intent behind the provision. In ***Pepper (Inspector of Taxes) v. Hart [1994] 210 ITR 156 (HL),*** *Lord Griffith observed "the days have long passed when the courts adopted a strict constructionist view of interpretation which required them to adopt the literal meaning of the language. The courts now adopt a purposive approach which seeks to give effect to the true purpose of legislation and are prepared to look at much extraneous material that bears upon the background against which legislation was enacted."*

Goulding J. said in ***Comet Radio Vision Services v. Farnell Trand Berg [1971] 3 All ER 230****: "... The language of Parliament though not to be extended beyond its fair construction, is not to be interpreted in so slavishly literal a way as to stultify the manifest purpose of the Legislature."*

To quote the Karnataka High Court in ***Leelavathi v. Smt. M.Sharada AIR 1988 Kar 26****:"The purpose of interpretation is to discover the intention of the Legislation, if such intention is not clear from the language used. An interpretation which thus achieves the purpose behind insertion of section 32(i)(iia) needs to be given effect.*

This interpretation also gets support from the fact that there is no specific bar against such a claim under second proviso to section 32(1)(ii). The second proviso to section 32(1)(ii) only creates a restriction with respect to the time over which additional deprecation could be claimed.

K.R Ramamani
Memorial Taxation
Moot Court Competition

The second proviso to section 32(1)(ii) does not affect the ***vested right*** *of the assessee towards additional depreciation which it gets by making investment in the new machinery or plant. One may state that the assessee earns his entitlement towards additional depreciation as soon as he incurs a cost on acquisition of plant or machinery. The entitlement towards additional*

depreciation crystallizes with the event of incurrence of cost on plant or machinery and has no relation with the WDV of the block of asset. In other words, a right to claim full additional depreciation vests with an assessee as soon as he incurs cost on acquisition and installation of a new machinery or plant during the relevant previous year. While construing a provision that creates a right, one must take a construction which saves the right rather than the one which defeats it. This was so held in ***CWT v. Jagdish Prasad Choudhary 211 ITR 472 (Pat)****. In this connection one may refer to the views expressed in the* ***10th Edition of Sampath Iyengar's Law of Income Tax****. The observations of learned authors on page 2645 of the commentary support the construction discussed hereinabove. The observations read as under: "After the block depreciation has come into vogue, it is not possible to argue that any part of the block has not been used during the year. Once it becomes eligible for depreciation, such depreciation under section 32(1)(iia) will be allowed first and the balance taken to the block. If such asset is eligible for additional depreciation and is acquired in later part of the year, 50% will be allowed in the year it is first brought to use and balance of 50% allowed in the next succeeding year. The question of disallowance of the remaining balance in the succeeding year cannot arise, because the amount is already earned in the year of expansion, though allowable in the succeeding year……"*

The submissions filed by the assessee have been carefully considered. The thrust of the assessee is that a vested right has been endowed by the additional depreciation clause of S.32(1)(iia) and that it cannot be taken away by provisions. The same cannot be accepted for the following reasons:

K R Ramamani Memorial Taxation Moot Court Competition

1. **<u>Additional depreciation is available only for the new assets added during the year:</u>**

As per the provisions of section 32(1)(iia), the additional depreciation shall be available only for the new assets added during the year. For better clearance, the relevant provisions of Section 32(1)(iia) is reproduced as under:

"32(1)(iia) in the case of any new machinery or plant (other than ships and aircraft), which has been acquired and installed after the 31st day of March, 2005, by an assessee engaged in the business of manufacture or production of any article or thing, a further sum equal to twenty per cent of the actual cost of such machinery or plant shall be allowed on deduction under clause (ii):"

Based on the above legal position, it is clear that the additional depreciation shall be provided only for the new Plant & Machineries added during the current year. However the assessee strongly submitted that only criteria was the plant and machinery has to be acquired and installed after 31st March 2005 and there is no such restriction on the year of claim of additional depreciation. Furthermore the assessee pointed out that there was an amendment w.e.f 1-4-2006 prior to which only there was such restriction and after amendment the only requirement was that the asset has to be acquired and installed *after* 31st March 2005 – nothing more, nothing less.

