

## **Transfer pricing rules do not apply if dealing doesn't lead to income rise'**

A recent ruling by a Hyderabad income tax court that an investment by an Indian company in its foreign subsidiary can't be taxed locally has come as a boost to India Inc's arguments that transfer pricing rules are not applicable to transactions that do not lead to a rise in income.

A host of Indian companies, led by the Tatas and Birla-owned Hindalco, are facing transfer pricing-based tax demand for giving loan guarantees to their foreign subsidiaries for acquisitions abroad and investments in foreign arms. Besides, many global companies like Shell are also fighting the department's argument that shares issued by local subsidiaries at a lower valuation should be taxed in India.

The order dated May 31 was in the case of Vijay Electricals that was slapped a tax demand notice for investing ~21 crore in three subsidiaries abroad. The department called the investments an "international transaction."

Tax lawyers say this ruling assumes significance in view of the recent controversy following the department's action in several cases on the issue of fresh shares by Indian subsidiaries to their parents abroad, seeking to tax the differential amount and/or notional interest thereon in the hands of the company issuing the shares.

"The tribunal has reaffirmed an important principle that only transactions which give rise to some income are subject to transfer pricing provisions. If this principle is followed, transfer pricing should not apply to a fresh issue of shares to an associated enterprises, as no income arises from such an issue of shares," according to tax advisory firm BMR Advisor's communication to its clients.

During the hearing before the tribunal, the company argued since the investment in a foreign subsidiary is not an global transaction by Section 92B of the Act, there was no requirement of filing a separate report to the department. It argued the transfer pricing provisions applied when there was income chargeable to tax arising from the transaction, which was not the case.

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