IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCHES "J", MUMBAI

BEFORE SHRI SHAMIM YAHYA (AM) AND SHRI RAM LAL NEGI (JM)

ITA No. 6070/MUM/2017
Assessment Year: 2013-14

Vinca Developers Private Limited, Unit No. 116, First Floor, Rehab Building No. 4, " Akruti Annex" , Road No. 7, Marol MIDC, Andheri (East), Mumbai - 400093 PAN: AACCV8042J	**Vs.**	Assistant Commissioner of Income Tax, Circle 11(3)(2), Room No. 427, Aayakar Bhavan, Maharshi Karve Road, Mubmai - 400020
(Appellant)		**(Respondent)**

Assessee by : Shri Viral Doshi (AR)
Revenue by : Shri Manish Kumar Singh (DR)

Date of Hearing: 16/04/2019
Date of Pronouncement: 12/07/2019

O R D E R

PER RAM LAL NEGI, JM

This appeal has been filed by the assessee against the directions dated 28.06.2017 passed by the Ld. Dispute Resolution Panel-2 (for short 'the DRP'), Mumbai, u/s 144 C(5) of the Income Tax Act, 1961 (for short the 'Act') for the assessment year 2013-14. Pursuant to the aforesaid directions, the AO determined the total income of the assessee at Rs. 7,36,61,650/- after making addition amounting to Rs. 7,87,50,311/- on account of transfer pricing adjustment determined by the Ld. TPO in respect of international transaction entered with its Associated Enterprises (AEs).

2. The assessee has preferred the present appeal before the Tribunal on the following effective grounds:-

"Following grounds are without prejudice to each other:
Transfer Pricing Grounds

1. *Ground No. 1: Relating to non-applicability of transfer pricing provisions:*

1.1. The Hon'ble DRP erred on facts and in law by concurring with the learned AO / TPO's view that Appellant and Nederlandse Financierinngs Maatschappij Voor Ontwikkelingslandern N.V. ('FMO)') are associated enterprises as per section 92 of the Act and therefore transfer pricing provisions are applicable to it. The appellant contends that FMO is not an associated enterprise as per the provisions of Act and DTAA between India and Netherlands and hence transfer pricing provisions are not applicable to it.

1.2. The Hon'ble DRP erred on facts and in law by concurring with the learned AO / TPO's view that the Compulsory Convertible Debentures (CCDs) are in the nature of loan and therefore covered under the deeming provision under Section 92A(2)(c).

1.3. The Hon'ble DRP erred on facts and in law by concurring with the learned AO / TPO's view that section 92A(2) overrides section 92A(1) ignoring the fact that section 92A(2) only supplements the primary definition of associated enterprises under sub-section (1).

1.4. The Hon'ble DRP erred on facts and in law by concurring with the learned AO / TPO's view that since the Appellant has complied with TP provisions in this year and earlier years, transfer pricing provisions are applicable without appreciating the fact that compliance was done on without prejudice basis.

2. Ground No. 2: Relating to benchmarking analysis undertaken by Appellant:

2.1. The Hon'ble DRP erred on facts and in law by upholding rejection of the transfer pricing study report and the benchmarking analysis adopted by the Appellant while arriving at the arm's length interest rate at which interest is paid to EMO on the CCD's without any cogent reason.

2.2. The Hon'ble DRP erred on facts and in law in rejecting comparable debentures identified by the Appellant having similar parameter as that of CCD's issued by it to FMO without giving any cogent reasons.

2.3. The Hon'ble DRP further erred on facts and in law by disregarding the credit rating analysis done by the Appellant based on the scientific procedure laid down by the Securities and Exchange Board

of India ('SEBI') and upholding the learned AO's /TPO's approach and not examining the detailed submissions made by the Appellant. 3.

Ground No. 3: Relating to of use of SBI PLR as ALP:

3.1 The Hon'ble DRP erred on facts and in law by merely accepting the State Bank of India's ('SBI') Prime Lending Rate ('PLR') as computed by the learned AO/TPO while determining the arm's length nature of interest paid by the Appellant on CCD's issued to FMO without carrying out detailed analysis or making any adjustment for the differences in terms and nature of CCD's and PLR rates.

