IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI E BENCH, MUMBAI

Before Shri Pramod Kumar, Accountant Member
and Shri V Durga Rao, Judicial Member

ITA No. 1176/Mum/2010
Assessment year: 2004-05

Deputy Commissioner of Income Tax
Circle 2 (3), Mumbai ……..…… ***Appellant***

Vs.

Tech Mahindra Limited …… ***Respondent***
(formerly Mahindra British Telecom Ltd)
Gateway Building,
Apollo Bunder, Mumbai 400 001
PAN : AAACM3484F

Appearances:

Jay Kumar and Vijay Shankar, *for the appellant*
None, *for the respondent*

O R D E R

Per Pramod Kumar :

1. This appeal, filed by the Assessing Officer, is directed against the order dated 8th December 2009, passed by the Commissioner (Appeals), in the matter of assessment under section 143 (3) of the Income Tax Act, 1961 (hereinafter referred to as 'the Act'), for the assessment year 2004-05.

2. Ground No. 1 is general in nature and does not, as such, call for any specific adjudication by us.

3. In the second ground of appeal, the Assessing Officer has raised the following grievance:

> **On the facts and in the circumstances of the case and in law, the CIT(A) erred in determining the ALP interest rate of 2% for trade credit chargeable to the AE, without appreciating the fact that the same was required to be charged @ 10% being the rate charged by the assessee to its German AE on an euro denominated loan.**

4. The relevant material facts are like this. The assessee, a joint venture between an Indian company by the name of Mahindra & Mahindra Ltd and a UK based company by the name of British Telecommunications, is engaged in the business of software services relating to telecommunication, internet technology and engineering etc. During the assessment proceedings, it was noticed that the assessee had allowed credit to its US based associated enterprises, beyond the stipulated credit period. It was in this backdrop, and pursuant to a reference made by the Assessing Officer to the Transfer Pricing Officer for determination of arms-length price, on account of notional interest relating to excess credit period granted by the assessee to its AEs, that the assessee was required to show cause as to why interest @ 10% not be treated as arms-length interest for such delayed receipts on account of services provided to the AEs. The stand of the assessee was that excess credit period was allowed to the US AE in view of the liquidity problems faced by the AE, and that, in any event, no such interest is charged from even independent enterprises. It was also submitted that interest was not charged because of the

business expediency. The Transfer Pricing Officer was, however, not impressed by the stand so taken by the assessee. He was of the view that a cost should have been charged by the assessee for having allowed this excess credit period to the US AE, and the mere fact that the assessee has not charged the independent enterprises, for excess credit period allowed to them, does not help the cause of the assessee was having low level of business with such independent enterprises. The dealings with independent enterprises were thus rejected on the ground that these dealings constitute inappropriate comparables. While the Assessing Officer did observe that "it is not denied that there may be a reason for business expediency and also the genuineness of transaction", he held that "by not charging interest on such extended period granted to the AE, the assessee has not carried out the transaction at arm's length". He also noted that the assessee has charged interest @ 10% from its German AE on the Euro denominated loan granted by the assessee, and, accordingly, adopted the same interest rate as an arms length interest for such excess credit period allowed. The interest on excess credit period thus allowed was computed at Rs 1,87,52,378, and an ALP adjustment was made in respect of the same. Aggrieved, assessee carried the matter in appeal before the CIT(A), who confirmed the ALP adjustment in principle but restricted the same to USD LIBOR rate (which was 1.22% at that point of time) plus a mark up of 80 basis points, which was rounded off to 2%. Aggrieved by the relief so granted by the CIT(A), the Assessing Officer is in appeal before us.

5. Having heard the learned Departmental Representative, and having perused the material on record, we are not inclined to interfere in the matter at the instance of the Assessing Officer. Learned Departmental Representative's spirited defence of, and vehement reliance on, the stand

