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Executive Summary

- The Mumbai Bench of the Income-tax Appellate Tribunal (Tribunal) pronounced its ruling in the case of Vodafone India Services Private Limited (taxpayer/ VISPL). The Tribunal held that recasting of Framework Agreement (FWA) in 2007[1], tantamounts to assignment of the option rights held by VISPL and constitutes an international transaction with Associated Enterprise (AE) and requires to be dealt at Arm's Length.
- The Tribunal observed that arrangement of sale of call centre business to HWP India is merely an interpose to give a different colour to the transaction with motive to circumvent transfer pricing provisions. Consequently, the Tribunal validating lifting of corporate veil, held that sale of call centre business in substance is between the taxpayer and its non-resident associated enterprises and therefore is an "international transaction" in terms of section 92B(1) of the Income tax Act, 1961 (the Act).
- With respect to the benchmarking of provision of IT enabled services (ITES), the Tribunal has remanded the matter back to the revenue authorities for the determination of Arms Length Price (ALP).

[1] FWA 2007- Framework Agreement dated 5 July 2007

Facts

- The taxpayer, was initially an indirectly held subsidiary of the Hutchison group company, CGP Investments Holdings Limited, Cayman Islands (CGP). In February 2007, an SPA[2] was entered into pursuant to which the shares of CGP were transferred by its holding company, Hutchison Telecommunications International Limited (HTIL) to Vodafone International (Holdings) BV (VIH BV). Various FWAs and arrangements were executed pursuant to the SPA. Pursuant to the SPA, the taxpayer became an indirect subsidiary of VIH BV.
- Broadly three major transactions were dealt by the Tribunal:
- Assignment of call options
- Sale of call centre business
- Benchmarking of margins from providing ITES services to AE
- Assignment of call options
- Analjit Singh (AS) and Asim Ghosh (AG) had acquired shares in Telecom Investments India (TII) which held shares in Hutchison Essar Limited (HEL) [currently known as Vodafone India Limited (VIL)], through its group entities with credit support provided by HTIL. In consideration of the same, an FWA 2006[3] was entered conferring call option resulting in 12.25% shares in VIL on the taxpayer Under the said FWA, corresponding put options were also granted to AG and AS requiring the taxpayer or its nominated person to acquire underlying shares.
- As VIH BV acquired shares of CGP vide SPA with HTIL in 2007, VIH BV became an indirect parent of the taxpayer. HTIL pursuant to the SPA also agreed that each of its group companies would not terminate or modify their rights under the FWA or exercise their options thereunder.
- Subsequently, the FWA 2006 was modified in 2007 (FWA 2007), conferring the rights under the call option to purchase the shares held by AG and AS group in TII from the taxpayer to CGP India Investments Limited, Mauritius (CGP Mauritius), which post SPA was a wholly owned subsidiary of the Vodafone Group.
- Further, a shareholder’s agreement was entered into between the shareholders of TII (TII SPA[4]) on one hand and CGP Mauritius, TII and VIH BV on the other.
- The Revenue authorities contended that the said modification of FWA 2006 and TII SPA between the taxpayer and its AEs was with an intention to secure the option rights from taxpayer to CGP Mauritius. According to the Revenue authorities, the act, constituted a transfer of right from the taxpayer to CGP Mauritius and consequently brought the transaction to tax.
- The Taxpayer had not disclosed the said transaction in its Form 3CEB contending that the same was not an international transaction. However the Revenue authorities held that the overall arrangement was in the nature of mutual understanding and action in concert for securing option rights (to gain underlying interest in VIL) by Vodafone group. Hence, the taxpayer needs to be compensated for

[2] SPA- Share Purchase Agreement dated 11 February 2007
[3] FWA 2006 – Framework agreements dated 01 March 2006
[4] TII SPA dated 05 July 2007 - the indirectly held companies of Analjit Singh and Asim Ghosh were a party to the agreement.

facilitation of the said arrangement and assignment of its right to CGP Mauritius.