3.2 The Hon'ble DRP erred by ignoring the fact that same interest rate on debentures that were issued in the earlier year relevant to assessment year 2010-11 has been accepted at ALP by the TPO itself and thereby ignoring the principle of res judicata.

Corporate Tax Grounds

4. Ground No. 4: Penalty Proceedings:

4.1 The Hon'ble DRP / learned TPO / AO erred, in law and in initiating penalty proceedings under section 271(1)(C). The Appellant craves the leave to amend or alter any ground or add a new ground which may be necessary."

3. At the outset, the Ld. Counsel for the assessee submitted that the issue involved in the present case is covered in favour of the assessee by the decision of the ITAT, Mumbai rendered in assessee's own case ITA No.649/M/2016 for A.Y. 2011-12 and ITA No. 2087/Mum/2017 for the AY 2012-13. In the said cases, the Tribunal has held that Netherlands Development Finance Company called 'Nederlands *Financierrings-Maatschappij Voor Ontwinkkelingslanden* N.V.' (FMO) is not an Associate Enterprise (AE) of the assessee company and therefore there is no need for computation of Arm's Length Price (ALP). The Ld. A.R. accordingly submitted that the appeal pertaining to the assessment year under consideration may be decided accordingly.

4. The Ld. D.R., on the other hand, fairly admitted that the issue raised by the assessee in the present appeal is covered in favour of the assessee by the decision of the coordinate Bench of the Tribunal, however, supported the order passed by the AO in accordance with the directions of the Ld. DRP.

6. We have perused the material on record in the light of the submissions made by the Ld. counsel for the assessee. Vide Ground No. 1 to 3.2 of the appeal, the assessee has raised the issue regarding non applicability of transfer pricing provisions, benchmarking analysis undertaken by the assessee and accepting the prime lending rate of State Bank of India while determining the arm's length price. Perusal of the said decision in ITA No.649/M/2011 for A.Y. 2011-12 (supra) reveals that the Tribunal has decided the identical issue in favour of the assessee holding that FMO is not an associate enterprise of the assessee and therefore the transfer pricing provisions are not applicable. The relevant operative portion of the order of the coordinate Bench for the AY 2011-12 is extracted below:

> *"11. A careful reading of section 92A makes it clear that basic rule for treating the enterprises as AE is set out in Section 92A(1). Section 92A(1) lays down the basic rule that in order to treat an entity as associated enterprise, one enterprise, in relation to another enterprise, participate, directly or indirectly, or through one or more intermediaries, "in the management or control or capital of the other enterprise" or when "one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise". Further, careful reading of Section 92(A)(2) only prescribed the illustrations of the cases in which such an enterprise participates in management, capital or control of another enterprise. Which means that Section 92A (1) decides is the principle on the basis of which one has to examine whether or not two or more enterprise are associated enterprise or not. The principle is, as we have noted above, that one of the enterprise, in relation to other enterprise, participate, directly or indirectly, in the management or control or capital of the other enterprise and that persons who participate in such management, control or capital of both the enterprises are common. As long as an enterprise participates in any of the three aspects of the other enterprise, i.e. (a) management; (b) capital; or (c) control.*
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> *12. Hon'ble Supreme Court in Narendra Kumar Vs UOI (AIR 1989 SC 2138) while considering the meaning of Compulsory Convertible debenture('CCD') held that CCD does not postulates any repayment of principal. Therefore, it does not constitute a 'debenture' in its*

classical sense. The Hon'ble Apex Court also referred and relied the Guidelines for the 'Protection of Debenture Holders' issued on 14th January 1987, which recognised the basic distinction between convertible and non convertible debenture. On the basis of said guideline it was held that instrument which is compulsorily convertible in to shares, is regarded as "equity" and not as a 'loan' or 'debt'. Therefore, we may conclude that the CCD is not a loan and hence FMO would not fall within the definition of AE as provided in section 92A(2)(c) of the Act.

