

ITEM NO.1

COURT NO.1

SECTION IIIA

S U P R E M E C O U R T O F I N D I A
R E C O R D O F P R O C E E D I N G S

Petition(s) for Special Leave to Appeal (Civil) No(s).18121/2007

(From the judgement and order dated 12/01/2007 in WP No.2111/2006
of The HIGH COURT OF DELHI AT N. DELHI)

COMMR.OF INCOME TAX-IV, DELHI & ANR.

Petitioner(s)

VERSUS

M/S GLAXO SMITHKLINE ASIA(P) LTD.

Respondent(s)

(With prayer for interim relief and office report)
[For Final Disposal]

Date: 26/10/2010 This Petition was called on for hearing today.

CORAM:

HON'BLE THE CHIEF JUSTICE
HON'BLE MR. JUSTICE K.S. RADHAKRISHNAN
HON'BLE MR. JUSTICE SWATANTER KUMAR

For Petitioner(s) Mr. Gopal Subramaniam,SG.
Mr. V. Shekhar,Sr.Adv.
Mr. Arijit Prasad,Adv.
Ms. Pia Singh,Adv.
Mr. Tanmay Mehta,Adv.
Mr. H. Raghavendra Rao,Adv.
Mr. B.V. Balaram Das,Adv.

For Respondent(s) Mr. Ajay Vohra,Adv.
Ms. Kavita Jha,Adv.

UPON hearing counsel the Court made the following
O R D E R

In this special leave petition, the key question which arose for determination before the Authorities below was, whether the assessee-Company and it's service provider [GSKCH] are related Companies in terms of Section 40A(2) of the Income - Tax Act, 1961? If the answer to the said question was to be in the affirmative, then the next question on merits which arose for determination was, whether allocation of cross-

charges by the assessee was the correct test applied by the assessee? In other words, whether allocation of cross-charges should be allowed or disallowed by the Department?

The Authorities below have recorded a concurrent finding that the said two Companies are not related Companies under the said section. Being aggrieved by the said decision, the matter has come to this Court by way of special leave petition filed at the instance of the Department. In this special leave petition, we are concerned with Assessment Year 2001-2002.

Having gone through the relevant material placed before us concerning Assessment Year 2001- 2002, we are of the view that, as far as this special leave petition is concerned, no interference is called for as the entire exercise is a revenue neutral exercise. Hence, this special leave petition filed by the Department stands dismissed.

However, we may clarify that proceedings are pending even today at various stages for different assessment years before the Authorities under the Income Tax Act. We express no opinion with regard to those proceedings. However, we direct the Authorities to examine as to whether there is any loss of revenue in any of the assessment years in question. If, however, the Authorities find that the exercise is a revenue neutral exercise, then the matter may be decided accordingly. We say no more in that regard.

However, a larger issue is involved in this case. The main issue which needs to be addressed is, whether Transfer Pricing Regulations should be limited to cross-border transactions or whether the Transfer Pricing Regulations be extended to domestic transactions? In the case of domestic transactions, the under-invoicing of sales and over-invoicing of expenses ordinarily will be revenue neutral in nature, except in two circumstances having tax arbitrage—

[i] If one of the related Companies is loss making and the other is profit making and profit is shifted to the loss making concern; and

[ii] If there are different rates for two related units [on account of different status, area based incentives, nature of activity, etc.] and if profit is diverted towards the unit on the lower side of tax arbitrage. For example, sale of goods or services from non-SEZ area [taxable division] to SEZ unit [non-taxable unit] at a price below the market price so that taxable division will have less profit taxable and non-taxable division will have a higher profit exemption.

All these complications arise in cases where fair market value is required to be assigned to the transactions between related parties in terms of Section 40A(2) of the Income Tax Act, 1961 [‘Act’, for short]. To get over this situation, we are of the view that the matter needs to be examined by Central Board of Direct Taxes [‘CBDT’, for short]. We are informed that the matter has been examined by CBDT and it is of the view that amendments would be required to the provisions of the Act if such Transfer Pricing Regulations are required to be applied to domestic transactions between related parties under Section 40A(2) of the Act.

In order to reduce litigation, we are of the view that certain provisions of the Act, like Section 40A(2) and Section 80IA(10), need to be amended empowering the Assessing Officer to make adjustments to the income declared by the assessee having regard to the fair market value of the transactions between the related parties. The Assessing Officer may thereafter apply any of the generally accepted methods of determination of arm's length price, including the methods provided under Transfer Pricing Regulations. However, in number of matters, we find that, many a times, the Assessing Officer is constrained by non-maintenance of relevant documents by the taxpayers as, currently, there is no specific requirement for maintenance of documents or getting specific transfer pricing audit done by the taxpayers in respect of domestic transactions between the related parties. One of the suggestions which needs consideration is whether the law should be amended to make it compulsory for the taxpayer to maintain Books of Accounts and other documents on the lines prescribed under Rule 10D of the Income - Tax Rules in respect of such domestic transactions and whether the taxpayer should obtain an audit report from his Chartered Accountant so that the taxpayer maintains proper documents and requisite Books of Accounts reflecting the transactions between related entities as at arm's length price based on generally accepted methods specified under the Transfer Pricing Regulations? Normally, this Court does not make recommendations or suggestions. However, as stated above, in order to reduce litigation occurring in complicated matters, we are of the view that the question of amendment, as indicated above, may require consideration expeditiously by the Ministry of Finance. In the meantime, CBDT may also consider issuing appropriate instructions in that regard. Accordingly, we direct the Registry to forward copies of this Order both to the Ministry of Finance and CBDT for consideration.

[T.I. Rajput]
A.R.-cum-P.S.

[Madhu Saxena]
Assistant Registrar