

आयकर अपीलीय अधिकरण, 'डी' न्यायपीठ, चेन्नई

IN THE INCOME TAX APPELLATE TRIBUNAL

'D' BENCH, CHENNAI

श्री एन.आर.एस. गणेशन, न्यायिक सदस्य एवं
श्री ए. मोहन अलंकामणी, लेखा सदस्य केसमक्ष

BEFORE SHRI N.R.S. GANESAN, JUDICIAL MEMBER AND
SHRI A. MOHAN ALANKAMONY, ACCOUNTANT MEMBER

आयकर अपील सं./ITA No.458/Mds/2016

निर्धारण वर्ष / Assessment Year : 2011-12

M/s TVS Logistics Services Ltd.,
7-B, TVS Building, West Veli Street,
Madurai – 625 001.

v. The Deputy Commissioner of
Income Tax,
Corporate Circle – 2,
Madurai.

PAN : AACCT 1412 E

(अपीलार्थी/Appellant)

(प्रत्यर्थी/Respondent)

अपीलार्थी की ओर से/Appellant by : Shri M. Viswanathan, CA

प्रत्यर्थी की ओर से/Respondent by : Smt. Vijayalakshmi , CIT

सुनवाई की तारीख/Date of Hearing : 09.05.2016

घोषणा की तारीख/Date of Pronouncement : 09.06.2016

आदेश /ORDER

PER N.R.S. GANESAN, JUDICIAL MEMBER:

This appeal of the assessee is directed against the order of the Assessing Officer consequent to the direction of the Dispute Resolution Panel dated 21.12.2015, and pertains to assessment year 2011-12.

2. The first issue arises for consideration is determination of arm's length price with regard to commission for Corporate Guarantee given by the assessee to its Associate Enterprises.

3. Shri M. Viswanathan, the Ld. representative for the assessee, submitted that the assessee-company is a subsidiary of T.V. Sundaram Iyengar & Sons Limited. According to the Ld. representative, the assessee-company advanced a sum of ₹44,41,750/- to its Associate Enterprise M/s TVS Americas Inc. USA without charging any interest. Similarly, ₹14 Crores was advanced to M/s TVS Logistics Investment UK Limited without charging any interest. Another sum of ₹21 Crores was advanced to M/s TVS Logistics Investments USA Inc. and no fee/interest was charged. According to the Ld. representative, the assessee-company is the ultimate authority to decide to expand its business in other countries. Therefore, the assessee-company is under the obligation to advance money to its Associate Enterprises for business expansion. The Ld. representative further clarified that the advances made to Associate Enterprises were not from borrowing. According to the Ld. representative, the assessee had surplus funds in the form of equity capital raised through issuance of share to

Private Equity Investors. The Ld. representative further submitted that the assessee utilised the funds only for the purpose of expansion of its business through inorganic growth irrespective of the geographical boundaries. Therefore, adoption of LIBOR rate of interest is not warranted.

4. On the contrary, Smt. Vijayalakshmi, the Ld. Departmental Representative, submitted that the assessee made interest-free advances to its Associate Enterprises and claimed before the authorities below that it is an activity of shareholder to advance funds to its subsidiary companies. According to the Ld. D.R., when the assessee advanced funds to its Associate Enterprises outside the country and admittedly paid ₹10.05 Crores towards interest on the borrowed loan, naturally, the profit of the assessee-company to the extent of payment of interest is reduced and the profit was shifted to outside the jurisdiction of the country. Therefore, according to the Ld. D.R., the Assessing Officer has rightly found that the advancement of interest-free loan to its Associate Enterprises outside the country is for reducing/shifting the taxable profit in India. Accordingly, the Transfer Pricing Officer computed the interest at LIBOR rate on the advance made to its Associate

Enterprises. The Dispute Resolution Panel, after examining the facts of the case, including the payment of interest to the extent of ₹10.05 Crores, found that the TPO computed the interest by using CUP method / Yield Approach method. According to the Ld. D.R., the DRP has rightly confirmed the order of the Transfer Pricing Officer.

5. We have considered the rival submissions on either side and perused the relevant material available on record. It is not in dispute that the assessee advanced interest-free loan / advance to its Associate Enterprises outside the country. It is also not in dispute that the assessee has not charged any interest on the loan given to its Associate Enterprises. The assessee claims before this Tribunal that the borrowed funds were not diverted for making advance to its Associate Enterprises. The assessee contends that it had surplus funds in the form of equity capital raised through issuance of share to Private Equity Investors. As per the shareholding arrangement, the assessee claimed before the lower authorities that the surplus funds in the form of equity capital raised has to be applied only for the purpose of expansion of its business through inorganic growth irrespective of geographical boundaries.