13. The coordinate bench of Hyderabad Tribunal in Adama India (P) Ltd Vs CIT [78taxmann.com 75 (Hyd)] held that CCD are not loan with the following observation:

"8. We have considered the issue and examined the rival contentions. There is no dispute with reference to the fact that the CCDs were issued in Indian Rupees. Accordingly, following the principles laid down by the Co-ordinate Benches and the Hon'ble High Court as relied on by the assessee in the submissions, we have to hold that TPO has wrongly treated the issuance of CCDs as a loan, by treating it as an external commercial borrowing, ignoring the fact that loan is a debt, whereas CCD is hybrid instrument in nature basically categorised as equity in nature. It was accepted by the Hon'ble Supreme Court in the case of Sahara India Real Estate Corpn. Ltd. (supra) while assigning the jurisdiction to SEBI as an 'equity instrument'. Further, the policy of Govt. of India and also RBI effective from 01- 04-2010 also indicate that issuance of CCD is part of FDI being quasi-equity in nature and considering the same as a loan would be completely against regulations laid by DIPB, RBI and FEMA."

14. The coordinate bench of Chennai Tribunal in Orchid Pharma Ltd. Vs DCIT while considering the definition of AE as prescribed under section 92A(1) held as under;

"14. As evident from the limited narration of facts in the said decision, the assessee-company (i.e. Page Industries Ltd; PIL in short) was "a licensee of the brand- name 'Jockey' for exclusive manufacture and marketing of goods under license agreement" but "the assessee-company owns entire manufacturing facility, capital investment of Rs.100 crores and 15000 employees" and "there is no participation of JII (i.e. Jockey International Inc., USA) in the capital and management of the assessee-company". On these facts, the coordinate bench has held that JII and PIL are not associated enterprises as there is no participation by JII in "management or capital of PIL(emphasis supplied by us)". We have our reservation,

whatever be it's worth, on the conclusions arrived at in this case but that does not dilute our highest respect for an important principles of law laid down by the coordinate bench. The reasons for this approach are as follows. The expression 'control' appearing in Section 92A(1) is very crucial and the manner in which control is exercised could go well beyond capital and management, but the coordinate bench had no occasion to deal with the "control" aspect at all. As held in the case of Diagco India (P.) Ltd. v. Dy. CIT [2011] 47 SOT 252/13 taxmann.com 62 (Mum.), even when an enterprise exercise control over the other enterprises by way of controlling the supply of raw material or use of trade marks, this also constitutes 'participation in control' leading to the status of associated enterprises under section 92A(1). It appears that this aspect of the matter has not been brought to the notice of, or pleaded before, the bench. While the conclusion arrived at by the bench clearly overlooks the specific mention of the word "control" in both limbs of the basic rule under section 92A(1) (i) as also under section 92A(1)(ii), and to that extent we are unable to concur that in the absence of participation in capital or management, two enterprises cannot be 'associated enterprises' under section 92A, what is important to us is that the coordinate bench has, inter alia, also held that, "....in order to constitute relationship of an AE, the parameters laid down in both subsections (1) and (2) should be fulfilled" and justified this approach by observing that "if we were to hold that there is a relationship of AE, once the requirements of sub-sec.(2) are fulfilled, then the provisions of subsec.(1) renders otiose or superfluous" and that "it is well settled canon interpretation of statutes that while interpreting the taxing statute, construction shall not be adopted which renders particular provision otiose". The coordinate bench then further observed that "when interpreting a provision in a taxing statute, a construction, which would preserve the purpose of the provision, must be adopted". The legal position thus summed up by the coordinate bench is that in a situation in which the conditions, with respect to a set of enterprises, set out in section 92A(1) are clearly not fulfilled, even if the conditions under one of the clauses of section 92A(2) are fulfilled, such enterprises cannot be treated as associated enterprise under section 92A. To the limited extent of the principle so laid down by the coordinate bench, we are in considered agreement with the views of the coordinate bench, and it is this principle which is relevant for the purposes of our adjudication. It does directly affect the issue in appeal before us inasmuch as we are also dealing with a situation in which admittedly words of section 92A(2)(i) are clearly satisfied on the

facts of this case, the scale of commercial relationship is so insignificant vis-à-vis total business operations of the assessee that there is admittedly no participation in control by one of the enterprise over the other enterprise so as to satisfy the mandate of Section 92A(1).