The submissions of the assessee cannot be accepted as discussed above and the claim of additional depreciation related to the assets added during the assessment year 2008-09 is not allowable

2. Notwithstanding the above facts, the assessee is also not eligible for the residual additional depreciation claim based on the following reasons.

a. The quantum of additional depreciation to be allowed is restricted by the second proviso to Sec. 32(1). The said proviso restricts the allowance of additional depreciation to 50% of the amount calculated at the percentages prescribed for the

relevant assets in the event of the said assets having been put to use for a period less than 180 days in the previous year. For better clearance, the relevant provisions of section 32(1) & 32(1)(iia) is reproduced as under:

Second Proviso to Section 32(1)

> "*Provided further that where an asset referred to in clause (i) or clause (ii) or clause (iia), as the case may be, is acquired by the assessee during the previous year and is put to use for the purposes of business or profession for a period* ***of less than one hundred and eighty days in that previous year, the deduction under this sub-section in respect of such asset shall be restricted to fifty per cent of the amount calculated at the percentage prescribed for an asset under clause (i) or clause (ii) or clause (iia) as the case may be:"***

From the above, it is clear that the quantum of additional depreciation depends upon the period for which such assets were put to use. The Madras High Court in ***M.M.Forgings vs. ACIT (TCA No.1130 of 2010, 11th January 2011)*** has upheld the application of second proviso of S.32(1) to apply to additional depreciation case too and hence in my viewpoint also implicitly prohibits the carry forward of balance additional depreciation to next year. The assessee submitted that *M.M.Forgings (supra)* has no relevance as it is only about application of second Proviso to S.32(1) which is clear enough from plain reading of the statute and does not talk about or refer to balance additional depreciation being claimable in subsequent year. This argument, as discussed above, according to the Department is implicit from the order of the Hon'ble High Court.

b. Furthermore, when the additional depreciation itself was provided in the first place by specific provision of the Act, **there must exist a specific provision of Act to allow carry forward of balance additional depreciation not obtained in particular year**, to the subsequent year; given that there is no such specific

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provision it is untenable to take the argument of vested right to the assessee. **Such fiction cannot be created without basis.**

c. Further, as per the **circular No.8/27.08.2002 of the CBDT**, the claim of the additional depreciation in the year of claim shall be reduced from the written down value of the asset. For better clarity, the relevant paragraph of the circular is reproduced as under:

> "*Clause (iia) has been inserted in sub-section (1) of section 32 to allow a deduction of a further sum equal to fifteen percent of the actual cost of such machinery or plant acquired and installed after 31st day of March, 2002(i) in the case of a new industrial undertaking, in the previous year in which it begins to manufacture or produce any article or thing or (ii) in the case of an industrial undertaking existing before 1st April, 2002,* ***in the previous year in which it achieves substantial expansion*** *by way of increase in the installed capacity by not less than twenty five percent.*
>
> ***Such further sum shall be deductible from the written down value of the asset.*** *The deduction shall be allowed only if the assessee furnished the details of plant and machinery and the increase in installed capacity of production in the prescribed form along with the return of income and a report from an accountant certifying that the deduction has been correctly claimed in accordance with the provisions of the clause.*"

K.R.Ramamani

Further, as per the above circular, it is clear that the residual additional depreciation cannot be considered as a separate block for the purpose of claiming depreciation in the subsequent year unlike other block of assets. Therefore, it is clear from the above provisions of the Income tax Act that, the assessee has to claim the additional depreciation only on the new Plant & cannot claim the residual additional depreciation in the succeeding previous year since the residual additional depreciation become part of the closing WDV of the block of assets.

Memorial Taxation
Moot Court Competition

d. Further, in the case of ***CRI Pumps (P) Ltd Vs ACIT*** 58 SOT 134 Chennai, the jurisdictional Hon'ble ITAT has held that in terms of clause (iia) of section 32(1), additional depreciation is available in year in which the machinery is new and first put to use and not for any succeeding year. The assessee in turn has relied on non-jurisdictional Tribunal decisions in ***DCIT Vs. Cosmo Films Ltd. (2012) 139 ITD 628 (Del.) (Trib.)*** **and** ***ACIT vs. SIL Investment Ltd. (2012) 73 DTR 233 (Del.)(Trib.)*** where a contrary view seems to have been taken.