Section 92 of the Income-tax Act, 1961 (in short 'the Act') provides for computation of income from international transaction having regard to arm's length price. The object of determination of arm's length price is to prevent the assessee from shifting the profit from one taxable jurisdiction to other taxable jurisdiction. In this case, the assessee advanced funds to its Associate Enterprises and claiming before this Tribunal that it is mandatory for the assessee to advance for its expansion of business as per the shareholding arrangement in the form of equity capital raised. There may be an obligation, being shareholder of the Associate Enterprises, to advance money for expansion of its business. The question arises for consideration is when the assessee advanced funds to its Associate Enterprises in foreign country, from the equity capital raised and borrowed funds for its business in India and paid interest to the extent of ₹10.05 Crores, whether the profit of the assessee-company was shifted outside India so as to reduce tax burden in India? This Tribunal is of the considered opinion that the equity shares raised by the assessee is only for the purpose of expansion of its business and there is no compulsion for the assessee to utilize the funds raised in the form of equity capital in India. In other words, the funds raised from equity capital can also be utilized outside India since no cost

involved in such capital. There is no prohibition for expanding the assessee's business outside India by investing its own funds outside India after observing necessary formalities. However, when the assessee borrowed funds in India and paid interest to the extent of ₹10.05 Crores in India, investment of funds outside India would naturally reduce the tax liability in India. Therefore, this Tribunal is of the considered opinion that this is a method adopted by the assessee to reduce the tax burden in India by paying interest to the extent of ₹10.05 Crores on the borrowed funds. If the equity capital funds raised from its shareholders are not diverted to its Associate Enterprises outside India, there may not be any necessity for the assessee to borrow funds and pay interest of ₹10.05 Crores on the borrowed funds. From the material available on record, it is obvious that just to shift the profit outside India and reduce the tax liability in India, the assessee diverted its funds raised through equity capital outside India, and borrowed funds in India. Had the assessee used the equity capital in India, there is no necessity to borrow funds in India and pay interest to the extent of ₹10.05 Crores. In such a situation, the profit of the assessee will increase to the extent of ₹10.05 Crores in India and the assessee is liable to pay tax on that.

6. Now, by diverting the equity capital raised to its Associate Enterprises, the assessee is claiming the payment of interest on the borrowed funds to the extent of ₹10.05 Crores as expenditure. Therefore, this Tribunal is of the considered opinion that it is an attempt on the part of the assessee to reduce the tax burden to that extent. Therefore, this Tribunal is of the considered opinion that interest on the funds advanced to Associate Enterprise outside India has to be computed on notional basis by applying LIBOR rate. LIBOR is one of the internationally accepted rates for the loan advanced in the international market. Therefore, the TPO has rightly determined the arm's length price for the advance made by the assessee to its Associate Enterprises by adopting LIBOR rate of interest. Therefore, this Tribunal do not find any reason to interfere with the order of the lower authority and accordingly the same is confirmed.

7. The next issue arises for consideration is with regard to Corporate Guarantee given by the assessee to its Associate Enterprises.

8. Shri M. Viswanathan, the Ld. representative for the assessee, submitted that the assessee has provided a Corporate

Guarantee of approximately ₹14 Crores in favour of Multipart Solutions Limited, UK, a wholly owned subsidiary company of the assessee. According to the Ld. representative, the guarantee was for a bridge loan obtained by Multipart Solutions Limited from Export & Import Bank. The loan was obtained by the Multipart Solutions Limited, UK for meeting its working capital requirements. For providing the guarantee, according to the Ld. representative, the assessee has not charged any fee. Since the guarantee was provided to its Associate Enterprise, the assessee-company believed that the transaction was at arm's length as provided in Section 94C of the Act. The Ld. representative further submitted that providing guarantee to its Associate Enterprise does not involve any cost to the assessee, therefore, according to the Ld. representative, it has no bearing on profit, income, loss or asset of the assessee. Therefore, according to the Ld. representative, such guarantee is outside the ambit of international transaction. The Ld. representative placed his reliance on the decision of this Tribunal in *Redington (India) Limited v. ACIT (2015) 42 ITR (Trib) 408*.