15. While dealing with this, we may also refer to some observations made by Dr Ramon Dwarkasing, an Associate Professor in Transfer Pricing at Maastricht University, the Netherlands, in his book "Associated Enterprises - A Concept Essential for Application of the Arm's Length Principle" [ISBN: 978-90-81724-0-1, published by Wolf Legal Publishers, the Netherlands @page 6], as follows:

'....in various countries, the concept of associated enterprises may even cover relationships between independent enterprises, for instance, where a foreign buyer has a strong negotiating power. For example, an Indian software company has a customer in Netherlands which is responsible for more than 90% of turnover of Indian software developer. The Dutch customer is able to dictate the prices to Indian software developer. The Indian software company is, therefore, able to charge a price with 1% margin/mark up, which is very low compared to his Indian counterparts (which apply, for instance, 6% markup).

According to the Indian transfer pricing law, if the gods or articles manufactured or processed by one enterprises, are sold to other enterprise abroad or to person specified by such other enterprise, and the prices and other conditions relating thereto are influenced by such other enterprises, the two enterprises shall be deemed to be associated enterprises [See section 92A(2)(i) of the Indian Income Tax Act, 1961].

The Indian tax authorities consider the Indian software developer and its Dutch customer to be associated. They may adjust the prices and tax an unrealized profit, i.e. difference between real results and results based on prices derived from other software developers in India. The Netherlands does not consider the companies to be associated as it applies a narrow concept that does not include "de facto control" as a criterion for association. "Control" in the absence of company law based relationship or in the absence of any formal right to exercise control can be described as "de facto" control. Participation in capital and management can be characterized as "de jure" concepts; concepts covered by company law.' [Emphasis, by underlining, supplied by us]

16. While the above observations do seem to be at variance with the plain words of the statutory provision inasmuch as it refers to influence by way of "strong negotiating power" rather than an

influence simplictor- as is the apparent scheme of the statutory provision, what is immediately discernible from the above extracts is that the 'de facto' control is the foundation of the wider approach to the concept of 'associated enterprises, and, of course, the impression that one of the ways in which use of expression 'influence', in concept of associated enterprises under the transfer pricing, can be rationalized is as dominant influence in the nature of de facto control. The definition of 'associated enterprise', as the above academic analysis shows, has two approaches- wider approach and narrow approach. A narrow approach to the concept of associated enterprises takes into account only "de jure" association i.e. though formal participation in the capital or participation in the management. A wider approach to the concept of 'associated enterprises' takes into account not only the de jure relationships but also de facto control, in the absence of participation in capital or participation in management, through other modes of control such as commercial relationships in which one has dominant influence over the other. This wider concept is clearly discernible from the principles underlying approach to the definition of 'associated enterprises' in the tax treaties and has also been adopted by the transfer pricing legislation in India in an unambiguous manner. There is no other justification in the Indian transfer pricing legislation, except the participation in capital of an enterprise, management of an enterprise or control of an enterprise, which can lead to the relationship between enterprise being treated as 'associated enterprises'. What essentially follows is that clause (i) of Section 92A(2) has, at its conceptual foundation, de facto control by one of the enterprise over the other enterprise, on account of commercial relationship of its buying the products, either on his own or through any nominated entities, from such other enterprise and in a situation in which it can influence the prices and other related conditions. The wordings of clause (i), however, do not reflect this position in an unambiguous manner inasmuch as it does not set out a threshold of activity, giving de facto control to the other enterprise engaged in such commercial activity, in percentage terms or otherwise- as is set out in clause (g) and (h) or, for that purpose, in all other operative clauses of Section 92A(2). If the words of this clause are to be interpreted literally, as the authorities below have read, even if there is one isolated transaction with an enterprise in such an enterprise can influence the prices, such an enterprise is to be treated as an associated enterprise- whether or not this commercial relationship amounts to control on the other enterprise. That will clearly be an incongruous result. However, as Section