- The revenue authorities in determining the ALP of the transaction, compared the cashless option assigned by IDFC Investors to the taxpayer for a consideration of Rs. 6.22 millions under a similar arrangement to relinquish its rights in favour of the taxpayer to acquire 0.1234% shares in VIL. The Revenue authorities used this transaction as Comparable Uncontrolled Price (CUP) for purpose of benchmarking the transaction. The revenue authorities thus proposed a transfer pricing addition to the tune of Rs. 617.88 millions being proportionate cost of 12.25% shares of VIL sought to be acquired under the call option in question.
- Sale of call centre business and applicability of transfer pricing provisions
- The taxpayer was engaged in providing Call Centre services to Hutchison Whampoa Limited (HWL) Group entities in the UK and Australia.
- At the time of entering into the SPA, it was agreed upon between HTIL and VIH BV that call centre business of the taxpayer will not be acquired by VIH BV. Accordingly, the taxpayer transferred call centre business to Hutchison Whampao Properties (India) Pvt. Ltd. (HWP India), a subsidiary of HWL Group, for a consideration of INR 64 Crores pursuant to Business Transfer Agreement (BTA) entered into between the taxpayer and HWP India.
- The taxpayer contended that since the sale of call centre business is between two resident entities in India, transfer pricing regulations do not apply.
- During TP assessment proceedings, the revenue authorities after considering SPA, BTA and other documents, concluded that SPA is a prior agreement as envisaged under section 92B(2) of the Act wherein the terms of relevant transaction are determined. Based on the above, the revenue authorities concluded that sale of call centre business by the taxpayer to HWP India is a deemed international transaction under section 92B(2) of the Act and therefore requires to be at arm’s length.
- In determining arm’s length price of sale of call centre business, the revenue authorities rejected business valuation report wherein PECV/NAV methods were used by the taxpayer and made a transfer pricing adjustment using P/E multiple of comparable companies in absence of relevant data for DCF method.
- Aggrieved by the order of the revenue authorities, the taxpayer filed objections before the DRP against transfer pricing adjustment proposed under the Draft Assessment Order. The DRP upheld the findings of the revenue authorities that sale of call centre business is deemed international transaction u/s 92B(2) of the Act and also held that alternatively, it is an international transaction u/s 92B(1) of the Act as since the transaction is effectively between two associated enterprises i.e. taxpayer and HWL.

Others

- Benchmarking of margins from providing ITES services to AE
- The taxpayer provided ITES services to its AEs and benchmarked the said transactions by comparing its margin against 11 comparable companies selected by it. The revenue authorities rejected certain comparables selected by the taxpayer and included other fresh comparables by rejecting/modifying the search criteria and proposed an adjustment in this regard.
- Aggrieved by the adjustments proposed by the revenue authorities, the taxpayer approached the

Hon'ble Bombay High Court (HC) vide a writ petition challenging the lack of jurisdiction in respect of the transfer pricing adjustments. The HC upholding the jurisdiction of the Revenue authorities to consider the transaction dismissed the petition and held that there are several issues of facts and law which must be considered by the Revenue authorities and therefore it is not a fit case to invoke extraordinary jurisdiction under Article 226 of the Constitution of India. The HC, therefore, remanded the case to the Tribunal for finding of facts based on various documentary evidences.

Issues before the Tribunal

In relation to call options:

- In view of the amended definitions of the terms 'capital asset' and 'transfer' under section 2(14) and section 2(47) of the Act respectively, whether re-casted FWA 2007 read with TII SPA tantamounts to assignment of option rights held by the taxpayer?
- Whether the arrangement between the taxpayer and its AE for securing of option Rights and payment therefor constitutes an international transaction?
- Whether CUP method applied by the Revenue authorities is appropriate for valuing the options rights?

In relation to sale of call centre business

- Whether sale of call centre business between two resident entities is an "international transaction" or "deemed international transaction" within the meaning of section 92B of the Act?

Others

- Whether the revenue authorities is correct in selection of comparables and filters for benchmarking the transaction of provision of ITES services by the taxpayer?

Observations & Ruling of the Tribunal

Assignment of call options

- On the issue of whether the recasting of FWA tantamounts to assignment, the observations of the Tribunal are as under:-
- With respect to the ruling of Apex Court in the case of Vodafone International Holdings BV Vs. Union

of India[5], the Tribunal noted that the Apex Court ruling is based on the unamended provisions of section 2(47) of the Act

- Further, the ruling is binding only with respect to the principle laid down on the substantial question of law and not in entirety
- In both, FWA 2006 and the re-casted FWA 2007, the tax payer had the right to assign the option rights to one of the nominees and till the assignment took place the rights remained vested with the tax payer. However, under TII SPA, these rights to call option stands transferred and vested in CGP Mauritius resulting in transfer of capital asset under the amended provisions of section 2(14) and section 2(47) of the Act.
- On the issue of whether the arrangement constitutes an international transaction, the observations of the Tribunal were as follows:-
- Section 92B r.w.s 92F(v) does not require transfer or assignment or creation of right/ interest in the property but mere arrangement, understanding, action in concert (whether or not meant to be enforced) between the AEs; which has bearing on the profits, income, assets of the enterprise shall fall within the ambit of an international transaction
- The legislation has deliberately left the term ‘transaction’ undefined and the same is to be given wide import
- In the facts of the present case, there is a mutual understanding and arrangement as well as concert between the taxpayer and VIH BV for securing the option rights along with consideration paid by VIH BV which has bearing on profits, income, assets of the AE and hence the said transaction fulfills all the preconditions to be covered under the definition of international transaction.
- The Tribunal, in relation to the comparability of option rights under IDFC cashless options with the current options, observed as under:-
- Taxpayer was the holder of valuable option rights under the FWAs (2006 & 2007) and had as a part of the wider group, facilitated and concerted in securing the rights in VIL shares for the benefit of VIH BV group. However, no consideration was received by taxpayer for such facilitation
- Option rights under FWAs (2006 & 2007) with AG & AS as well as with IDFC investors are for ultimately acquiring underlying VIL shares and hence comparable
- Consideration paid for assignment of cashless option was to remove the deficiency in the option rights of the taxpayer under IDFC FWA in comparison to the rights under FWAs (2006 & 2007) with AS and AG. Thus, the right under IDFC FWA were brought in par with rights in AG and AS FWAs (2006 & 2007) and no third party could be assigned the option
- In absence of other assets with the holding companies the value is derived from the same underlying shares of VIL and accordingly, the benchmarking using CUP method was appropriate.