9. On the contrary, Smt. Vijayalakshmi, the Ld. Departmental Representative, submitted that the Transfer Pricing Officer found

that the assessee gave a Corporate Guarantee in favour of TVS Logistics Investments UK limited. The said guarantee, however, was not outstanding at the end of the relevant financial year. According to the Ld. D.R., the acceptance of the guarantee does not result in implicit support to the recipient entity. According to the Ld. D.R., the Transfer Pricing Officer further found that interest received could be an appropriate way of determining the appropriate fee for guarantee. The Ld. D.R. further submitted that by giving a bank guarantee to its Associate Enterprise, the assessee-company is inviting a risk by itself. If the Associate Enterprise fails to repay the loan borrowed on the basis of Corporate Guarantee given by the assessee, then the assessee has to naturally repay the loan. In that case, the profit of the assessee and tax thereto will be shifted to outside the jurisdiction of the country. The Ld. D.R. further submitted that guarantee to the banker in most cases result in a loan with lower rate of interest. Therefore, according to the Ld. D.R., there is a cost saving to the group concern which would reflect in the books of account as well. The Ld. D.R. further submitted that the decision of this Tribunal in Redington (India) Limited (supra) has not reached finality and the matter is pending before the High Court. Moreover, the opinion of this Tribunal and various Benches of the

Tribunal are equally divided. Therefore, the DRP found that the benefit accrued to the Associate Enterprises because of the guarantee given by the assessee has to be estimated by applying LIBOR rate of interest. Accordingly, the DRP has rightly confirmed the decision of the Transfer Pricing Officer.

10. We have considered the rival submissions on either side and perused the relevant material available on record. It is not in dispute that the assessee has offered Corporate Guarantee to its Associate Enterprises at UK. An identical fact was considered by this Tribunal in Redington (India) Limited (supra). This Tribunal, after considering the decision of Delhi Bench of this Tribunal in Bharati Airtel Ltd. v. Addl. CIT (2004) 43 taxmann.com 150 found that the Corporate Guarantee given by the assessee to its Associate Enterprise does not involve any cost to the assessee, therefore, it was outside the ambit of international transaction. In view of this decision co-ordinate Bench of this Tribunal on identical set of facts in respect of similar Corporate Guarantee, this Tribunal is of the considered opinion that determination of arm's length price may not be necessary. Mere pendency of appeal against the decision of this Tribunal in Redington (India) Limited (supra) cannot

be a reason to take a different view. Unless and until order of this Tribunal is reversed by the Madras High Court in Redington (India) Ltd., the authorities below cannot take a different view on the subject. Therefore, by following the decision of co-ordinate Bench of this Tribunal in Redington (India) Ltd. (supra), the orders of the lower authorities are set aside. The adjustment made by the Transfer Pricing Officer as confirmed by the Dispute Resolution Panel is not justified. Accordingly, the addition made by the Transfer Pricing Officer is deleted.

11. The next ground of appeal is with regard to disallowance made under Section 14A of the Act.

12. Shri M. Viswanathan, the Ld. representative for the assessee, submitted that Section 14A of the Act would come into operation in case there is no income exempted from taxation was earned. In the case on hand, according to the Ld. representative, the assessee has not received any dividend for the year under consideration, therefore, no income was earned by the assessee which does not form part of the total income. Therefore, the provisions of Section 14A of the Act are not applicable at all. The Ld. representative further submitted that the investment was made

by the assessee in the Associate Enterprise, therefore, the dividend income earned from the Associate Enterprise are taxable in India. Hence, the DRP is not justified in confirming the order of the Transfer Pricing Officer.

13. On the contrary, Smt. Vijayalakshmi, the Ld. Departmental Representative, submitted that the assessee has not maintained any separate books of account with regard to investment from which the income was earned. The claim of the assessee before the lower authorities appears to be that no expenditure was incurred for the investment made for earning the tax-free dividend income. The assessee has also claimed that no income exempted from taxation was earned by the assessee. The Ld. D.R. further submitted that it is an admitted fact that the assessee borrowed loan for the business and paid interest to the extent of ₹10.05 Crores during the year under consideration. The investment decision was taken by the top most executives of the company and the investment was managed by its key management personnel and executives. The corporate structure itself requires an administrative establishment, which requires incurring of multifarious expenses including establishment, general and administrative expenses. The decision on investment

and how and where to be invested need considerable time and expertise. Therefore, the decision taken at the high level of the corporate entity involves time and cost. Hence, it is not correct to say that no expenditure was incurred.

14. Referring to Section 14A of the Act, the Ld. Departmental Representative pointed out that the assessee was expected to maintain books of account with regard to investment made. Since the assessee has not maintained any books, the assessee cannot say that no expenditure was incurred. The administrative and establishment expenses cannot be ruled out for taking decision on investment and maintaining the investment portfolio. Therefore, according to the Ld. D.R., the Transfer Pricing Officer has rightly disallowed the expenditure for earning the exempted income.