92A(2)(i) is to be read along with Section 92(A)(1), in such a situation in which an enterprise does not participate in (a) capital, (b) management, or (c) control of other enterprise, and thus does not fulfil the basic rule under section 92A(1), even if the conditions of Section 92A(2)(i) are fulfilled, these enterprise cannot be treated as 'associated enterprise'. In the case before us, it is not even the case of the revenue that the assessee has any participation in management or capital of the other enterprise, nor there is anything to even remotely indicate, much less establish, that one of the enterprise, by way of this commercial relationship, participates in control over the other enterprise. Viewed thus, Northstar, even if it is assumed that it can influence prices and other conditions relating to sale, cannot be treated as associated enterprise of the assessee before us. It is also important to bear in mind the fact that given the context in which the expression "prices and other conditions relating thereto are influenced by such other enterprise" appears in Section 92A(2)(i), this influence has to be something more than influence in the ordinary course of business and in the process of negotiation, because, even in the course of ordinary every business and in the course of day to day negotiation, selling prices as also conditions of sale are invariably, in a way, influenced by the buyer. Therefore, even when a customer offers terms to someone with a 'take it or leave it' message, such an approach, by itself, cannot be termed as 'influence', for our purposes, unless the seller is in such a position and under such an influence that he has to simply accept the dictated terms. Any other view of the matter will result in all the enterprises dealing with each other as every party to a transaction has an influence over the price and conditions relating to the sale, and will lead to a situation in which all the enterprises dealing with each other on negotiated prices will have to be as associated enterprises. That again is a clearly absurd and unintended result, and it is only elementary that law is to be interpreted in such a manner as to make it workable rather than redundant. This principle is expressed in the latin maxim "ut res magis valeat quam pereat. Explaining this principle, Hon'ble Supreme Court has, in the case of CIT v. Hindustan Bulk Carriers [2003] 259 ITR 449/126 Taxman 321 (SC), has observed that "A construction which reduces the statute to a futility has to be avoided" and that "A statute or any enacting provision therein must be so construed as to make it effective and operative on the principle expressed in maxim utres magis valeat quam pereat i.e., a liberal construction should be put upon written instruments, so as to uphold them, if possible, and carry into effect the intention of the parties. [See Broom's Legal

Maxims (10th Edition), p. 361, Craies on Statutes (7th Edition) p. 95 and Maxwell on Statutes (11th Edition) p. 221.]" It is, therefore, important that the expression 'influence' is given a sensible meaning so as to make the provisions of Section 92A(2)(i) workable rather than adopting a literal meaning which will lead to wholly incongruous results.

17. Viewed in this perspective, we must adopt a sensible meaning of expression 'influence' which advances the scheme of the transfer pricing provisions rather than making these provisions unworkable. That meaning had to be a dominant influence which leads to de facto control over the other enterprise rather than an influence simplictor. If we are to adopt literal meaning of influence, as has been adopted by the authorities below, all the transactions on negotiated prices will be hit by the provisions of Section 92A(2)(i). In the light of the discussions above, the expression 'influence', in the present context, must remain confined to dominant influence which amounts to de facto control. Acceptance of terms of the buyer on commercial considerations, as in this case, cannot be treated as influence of the buyer. It is a commercial decision whether to accept the terms of the buyer, with respect to the price or related conditions, or not. It becomes influence, for the purpose of Section 92A(2)(i), when the seller is placed in such a situation that he has no choice, because of buyer's dominant influence, but to accept it. It is thus clear that context in which a reference is made to the expression 'influence' in section 92A(2)(i) requires this expression to be read as a dominant influence in the sense of control by one enterprise over the other. Given the fact that the assessee's exports through the distribution part constitutes less than 5% of its entire exports, and less than 6% of its entire sales, Northstar is certainly not in a position to exercise any dominant influence, over the assessee. The assessee's decision to accept the terms set out by Northstar, even if that be so, may be justified on account of commercial expediencies or warranted by business exigencies or may simply be compulsion of this somewhat unique and complex business model, but it cannot, by any stretch of logic, be on account of dominant influence of Northstar as a customer. It may even be a sound business strategy to accept a rather passive and back seat role, if one can term it that way, in day to day decision making under this business model, but cannot be on account of dominant influence that Northstar exercises on buying of products from the assessee. The influence of Northstar, given the scale of business through Norrthstar as a distribution part, is too modest to make it a dominant influence in the nature of control. In this view of the

matter, as also bearing in mind the earlier discussions on the issue, the assessee and Northstar cannot be treated as 'associated enterprises' under section 92 A. We uphold the plea of the assessee.

