Different transfer pricing method no ground for penalty: Income Tax Appellate Tribunal

In a first of its kind ruling on transfer pricing, a Mumbai bench of Income Tax Appellate Tribunal said that the I-T department cannot levy penalty on charges of concealment of income merely because it does not agree with the method adopted by the taxpayer to compute its income arising from cross-border transactions with related parties.

The department had levied penalty after rejecting the method, Transactional Net Margin Method (TNMM), adopted by the taxpayer company RBS Equities, formerly ABN Amro Asia Equities, in transfer pricing returns. TNMM is one of the five methods prescribed under transfer pricing rules of the I-T Act for computing income from cross-border transactions.

Instead of TNMM, the department adopted Comparable Uncontrolled Price (CUP), another method permissible under the TP Rules and said that the company was liable to pay penalty as it had concealed income. The ITAT held that a different method adopted by the taxpayer cannot be construed as evidence to prove that the taxpayer had a motive to conceal income. Under provisions of the I-T Act, penalty is levied at the rate of 100-300 % of the income sought to be concealed.

Transfer pricing rules are part of the I-T Act, put in place with a view to check loss of revenue to the government while computing income arising from cross-border transactions with associated enterprises.

The assessing officer rejected TNMM and applied CUP which, he said, is an easier and more transparent method than TNMM. The CUP method involves comparison of prices at which goods and services are offered to associated enterprises as well as non-associated enterprises.

The company had claimed that it was not possible to adopt the CUP method as it was not possible to compare the services provided to AE that do not involve marketing and other costs and the services provided to non-associate enterprises which involve these costs.

The taxpayer company had provided stock broking services to some of its associated enterprises as well as third parties during 2004-05. The grounds on which TNMM was rejected is a reasonably debatable aspect of the assessment and therefore lack of good faith and due diligence, two important conditions for levying penalty, cannot be inferred, the ITAT observed.

Vispi T Patel of Vispi T Patel & Associates told ET: "Penalty can be levied only if the taxpayer fails to establish that the prices charged and paid in cross-border transactions are computed in accordance with provisions of TP Rules."

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