On the basis of the above discussion, the submission of the assessee is rejected and the claim of additional depreciation amounting to **Rs. 4,84,02,666/-** is confirmed.

Add: **Rs. 4,84,02,666/-**

Based on the above facts and circumstances of the case, the assessment is completed as under:

	Returned Income	Rs. 55,55,90,132/-
Add	Transfer Pricing Adjustments	Rs. 1,29,60,020/-
Add	Additional Depreciation	Rs. 4,84,02,666/-
	Assessed Income	**Rs. 61,69,52,818/-**

In view of the provisions of Section 144C of the Act, this draft order is being forwarded to the assessee as a proposed assessment order for AY 2009-10

As per the provisions of Section 144C, the assessee is required to file its acceptance or file objections to Dispute Resolution Panel and the Assessing Officer within 30 days of receipt of this draft order. If no reply is received within the prescribed time limit, the draft order will be final.

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Penalty u/s 271(1)(c) will be initiated separately in respect of the various other additions made for the reasons discussed in the various paragraphs as above, subject to the outcome of the findings of the Dispute Resolution Panel.

Draft Assessment Order is being issued u/s 143(3) r.w.s 144C(1) of the Act.

Sd/-

(Sri. Arvind Hazare)

Additional Commissioner of Income Tax,

Large Taxpayer Unit – II, Chennai

Copy to:

Assessee (Registered Office Address)

Transfer Pricing Officer

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ANNEXURE G

INCOME TAX DEPARTMENT

Proceedings of the Transfer Pricing Officer – I

Room No. 420, IV Floor, Main Building,

No. 121, M.G.Road, Nungambakkam, Chennai – 34

ORDER U/S 92 CA OF THE INCOME TAX ACT, 1961 **Present : Sri. John Galt** **Joint Commissioner of Income Tax** **F.No. F -282/TPO-I/A.Y/2009-10 Date: 31.12.2012**			
1	Name and Address of the Assessee	:	Vulcantech India Pvt Ltd No. 105A, Dr. Radhakrishnan Salai, Mylapore, Chennai
2	Assessment Year	:	2009-10
3	Permanent Account Number	:	RRRRA1234B
4	Reference from	:	ACIT (LTU), Chennai
5	Date of Reference	:	16.08.2011
6	Quantum of International Transactions	:	Rs.41,56,57,130/-
7	Nature of Business	:	Trading, Reselling & Distribution of IT/business automation products
8	Name and address of AE and the country in which it is resident	:	Vulcantech Inc, USA VulcanTech Gulf FZE VulcanTech Singapore Pte Ltd.
9	Nature of Association as per Section 92A	:	Companies under common control & management
10	Section & Sub-section under which the order is made	:	92 CA(3)

K.R.Ramamani
Memorial Taxation
Moot Court Competition

A reference u/s 92CA(1) of the Income Tax Act in the case of Vulcantech India Pvt Ltd (hereinafter referred to as the assessee) was received from ACIT (LTU), Chennai. The Assessing Officer has made the reference for determination of Arm's Length Price with reference to all the transactions reported in Form 3CEB filed by the assessee for the AY 2009-10.

Accordingly, a notice u/s 92 CA(2) was issued to the assessee on 19.08.2011 to furnish all the relevant details with regard to the international transactions entered in to by the assessee with its associated enterprises. The authorised representative, Mr. Tim Botham, Deputy Manager - Taxation appeared and presented the case.

Background of the company:

The assessee, Vulcantech India Pvt. Ltd., is engaged primarily in trading, reselling and distribution in India of all categories of Information Technology (IT) and office automation products such as Personal Computers (PC), Peripherals, PC building blocks, networking products, software products and enterprise solution products.