15. Therefore, in view of above legal and factual discussion, we find force in the submissions of the ld AR for the assessee that the CCD not a loan and moreover, the Foreign entity namely "Netherlands Development Finance Company" called Nederlandse Financierings– Maatschappij Voor Ontwikkelingslanden N.V. ("FMO") would not fall within the definition of AE as provided in section 92A(2)(c) of the Act. And therefore, no reference for computation of ALP before the TPO was required.

16. The TPO has not brought on record any material on record to treat the FMO as AE of assessee. The TPO without discussing the legal issues raised by the assessee concluded that Article 9 of Netherlands India Double Taxation Avoidance Agreement (DTAA) is unfounded and the transfer pricing provisions are to be governed by the domestic law of a country. In our view the conclusion arrived by ld. TPO is unfounded, when the FMO is not AE of the assessee.

17. Therefore, in view of our detailed discussion as referred above, we are of the view that the foreign entity i.e. FMO is not AE of the assessee as there in no participation, directly or indirectly, in the management or control or in capital of the each other enterprise and in management, control or capital are common and hence, no reference for computation of ALP was warranted. Hence, the grounds No. 1 of the appeal of the assessee is allowed. As we have allowed ground No.1 of the appeal and held that FMO is not AE of assessee, therefore, discussion on merit raised in ground No. 2 and 3 related with the adjustment of ALP has become academic."

We therefore respectfully following the order of tribunal and maintaining consistency therewith allow the appeal of the assessee by holding that FMO is not an associate enterprise. The ground no. 1 raised by the assessee is allowed.

7. Since we have decided the issue in ground no. 1 in favour of the assessee by holding that FMO is not an associate enterprise of the assessee, the other issues raised by the assessee on merits are rendered academic and need not to be adjudicated.

8. In the result, appeal of the assessee is allowed."

7. We further notice that the coordinate Bench has decided the identical issue in the assessee's own case for the AY 2012-13 by following the decision of the coordinate Bench for the AY 2011-12. Since, there is no change of facts in

the present case and since the issues raised by the assessee in the present appeal are identical to the issues raised in assessee's case for the AY 2011-12 and 2012-13 discussed above, we do not find any reason to deviate from the view already taken by the coordinate Bench in assessee's own appeals. Hence, respectfully following the decisions of the coordinate Bench, we allow Ground No. 1 of the appeal in favour of the assessee. Since, we have decided ground No. 1 in favour of the assessee by holding that FMO is not an associated enterprises of the assessee the other issues raised by the assessee on merits have become academic. Hence, the said issues do not require adjudication.

In the result, appeal filed by the assessee for assessment year 2013-2014 is allowed.

Order pronounced in the open court on 12th July, 2019.

Sd/-	*Sd/-*
(SHAMIM YAHYA)	(RAM LAL NEGI)
ACCOUNTANT MEMBER	JUDICIAL MEMBER

मुंबई Mumbai; दिनांक Dated: 12/07/2019

Alindra, PS

आदेश प्रतिलिपि अग्रेषित/Copy of the Order forwarded to :

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent.
3. आयकर आयुक्त(अपील) / The CIT(A)-
4. आयकर आयुक्त / CIT
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, मुंबई / DR, ITAT, Mumbai
6. गार्ड फाईल / Guard file.

आदेशानुसार/ BY ORDER,

सत्यापित प्रति //True Copy//

उप/सहायक पंजीकार (Dy./Asstt. Registrar)

आयकर अपीलीय अधिकरण, मुंबई **/ ITAT, Mumbai**