



Transfer Pricing Alert

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**TP disputes on
comparable and filter
selection - not
“substantial question of
law”, not appealable in
HC**

Issue no: TP/2/2018

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Executive Summary

Hon'ble High Court of Karnataka (HC) pronounced recently its ruling in the case of Softbrand India Private Limited dismissing revenue appeal, against an order of the Tribunal rejecting certain TP comparables and application of different filters for comparability analysis.

The HC held that under section 260A of the Income tax Act, 1961 (the Act), the HC can admit appeal only on a "substantial question of law". Shortlisting of transfer pricing comparables or application of filters for comparability analysis is a fact finding exercise and the order passed by the Tribunal should be considered binding on the lower authority, unless there is any perversity in the order of the Tribunal. Even varying views taken by the Tribunal in different cases cannot lead to formation of a "substantial question of law".

Facts

- The assessee was engaged in providing software services and products related services to its associated enterprise (AE). During the assessment year, it earned an operating profit of 8.33% on cost. The assessee applied Comparable Uncontrolled Price (CUP) method for substantiating arm's length price (ALP) of its international transactions.
- Transfer pricing officer (TPO) rejected CUP method and applied Transactional Net Margin method (TNMM). The TPO used a set of 20 comparables and determined ALP at cost plus 20.68%, which after giving effect to working capital adjustment was worked out to be at 18.86%.
- The assessee filed an appeal before the Commissioner of Income tax (Appeals)[CIT(A)] against the order of the Assessing Officer (AO)/TPO. The CIT(A) applied related party (RPT) filter to the selection of the comparables made by the TPO along with turnover filter, and analysed other comparables with abnormal margins. This exercise by the CIT(A) led to rejection of all, but three comparables selected by the TPO.
- Both the assessee and the revenue filed an appeal before the Income Tax Appellate Tribunal (the Tribunal), *albeit* for different reasons. The Tribunal after detailed analysis of all the comparables, including the ones selected by the TPO, rejected the comparables selected by the CIT(A) and instead included some comparables of the TPO, after applying RPT filter of 15% and other functional comparability criteria.
- Despite that, the revenue filed an appeal before the HC against the order of the Tribunal.

Question before the High Court

- Whether the Tribunal was right in rejecting certain comparables by following earlier year's order, without appreciating the reasoning given by the TPO?
- Whether the Tribunal was justified in fixing the RPT filter at 15% and rejecting some comparables based on that?

Observations and rulings of the High Court

- The HC observed that in the instant case, the dispute essentially related to the pairing and matching of comparables with the transfer pricing analysis of the profit margin given by the assessee. Such exercise is generally done by the Tribunal to include or exclude the comparables after due analysis and reasoning.
- The High Court analysed the Tribunal's order and observed that the Tribunal had given adequate attention to the task and had discussed each comparable and filter criteria with cogent reasons, before accepting or rejecting any comparable.
- The HC held that the appeal before the High Court has to pass the test of "substantial question of law". Section 260A(6) provides the issues that can be appealed before the HC. But it does not give any extended power to HC to disturb the findings of the fact given by the Tribunal, under the broad rubric of "substantial question of law".
- The HC held that if it were to take the path of undertaking comparative analysis and work on the filters, it would drag itself into data analysis work. That, the HC felt, would very much defeat the purpose of section 260A of the Act. The appeal in such cases can be made to the High Court only if the appellant finds any perversity in the findings of the Tribunal.
- The Tribunal is the final fact finding authority, comprising expert members. The judgement by this quasi-judicial forum (the Tribunal), the court stated, should put an end to the factual aspects.
- The HC further added that it is not allowed to either party to invoke jurisdiction of the HC merely because the Tribunal reverses or modifies findings given by the lower authorities.
- The HC also stated that the appellant has not appealed on the perversity of the Tribunal's order, neither was there any perversity in the order of the Tribunal. Given that, the HC dismissed the appeal.

Conclusion

Comparability analysis has been one of the most prevalent dispute issues. Many disputes, involving comparability analysis in transfer pricing have come up for cost-plus remunerating service provider companies. Large number of such appeals are also pending before different jurisdictional HCs. This ruling will certainly have wider ramification on such appeals. There is a good chance that those appeals would get dismissed by the jurisdictional HC following this ruling of the Karnataka HC, unless the appellants demonstrate perversity in the order of the Tribunal.

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