Most of its products that it resells or distributes are directly sourced from third parties (such as HP™, Sony™, Nintendo™ , Apple™ etc.). A limited number of products (such as Microsoft™ software products) are sourced through its holding company VulcanTech Inc., USA

K.K.Ramani Memorial Taxation Moot Court Competition

Profile of the Associated Enterprise:

1. The assessee imports from its foreign holding company, VulcanTech Inc., certain IT products (specifically Microsoft™ software products & licenses like the MS™ Office™ Suite etc.) and resells them in the Indian market.

This AE transaction constitutes roughly 15% of its overall business turnover in India.

2. The assessee in the previous financial year i.e., FY 2007-08 setup an AE company namely a wholly-owned subsidiary in Dubai by name Vulcantech Gulf FZE (hereinafter referred to as "Vulcantech Gulf") to engage in the same line of business in the Middle East region. Assessee has very little quantum of trading transactions currently with VulcanTech Gulf as the subsidiary is in its fledgling state.
3. The assessee in the current financial year i.e., FY 2008-09 setup another AE namely a subsidiary in Singapore by name Vulcantech Singapore Pte Ltd (hereinafter referred to as "VulcanTech Singapore"), in which assessee had 51%, to establish its presence in the Singapore/APAC region. The assessee is supporting the Singapore entity in its initial year by providing interest free loan to the same helping it establish vendor network as well as open an office in Singapore

<u>International Transactions entered into by the assessee according to its FORM 3CEB</u>:

Name of the AE	Description of the transaction	Amount paid/received	Method adopted
Vulcantech Inc., USA	Import of trading goods	Rs.19,98,45,670/-	RPM
Vulcantech Singapore Pte Ltd.	Loan granted	Rs.10,23,45,680/-	N/A

K.R.Ramamani Memorial Taxation Moot Court Competition

The assessee further submitted:

a) That the ALP on its import transactions was calculated using RPM and that the Gross-Profit Margin was 25% which was comparable with the GPM of other traders in the same line of business (the assessee used 4 comparables to establish the same)
b) That the interest-free loan granted to Singapore Entity was in the nature of quasi-capital contribution as in the subsequent year the loan was converted into equity

The assessee was sent a show-cause notice dated 10th December 2011 which requested the following points:

a) Details of VulcanTech Singapore office and activity undertaken in Singapore till date by said office
b) A list of all transactions with its VulcanTech Dubai subsidiary, if any

The assessee replied in a letter dated 22nd January 2012 with the following overview:

a) VulcanTech Singapore was formed in relevant financial year (FY 08-09) and it was in the process of establishing proper office. Lease agreements were provided as well as office maintenance receipts, employee records etc.. Furthermore correspondence with local vendors and dealers and contracts entered into for distribution through dealer network for certain products (such as Sony™ and HP™ products) were provided
b) VulcanTech Dubai has been provided a corporate guarantee by the assessee which provided the same to Standard Chartered Bank, Dubai thereby allowing the VulcanTech Gulf AE to avail loan facilities as well as working capital & credit facilities from said Bank. This is to help VulcanTech Gulf establish similar line of business in that region. I find this is similar overall to the VulcanTech Singapore transaction except instead of direct loan it has provided corporate guarantee for

its AE entity to obtain loan (and other facilities) from the bank. VulcanTech Dubai has used this facility to avail of (equivalent on that date in INR) Rs.1,34,65,789/- for its local operations.

It is clear that the assessee has *suppressed* this corporate guarantee transaction by not reporting the same in its Form 3CEB. The assessee was issued another show-cause notice dated 20th August 2012 to clarify why this corporate guarantee payment was not reported in Form 3CEB to which the assessee had replied in essence that the corporate guarantee was not an "international transaction" as defined in S.92B and hence it did not require reporting in Form 3CEB. This issue has been dealt with in detail in subsequent paragraphs but prima facie there is a clear case of suppression of facts which is liable for penalty proceedings u/s 271(1)(c) which the AO is requested to initiate separately.