on the Transfer Pricing Officer does not impress us for more reasons than one. The very selection of comparable by the TPO is contrary to the scheme of the applicable transfer pricing regulations. We have noted that the TPO has proceeded to adopt the interest rate at which the assessee has given a Euro denominated loan to its AE, as an internal comparable under the Comparable Uncontrolled Price (CUP) method, but, in doing so, he apparently overlooked the fact that to be an internal comparable under the CUP method, the transaction has to be with an independent enterprises. Rule 10B(1)(a) specifically provides that, as a first step for determining the Comparable Uncontrolled Price "the price charged or paid for property transferred or services provided in a comparable **uncontrolled transaction**, or a number of such transactions, is identified (*emphasis by underlining supplied by us*)". Rule 10(a), in turn, defines the expression '**uncontrolled transaction**' as '**a transaction between enterprises other than associated enterprises, whether resident or non-resident**'. It is thus clear that a transaction between the associated enterprises cannot be taken as a comparable for the purpose of application of CUP method. Internal CUP, therefore, can only be a comparable transaction which the assessee enters into with an independent enterprise, while it will be an external CUP when the comparable transaction is between two independent enterprises not involving the assessee. Accordingly, a transaction admittedly with an associated enterprise of the assessee company cannot be taken as an internal comparable for the purpose of ascertaining the ALP. The Transfer Pricing was clearly in error in adopting the interest rate in respect of transactions between the AEs as an internal comparable under the CUP method and observing that "**when an internal comparable in the form of rate of interest charged on foreign currency loan is available, the same should be preferable over any other comparable" –** particularly when he himself had unambiguously noted that this loan was given by the

assessee to its associated enterprises in Germany. In the case of **Skoda Auto India Ltd Vs ACIT (30 SOT 319)**, a coordinate bench of this Tribunal also took the same stand. While holding so, the coordinate bench, speaking through one of us (i.e. the Accountant Member) observed as follows:

> **We have noted that there are references to the determination of arm's length price on the basis of CUP (comparable uncontrolled price) method, but, in the course of hearing before us, learned counsel for the assessee admitted that the transactions which were relied upon were transactions that the parent company had with other AEs and the price of Euro 680 thus given is not the price at which transactions have been entered into between independent persons. This is the price that the assessee had adopted as internal CUP. The assessee also submitted that external CUP is not available because the product is unique. To our understanding, this argument is totally devoid of any merits. To be considered as internal CUP also, the transaction has to be an independent transaction i.e., between two entities, which are independent of each other. The sale of car kit has admittedly taken place only between the associated concerns. Therefore, the price at which such transaction has taken place is irrelevant for CUP analysis; what is referred to as CUP (comparable uncontrolled price) is price of a comparable but controlled transaction, since to be termed as an uncontrolled transaction, the transaction has to be between two entities which cannot influence or control each other's decision. The transactions between AEs obviously do not satisfy such a criterion. There is thus no internal CUP, as**

claimed by the assessee before the authorities below and as stated in the information filed along with the IT return……."

6. Grievance of the assessee to the effect that the CIT(A) ought to have upheld the stand of the Transfer Pricing Officer is, therefore, devoid of any legally sustainable merits. As a matter of fact, in case the Transfer Pricing indeed wanted to adopt internal CUP in this case, it would *prima facie* appear that the correct comparable was the interest that the assessee was charging from independent enterprises – which was admittedly NIL in the present case. It is only elementary that an ALP adjustment can only be made to nullify the impact of interrelationships between the associate enterprises, i.e. for variations in assessee's dealings vis-à-vis dealings with independent enterprises, and, therefore, when assessee is not charging the interest on delayed payments from independent enterprises, a view is perhaps possible that the assessee cannot be subjected to the ALP adjustment in respect of delayed payments from associated enterprises either. In other words, the TPO need not consider what must happen in ideal circumstances but need to restrict himself to locating the differences in assessee's dealings with AEs vis-à-vis assessee's dealings with non AEs, and neutralize the impact of such differences. However, right now we are not concerned with the larger question whether an ALP adjustment could indeed have been made, in respect of the extended credit period allowed to the AE, and therefore these *prima facie* observations are not really relevant for determining the issue in appeal before us. Even assuming that an ALP adjustment could indeed have been made on the facts of this case, in our considered view, since the AE was based in United States, the right parameter to be applied in US Dollars LIBOR rate, with an appropriate mark up, as against the rate of interest on a Euro denominated loan granted by the assessee to another AE – as adopted by the Transfer Pricing Officer. In the case of Siva Industries & Holdings Ltd Vs ACIT (ITA

2148/Mds/10; order dated 20th May 2011, a coordinate bench of this Tribunal has observed as follows:

> **"The assessee has given the loan to the Associated Enterprises in US dollars. The assessee is also receiving interest from the Associated Enterprises in Indian rupees. Once the transaction between the assessee and the Associated Enterprises is in foreign currency and the transaction is an international transaction, then the transaction would have to be looked upon by applying the commercial principles in regard to international transaction. If this is so, then the domestic prime lending rate would have no applicability and the international rate fixed being LIBOR would come into play. In the circumstances, we are of the view that it LIBOR rate which has to be considered while determining the arm's length interest rate in respect of the transaction between the assessee and the Associated Enterprises. As it is noticed that the average of the LIBOR rate for 1.4.2005 to 31.3.2006 is 4.42% and the assessee has charged interest at 6% which is higher than the LIBOR rate, we are of the view that no addition on this count is liable to be made in the hands of the assessee".**

6. The view taken by us also finds support from these observations of the coordinate bench. When there is a choice between the interest rate of a currency other than the currency in which transaction has taken place and the interest rate in respect of the currency in which transaction has taken place, in our considered view, the latter should be adopted. In Siva Industries' case *(supra),* coordinate bench was making a choice between

the PLR (Prime Lending Rate in India) and the LIBOR (London Inter Bank Offered Rate). The coordinate bench held that "once the transaction between the assessee and the Associated Enterprises is in foreign currency and the transaction is an international transaction, then the transaction would have to be looked upon by applying the commercial principles in regard to international transactions", and accordingly proceeded to take into account interest rate in terms of LIBOR basis. We have adopted the same approach by taking into account the commercial principles and practices with regard to a US Dollar denominated extended credit for arriving at the benchmark rate, and take LIBOR as the base. Accordingly, the LIBOR (US Dollar) has to be as benchmark for US Dollar transactions - rather than the rate of interest on domestic borrowings, even which is lower than the interest rate of 10% taken as ALP by the TPO, or, for that purpose, rate of interest on any other currency loans. Having said that, we may also reiterate that as we hold so, we are not giving any decision on whether the ALP adjustment can be made, on the basis of LIBOR plus mark up, in respect of extended credit because we are dealing with a very limited issue in this appeal which does not require adjudication on the broader question as to whether an extended credit period can anyway be compared with a loan, much less a loan in some other currency which will have distinct lending rates depending on the peculiarities relating that currency, since it does not involve the lending period commitment as a loan necessarily involves. Be that as it may, the CIT(A) cannot thus be said to be in error in adopting the US Dollars LIBOR rate, with mark-up which is not in dispute for its being too low, as a basis for ALP adjustment - as long as he can be said to be justified in upholding the ALP adjustment. There is thus no justification in grievance raised by the Assessing Officer against the relief granted by the CIT(A). As we uphold the relief given by the CIT(A), we refrain from making any observations on whether or not such an ALP adjustment could have been

made in the first place. The mere fact that the relief granted by the CIT(A) is upheld, it does not imply that the CIT(A)'s action of confirming the ALP adjustment on the facts of this case, in principle, is upheld too. That remains an open question and need not be adjudicated in this appeal. With these observations, and to the extent the grievance of the revenue is concerned, we confirm the order of the CIT(A) and decline to interfere in the matter at the instance of the revenue authorities. Ground No. 2 is thus dismissed.

8. In ground no. 3, the Assessing Officer has raised the following grievance:

> **On the facts and in the circumstances of the case and in law, CIT(A) erred in including the expenses incurred in foreign currency on telecommunication charges and in providing technical services outside India in the total turnover for the purpose of computation of deduction under section 10A, ignoring the fact that in the absence of specific definition of total turnover, whether the same definition can be imported from the other sections for the computation of deduction under section 10 A of the Income Tax Act, 1961.**

9. Learned Departmental Representative submits that the issue is covered, in favour of the assessee, by Special Bench decision in the case of ITO Vs Sak Soft Limited (121 TTJ 865) and by Tribunal's decision in assessee's own case for the assessment year 2002-03. Respectfully following these decisions, we uphold the order of the CIT(A) on this issue

as well and decline to interfere in the matter. Ground No. 3 is also thus dismissed.

10. Ground No. 4 is general in nature and does not, therefore, call for any adjudication by us. This ground is also dismissed.

11. In the result, the appeal is dismissed. Pronounced in the open court today on 30th day of June, 2011.

Sd/- sd/-

(V Durga Rao) **(Pramod Kumar)**
Judicial Member Accountant Member

*Mumbai; 30th _day of **June** , **2011**.*

Copy forwarded to :

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2. *The respondent*
3. *Commissioner –Mumbai City , Mumbai*
4. *Commissioner (Appeals) , Mumbai*
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By Order etc.

Assistant Registrar
Income Tax Appellate Tribunal
Mumbai benches, Mumbai