15. We have considered the rival submissions on either side and perused the relevant material available on record. The assessee claims that major portion of investment was made in the Associate Enterprise outside the country. The assessee also claims that no expenditure was incurred for making the investment. The assessee has also claimed that if at all any income was generated on the investment made outside the country in Associate Enterprise that

would be taxable in the hands of the assessee. Therefore, there is no question of applying provisions of Section 14A of the Act. The fact remains that the assessee has not maintained any separate books of account for the investment made by the assessee. Even though the assessee claims that major investment was made in Associate Enterprise, no details of such investment are available on record. Therefore, the claim of the assessee that major investment was made in Associate Enterprise is not substantiated. The fact remains that the assessee has made investment in the Associate Enterprise and it is also an admitted fact that the assessee has paid interest to the extent of ₹10.05 Crores on the loan borrowed for the business. In the absence of any direct link between the payment of interest and the income earned by the assessee, this Tribunal is of the considered opinion that the provisions of second and third limb of Rule 8D(2) of the Income-tax Rules, 1962 have to be applied. In other words, the average of the amount as computed under second and third limbs of Rule 8D(2) has to be notionally taken for the purpose of disallowing the expenditure. In the absence of any other details, the DRP has rightly found that disallowance has to be made by applying Rule 8(2) of Income-tax Rules, 1962. Therefore, we

find no infirmity in the order of the lower authority and accordingly the same is confirmed.

16. The last issue arises for consideration is with regard to Letter of Comfort issued by the assessee-company to its Associate Enterprise.

17. Shri M. Viswanathan, the Ld. representative for the assessee, submitted that a Letter of Comfort was issued by the assessee-company as a procedural formality to be complied with by wholly owning shareholder to enable the subsidiary company to borrow funds from banks. According to the Ld. representative, the assessee has not derived any benefit out of this Letter of Comfort. In the absence of any benefit derived from Letter of Comfort, there is no justification for imputing the recovery charges of 1% on the amount generated along with incidental charges incurred by the assessee for issuing the Letter of Comfort as part of procedural compliance. According to the Ld. representative, it is obligation on the part of the assessee to give the Letter of Comfort to its Associate Enterprise so that the Associate Enterprise was able to borrow funds comfortably from financial institutions. The Ld. representative submitted that there is no element of profit involved

in giving the Letter of Comfort, therefore, it cannot be a subject matter of international transaction.

18. On the contrary, Smt. Vijayalakshmi, the Ld. Departmental Representative, submitted that the Transfer Pricing Officer made adjustment in respect of the payment actually made by the assessee. The notional adjustment was made to the extent of ₹21 lakhs which is for the risk taken by the assessee in respect of the loan availed by the Associate Enterprise. According to the Ld. D.R., by giving Letter of Comfort, the assessee exposed to the risk of the Associate Enterprise and the assessee itself is taking over the risk of Associate Enterprise. For taking risk, the assessee has provided Letter of Comfort to its Associate Enterprise so that the Associate Enterprise may get monetary benefit by way of loan from financial institutions. Therefore, the Transfer Pricing Officer has rightly computed the arm's length price by taking into consideration the actual payment made by the assessee close to 1% of the guarantee. The DRP has rightly found that the method adopted by the TPO is more appropriate.

19. We have considered the rival submissions on either side and perused the relevant material available on record. Letter of Comfort

is nothing but a guarantee given by the assessee-company to its Associate Enterprise to avail loan from financial institutions so as to enable the Associate Enterprise to avail loan facility. As rightly submitted by the Ld. D.R., by giving such loan, the assessee exposed itself to the risk of repaying the loan availed by the Associate Enterprise. This said Letter of Comfort is almost a guarantee given by the assessee to its Associate Enterprise. As found by this Tribunal in Redington (India) Limited (supra), by giving such a guarantee or Letter of Comfort by the assessee-company, it does not involve any cost to the assessee, therefore, it is outside the ambit of international transaction. By following the order of this Tribunal in Redington (India) Limited (supra) and for the reason stated therein, this Tribunal is of the considered opinion that there may not be any need to make any adjustment in respect of Letter of Comfort. Accordingly, the orders of the lower authorities are set aside and the Assessing Officer is directed to delete the addition made with regard to Letter of Comfort on notional basis.

20. In the result, the appeal of the assessee is partly allowed.

Order pronounced on 9th June, 2016 at Chennai.

sd/-

(ए. मोहन अलंकामणी)

(A. Mohan Alankamony)

लेखा सदस्य/Accountant Member

sd/-

(एन.आर.एस. गणेशन)

(N.R.S. Ganesan)

न्यायिक सदस्य/Judicial Member

चेन्नई/Chennai,

दिनांक/Dated, the 9th June, 2016.

Kri.

आदेश की प्रतिलिपि अग्रेषित/Copy to:

1. अपीलार्थी/Appellant
2. प्रत्यर्थी/Respondent
3. The Secretary, DRP-2, Bengaluru
4. Transfer Pricing Officer – 3, Chennai
5. विभागीय प्रतिनिधि/DR
6. गार्ड फाईल/GF.