Subsequently, hearings with the assesse's authorized representatives were conducted at various dates to discuss all these issues. Having heard the assessee and given fair opportunity for discussion, **it is clear that the assessee's international transactions are to be viewed as under:**

Name of the AE	**Description of the transaction**	**Amount paid/received**	**Method adopted**	**Adjustment warranted**
Vulcantech Inc., USA	Import of trading goods	Rs.19,98,45,670/-	RPM	NONE
Vulcantech Singapore Pte	Loan granted	Rs.10,23,45,680/-	N/A	Rs.1,12,58,030/- (being 11% of Rs.10,23,45,680/-

K.R.Ramamani Memorial Taxation Moot Court Competition

				rounded up)
VulcanTech Gulf FZE	Corporate Guarantee	Rs.11,34,65,780/-	External CUP	Rs.17,01,990/- (being 1.5% of Rs.1,34,65,780/- rounded up)

Each transaction in the above table is discussed, assessee's arguments analyzed and the Department's stance is substantiated in detail below:

a) **With respect to the import transaction with VulcanTech Inc, USA**, I find the same to be at arm's-length and no adjustment is hence required. The common practice is to use Resale Price method (RPM) and compare gross-profit margins. Prima facie the assessee has demonstrated by its TP study that it has sufficient gross margins to consider its import transactions at ALP.

b) With respect to the loan granted to VulcanTech Singapore Pte Ltd., it is clear that notional interest has to be charged on said loan:

   a. **If the same loan were to be obtained by a bank or a third-party interest would be charged for the same.** The same notional interest thus has to be charged on the loan provided by assessee to its AE. This is the very concept of ALP.
   b. **An independent lender** would never agree to an interest-free loan, in such a case it is obvious that there is a benefit
   c. The calculation of notional interest can be done by looking at the **weighted average cost of funds in the hands of the assessee which in the instant case works out to 11% p.a.** and hence that will be the interest that ought to have been charged by the

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assessee. The assessee's stand that at best LIBOR or American Interest rate should be applied is incorrect because the loans by Indian banks, which were on the basis of LIBOR, were granted on the basis of security given by the assessee company and are as such not comparable, and that the US interest rate would not be applicable as margins are charged by the US banks over and above the same

d. A plain reading of Section 92 substantiates this stand and in any case S.92B along with **the retrospective amendment inserted in S.92B via the Explanation inserted by Finance Act 2012 w.r.e.f 1-4-2002** makes it very clear that such loans fall under the ambit of international transaction and hence have to be justified to be at arm's-length.

"Meaning of international transaction*.*

92B*. (1) For the purposes of this section and sections 92, 92C, 92D and 92E, "international transaction" means a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises, and shall include a mutual agreement or arrangement between two or more associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises.*

(2) A transaction entered into by an enterprise with a person other than an associated enterprise shall, for the purposes of sub-section (1), be deemed to be a transaction entered into between two associated enterprises, if there exists a prior

K.R.Ramamani Memorial Taxation Moot Court Competition

agreement in relation to the relevant transaction between such other person and the associated enterprise, or the terms of the relevant transaction are determined in substance between such other person and the associated enterprise where the enterprise or the associated enterprise or both of them are non-residents irrespective of whether such other person is a non-resident or not.

Explanation.—For the removal of doubts, it is hereby clarified that—

(i) the expression "international transaction" shall include—

(a) the purchase, sale, transfer, lease or use of tangible property including building, transportation vehicle, machinery, equipment, tools, plant, furniture, commodity or any other article, product or thing;

(b) the purchase, sale, transfer, lease or use of intangible property, including the transfer of ownership or the provision of use of rights regarding land use, copyrights, patents, trademarks, licences, franchises, customer list, marketing channel, brand, commercial secret, know-how, industrial property right, exterior design or practical and new design or any other business or commercial rights of similar nature;

(c) capital financing, including any type of long-term or short-term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business;

(d) provision of services, including provision of market research, market development, marketing management, administration, technical service, repairs, design, consultation, agency, scientific research, legal or accounting service;

