

**Supreme Court held that determination of arm's length price ('ALP'), which is not in accordance with the guidelines stipulated in the Act and the Rules would be perverse and therefore, can be challenged before the High Court**

### Brief Background

The Bangalore Tribunal in the appeal filed by Sap Labs India Pvt. Ltd. ("the assessee") had held that while selecting the comparable companies, all the companies which had earned profits of less than 6% should be excluded. Against this order of the Tribunal, the assessee filed an appeal before the Karnataka High Court.

The Karnataka High Court dismissed the appeal of the assessee by holding that transfer pricing issues decided by the Tribunal are questions of facts and no substantial question of law arises under section 260A of the Act. No appeal can be filed before the High Court unless the taxpayer pleads or demonstrates that the order passed by the Tribunal was perverse. The Karnataka High Court, while deciding the appeal of the assessee relied on another decision of Karnataka High Court in the case of PCIT vs. Softbrands India (P.) Ltd. (406 ITR 513), wherein it was held that the Tribunal is the final fact-finding authority on determining the ALP. Once the Tribunal determines the ALP the same cannot be subject to further appeal before the High Court. Appropriateness of the comparables and selection of filters does not give rise to substantial question of Law for the same to be reviewed by the High court. Just because there are different views of ITAT on comparable/filter the same does not result in satisfying the requirement of substantial question of law.

The assessee filed a Civil Appeal before the Supreme Court. The Supreme Court had a batch of 148 Civil appeals, including that of the assessee to determine as to whether the ALP decided by the Tribunal can be challenged before High Courts.

### Arguments of the Income tax department

- In the scheme of transfer pricing, the ALP has to be determined taking into consideration the guidelines stipulated under the Act and the Rules ("Stipulated guidelines"). It is always open for the High Court to consider and/or examine whether the stipulated guidelines are properly followed or not.
- If the ALP is determined by the Tribunal without correctly following the stipulated guidelines, the determination of the ALP can be said to be perverse, which can be challenged before the High Court.

### Arguments of the taxpayers

- A substantial question of law can arise only when a question of law is fairly arguable, where there is room for difference of opinion on it. The High Courts as well as Supreme Court have consistently held that the Tribunal being the final fact-finding authority, in absence of demonstrated perversity in its finding, interference therewith by the High Court is not warranted.

- The question whether two companies are comparable, or selection of filters are usually questions of fact, which primarily depend on the functions performed, assets employed, and risks assumed by the tested party as well as comparable transactions. Unless perversity in the findings of the Tribunal is demonstrated, by placing material on record, no substantial question of law can arise.

### Held

- While determining the ALP, the Tribunal has to follow the stipulated guidelines. Any determination of the ALP without following the stipulated guidelines can be considered as perverse and it may be considered as a substantial question of law.
- There cannot be any absolute proposition of law that in all cases where the Tribunal has determined the ALP, the same is final and cannot be the subject matter of scrutiny by the High Court in an appeal.
- When the determination of the ALP is challenged before the High Court, it is always open for the High Court to consider and examine whether the ALP has been determined after following the stipulated guidelines.
- Even the High Court can examine the question of comparability of two companies or selection of filters and examine whether the same is done judiciously and on the basis of the relevant material or evidence on record. The High Court can also examine whether the comparable transactions have properly been taken into consideration and examine whether non comparable transactions are considered as comparable transactions.

Accordingly, all the 148 cases under the Civil Appeals were remitted back to the respective High Courts with the direction to decide the same, preferably within 9 months from the date of receipt of order of the Supreme Court. The High Court would be required to examine as to whether the stipulated guidelines are followed, while determining the ALP and whether the findings recorded by the Tribunal, while determining the ALP can be said to be perverse.

### CNK COMMENTS

- ❑ The Supreme Court's decision would increase the number of appeals before the High Courts, as both, taxpayers and the Income tax department can now file appeal before High Courts and subsequently before the Supreme Court. This will increase the number of appeals, creating an additional burden on the Courts.
- ❑ The High Courts may have to hear detailed argument of the taxpayer as well as Income tax department, as to whether particular comparable companies selected/ rejected is a comparable company after considering the stipulated guidelines. Earlier the transfer pricing cases would attain finality once the appeal was decided by the Tribunal. After the SC ruling, the option of further appeal before the High Court could prolong the finalization of transfer pricing disputes.
- ❑ The Supreme Court's decision may be viewed by foreign businesses as a two-step backward in the government of India's efforts to enhance ease of doing business. Foreign companies wanting certainty on the Transfer Pricing front may take recourse to entering into a Mutual Agreement Procedure and Advance Pricing Agreement with the Income tax department.

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