



## **Transfer Pricing Alert** Delivering Clarity

**TP disputes on  
Comparables and Filter  
selection - not a  
“substantial question of  
law”; not appealable in  
HC**

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## Executive summary

Hon'ble High Court of Karnataka (HC) pronounced recently its ruling in the case of Softbrands India Private Limited, dismissing revenue appeal against an order of the Tribunal, wherein, the Tribunal had rejected certain TP comparables and applied 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 authorities, 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 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 transaction (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 two 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.

## Questions before the Hon'ble High Court

- Whether the Tribunal was right in rejecting certain comparables by following earlier year's order and without appreciating the reasons given by the TPO and without appreciating that TPO has chosen the same after application of mind and materials on record?
- 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 the entire exercise of making transfer pricing adjustments on the basis of comparables is nothing but a matter of estimate of broad and fair guess work of authorities based on records and materials with them including the Tribunal. The HC also observed that the Tribunal being the last fact finding authority, also remains so, for disputes under Chapter X and therefore, unless the High Court is satisfied that a substantial question of law arises from the order of the Tribunal, an appeal under Section 260-A cannot be entertained. The HC 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 High Court. But it does not give any extended power to disturb the findings of the fact given by the Tribunal, under the broad rubric of "substantial question of law". The HC also compared the provisions of Section 260A with those of Section 100 and 103 of the Code of Civil Procedure (CPC). It concluded that what could be substantial question of law could be interpreted from settled jurisprudence on this issue\* covered by various Supreme Court's decisions.
- 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 HC stressed on the need for giving primacy to the Tribunal as the final fact finding authority, comprising expert members. The judgement by this quasi-judicial forum (the Tribunal), the HC 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 High Court merely because the Tribunal reverses or modifies findings given by the lower authorities.
- The HC also stated that in the present case, 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

In transfer pricing disputes, comparability analysis and use of appropriate filters has been one of the most prevalent issues, especially for captive cost plus remuneration service providers.

While this ruling follows the well-settled principle of when an appeal can be entertained in the High Court, it covers the discussion more comprehensively by analyzing the law, the various Supreme Court and High Court decisions and the background of transfer pricing cases and why particular issues such as comparability, filters etc., may not constitute a substantial question of law.

Large number of appeals on comparability analysis and use of appropriate filters are pending before different jurisdictional High Courts. Following this important HC ruling and others on the same issue, it is important for both the revenue and tax payers to satisfy themselves that a particular transfer pricing adjustment results in a "substantial question of law". The HC has made it clear that while applying these principles, though the revenue appeals are being dismissed, the same would be applicable for tax payers as well.

ACIT vs M/s Softbrands India P. Ltd. (I.T.A.No. 536/2015, C/W I.T.A.No. 537/2015)

\*1. Sir Chunilal V. Mehta and Sons Limited v. Century Spinning and Manufacturing Co. Ltd. AIR 1962 SC 1314

2. Santosh Hazari v. Purshottam Tiwari [2001] 3 SCC 179

3. Hero Vinoth (Minor) v. Seshammal [2006] 5 SCC 545

4. Vijay Kumar Talwar v. Commissioner of Income tax, Delhi [2011] 1 SCC 673

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