K.K.Ramani Memorial Taxation Moot Court Competition

(e) a transaction of business restructuring or reorganisation, entered into by an enterprise with an associated enterprise, irrespective of the fact that it has bearing on the profit, income, losses or assets of such enterprises at the time of the transaction or at any future date;" (emphasis supplied)

e) The assessee's stand that it is a quasi-capital transaction is wholly erroneous. Merely because it is a future equity transaction i.e., loan will/has been converted into equity in the coming years, it cannot fall out of the ambit of the ALP this financial year. Such future events do not have a bearing on current year and each assessment year is a separate period unit for taxation

c) With respect to the corporate guarantee:

a. Firstly, **I take *suo moto* cognizance of the corporate guarantee transaction** as it is clearly an international transaction. Though the assessee has quoted , the powers of TPO to take cognizance suo moto have been under dispute before but have been set to rest with the insertion of S.92CA(2B) with retrospective effect from 1-6-2002 (to plug the lack of effect of S.92CA(2A)). The retrospective operation of S.92CA(2B) allowing suo moto cognizance by TPO of such international transactions whether referred to by AO or considered in Form 3CEB has been upheld by the Special Bench of the Tribunal in the decision of ***LG Electronics (ITA No.5140/Del/2011)***. The assessee in that case had relied on decisions including ***CIT vs. Max India Ltd. (295 ITR 282 SC)*** to argue that the amendment cannot have retrospective effect. The Special Bench after detailed consideration of all decision including ***CIT vs. Amadeus (India) P. Ltd. (246 CTR Del. 338)*** which dealt with S.92CA(2A) held in favour of the

K.K.Ramamani Memorial Taxation Moot Court Competition

Department that indeed S.92CA(2B) has retrospective effect and the TPO was correct in taking suo moto cognizance.

b. **Having taken cognizance of the corporate guarantee transactions, I clearly find that these transactions of the assessee are international transactions as defined u/s 92B. Specifically Explanation (i)(c) to S.92B inserted with retrospective effect which clearly states that guarantees come under the ambit of international transaction.**

c. Furthermore, it is clear that the **AE has derived a benefit from this transaction**. Would the AE approach and obtain guarantee from any external party to be provided to its bank without being charged guarantee fees? The answer is in the NEGATIVE.

d. The assessee's authorized representatives took the hyper-technical point that S.92B(1) clear applies ONLY to ***"…transaction having a bearing on the profits, income, losses or assets of such enterprises"*** and this guarantee transaction does not have any bearing on profits, incomes, losses or assets of such enterprises. I find that statement incorrect, firstly it could be said that there can be a bearing on profits directly if the AE defaults. Furthermore, in any case, if there were no bearing on the profits, income, losses or assets why were these transactions undertaken? Finally, the statement refers to "such enterprises" which clearly means, leave alone the providing party, the receiving party i.e., the AE is included and a transaction which makes it expend less on interest rate on loan (obtained on guarantee of assessee) as opposed to high interest rates it would otherwise pay without guarantee by assessee has a direct bearing on its profits. Attention is also brought to S.92B Explanation (1)(e) which covers

K.K.Ramamani Memorial Taxation Moot Court Competition

the case of business restructuring or reorganization regardless which may also be construed to cover this transaction.

e. The assessee's authorized representative argued **that it was a contingent liability at best and would apply only if AE defaulted and hence was not a crystallized liability**. Hence, no accrual or mercantile system was relevant here as it could not be predicted whether corporate guarantee would be invoked or not. This argument I find sidesteps the issue – the issue is not whether it is mercantile system of accounting or accrued liability; it is whether a service benefiting AE has been provided and the short answer is in the affirmative and hence guarantee fees have to be charged. The assessee's authorized representatives are merely confusing TP provisions with accounting standards.

f. The **concept of guarantees being a "quasi-equity" transaction** was brought as follows by the assessee: the contention is that for the guarantee that assessee provides to the AE, it receives back equivalent benefits in the future in the form of dividend (taxable in India being that of foreign company) and so this "service" is not without a benefit. Furthermore such a setup of benefit flowing back is not and cannot be present with any other third-party for there to be comparable situation and hence ALP does not make any sense whatsoever in this context. Another argument put forth by assessee was that if a third party were to indeed provide such benefits to it (such as future returns in the form of dividends) the assessee may indeed provide the same guarantee service without charging. All these arguments are without basis. Firstly, merely because dividends *may* be given in future years cannot be the reason for providing corporate guarantee free of cost currently. Indeed third party guarantees are available in the market on