Sale of Call Centre business

- The Tribunal upheld lower authorities stand of lifting of corporate veil and substance over form and held that the arrangement was without any business, commercial or economic substance or interest of HWP India.

[5] 341 ITR 1

- It observed that sale of call centre business was not an independent decision of the taxpayer but it was a decision of its AE, HWL Group as per the terms and conditions of SPA pursuant to which the BTA was entered into.
- In concluding the above, the Tribunal observed that surrounding facts and circumstances such as intent and terms of SPA/BTA, absence of any business and inadequate funds in HWP India, amendment to Memorandum of Association of HWP India post acquisition of the business, acting in concert by relevant parties, etc. leads to a conclusion that the arrangement is merely an interpose to give a different colour to the transaction with motive to circumvent transfer pricing provisions.
- In view of the above, the Tribunal held that transaction of sale of call centre business in substance is between the taxpayer and its non-resident AE HTIL/HWL Group and is an “international transaction” under section 92B(1) of the Act.
- The Tribunal disregarded the Revenue’s alternate contention that sale of call centre business by the taxpayer to HWP India is a “deemed international transaction” under section 92B(2) of the Act. The Tribunal observed that applicability of section 92B(2) requires transaction between two unrelated parties. The Tribunal held that in the given case, these provisions are not applicable since the transaction is between the taxpayer and HWP India which, irrespective of their residential status, are AEs.
- In so far as the valuation of call centre business and determination of ALP is concerned, the Tribunal held that valuation of call centre business should be based on most appropriate method being DCF method as agreed by both the parties, and set aside the issue to the revenue authorities.

Others

- Benchmarking of margins from providing ITES services to AE
- The Tribunal analyzed the objections of the taxpayer and placing reliance on various rulings of the co-ordinate bench rejected two companies as comparables and remitted back the determination of ALP computation to the file of the revenue authorities after due verifications as directed by it.

Conclusion

This ruling has upheld the doctrine of lifting the corporate veil where taxpayers adopt colourable device(s) or collusive transactions to circumvent the taxing provisions.

Important guidance on ambit and scope of international transaction and deemed international transaction is also provided in this ruling. Based on the observations of the Tribunal, the transactions between two resident associated enterprises will not be caught within the ambit of deemed international transactions, however it is important to look at the substance over form by lifting the corporate veil to assess if the resident associated enterprise can be disregarded and the transaction can be brought under the net of international transaction. It is interesting to note that the Finance Act, 2014 amended the definition of deemed international transaction to include transaction between two resident enterprises.

Source : Vodafone India Services Pvt Ltd Vs ACIT Circle 3(3), Mumbai, ITA No. 7514/ Mum/2013; 10 December 2014

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Contacts

Ahmedabad
Heritage, 3rd Floor,
Near Gujarat Vidyapith,
Off Ashram Road,
Ahmedabad – 380 014.
Tel: + 91 (079) 2758 2542
Fax: + 91 (079) 2758 2551

Bangalore
Deloitte Centre, Anchorage II,
100/2, Richmond Road,
Bangalore 560 025.
Tel: +91 (080) 6627 6000
Fax: +91 (080) 6627 6010

Chennai
No.52, Venkatanarayana Road,
7th Floor, ASV N Ramana Tower,
T-Nagar,
Chennai 600 017.
Tel: +91 (044) 6688 5000
Fax: +91 (044) 6688 5050

Coimbatore
Shanmugha Manram
41, Race Course,
Coimbatore
Tamil Nadu - 641018
Tel: + 91 (0422) 439 2801
Fax: +91 (0422) 222 3615

Delhi/Gurgaon
Building 10,
Tower B, 7th Floor,
DLF Cyber City,
Gurgaon 122 002
Tel : +91 (0124) 679 2000
Fax : + 91 (0124) 679 2012

Hyderabad
1-8-384 and 385, 3rd Floor,
Gowra Grand S.P.Road,
Begumpet,
Secunderabad – 500 003.
Tel: +91 (040) 6603 2600
Fax:+91 (040) 6603 2714

Kolkata
Bengal Intelligent Park Building Alpha,
1st floor, Block EP and GP Sector V,
Salt Lake Electronics Complex,
Kolkata - 700 091.
Tel : + 91 (033) 6612 1000
Fax : + 91 (033) 6612 1001

Mumbai
Indiabulls Finance Centre,
Tower 3, 28th Floor,
Elphinstone Mill Compound,
Senapati Bapat Marg, Elphinstone (W),
Mumbai – 400013
Tel: + 91 (022) 6185 4000
Fax: + 91 (022) 6185 4101

Pune
106, B-Wing, 7th Floor,
ICC Trade Tower,
Senapati Bapat Road,
Pune – 411 016.
Tel: + 91 (020) 6624 4600
Fax: +91 (020) 6624 4605

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