K.K.Ramamani Memorial Taxation Moot Court Competition

submission of one's financials and/or project plans and/or collaterals and these are all charged guarantee fees, so ALP squarely applies to the instant case. Furthermore all these arguments of quasi-equity have been shot down in a detailed manner by the Tax Court in Canada in the landmark ***GE Capital Canada Inc Vs The Queen (2009 TCC 563)*** wherein the Tax Court of Canada has dealt with ALP determination of the guarantee fees and held that arguments such as "implicit support" given by parent to child cannot shield one from avoiding guarantee fees in toto. The same logic applies in the instant case too. The assessee on this point has contended strongly that the Canadian TP laws cannot be applied in the instant case. Again, this is an incorrect argument; the rationale & logic of guarantee fees to be charged for providing guarantees to related parties is being taken from the Canadian decision and applied in India using India's provisions.

g. Reliance is also placed on the **OECD Transfer Pricing Guidelines** which is used all around the world as a guidance for TP issues. Paragraph 7.13 specifically states ***"but an intra-group service would usually exist where the higher credit were due to a guarantee by another group member"***. In other words the assessee has provided an intra-group service to its AE which thus clearly comes under the ambit of Indian TP provisions.

K.K.Ramamani Memorial Taxation Moot Court Competition

h. Reliance is placed on a number of Tribunal decisions, one of which is the decision of Mumbai Bench of ITAT in the case of ***Everest Kanto Cylinders Ltd*** (***ITA No. 542/Mum/2012)*** where in the Indian parent company provided corporate guarantee against a loan obtained by its AE from ICICI Bank (Bahrain branch). The parent company charged 0.5% commission. The Transfer Pricing

Officer rejected the 0.5% of the taxpayer and applied a rate of 3% based on the information gathered by him on bank guarantee rates charged by various banks under various circumstances. The Hon'ble Tribunal rejected the taxpayer's contention that guarantee commission is not an international transaction and also that there could not be any method for evaluating the ALP for the guarantee commission. The ITAT referred to the amendment brought in by the Finance Act, 2012

i. Thus having substantiated the various angles by which the assessee's guarantee transactions have to be brought under Indian TP, **I proceed to quantify the same using "external CUP" method** by considering the case of Petroleum India Corporation Ltd. which was a company into oil exploration which has provided guarantee to its subsidiary in the Middle east region and charged guarantee fees of 1.5%. It is further noted that the so-called *naked* bank guarantee rates which are provided by banks and listed on their public websites such as Exim Bank etc. are ~3% and hence the proposed addition @ 1.5% of loan availed by AE due to this guarantee provided is indeed very reasonable. The assessee's computation using the "interest saved approach" leading to guarantee fees of 0.5% is thus summarily rejected as it does not reflect reality.

Memorial Taxation
Moot Court Competition

Conclusion:

The international transactions which require adjustment are therefore the interest free loan which has to be charged interest @ 11% as well as corporate guarantee fees which has to be charged @ 1.5% on loan availed by AE. The final adjustment arrives at:

Nature of transaction	International Transaction value	Adjustment
Loan provided to Singapore AE	Rs.10,23,45,680/-	Rs.1,12,58,030/- (being 11% of Rs.10,23,45,680/- rounded up)
Corporate Guarantee provided to Gulf AE	Rs.11,34,65,780/-	Rs.17,01,990/- (being 1.5% of Rs.1,34,65,780/- rounded up)
	TOTAL TRANSFER PRICING ADJUSTMENT	**Rs. 1,29,60,020/-**

It is hereby clarified that the findings and discussions made in this Order are applicable only in respect of reference received for assessment year 2009-10 and not for subsequent assessment years.

Sd/-
(Sri. John Galt)
Joint Commissioner of Income Tax
Transfer Pricing Officer – I
Chennai 600 034.

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Copy to:

Assessee (Registered Office Address)

Assessing Officer