Export profits arising out of suo-moto TP adjustment are eligible for tax holiday: Delhi ITAT

Summary

The Delhi Bench of Income-tax Appellate Tribunal (ITAT), in a recent case[1], has held that the taxpayer is eligible to claim 'tax holiday on export profits'[2] in respect of income declared on the basis of computation of arm's length price ('ALP') after undertaking voluntary transfer pricing (TP) adjustment made by the taxpayer in its tax return.

Facts of the case

- The taxpayer is engaged in the business of engineering and construction activities and is eligible for tax holiday on export profits.
- In its return of income, the taxpayer made a suo-moto transfer pricing adjustment on its related party transactions and as a result its net loss for the said year was converted in profit, against which it made tax holiday claim.
- The tax officer held that taxpayer is not eligible for deduction on export profits arising on account of Transfer Pricing adjustment.
- The Commissioner (appeals) allowed the taxpayers appeal by relying on the ITAT Bangalore ruling in the case of iGate Global Solutions Limited ('iGate')[3], and directed the tax officer to allow the claim for tax holiday.
- Aggrieved with the order of the Commissioner (appeals), the Revenue filed an appeal before the Delhi bench of the ITAT.

Revenue's contention

- The Revenue's counsel presented following arguments to support its grounds of appeal:

[1] GS Engineering & Construction India Private Limited v/s ACIT (ITA No. 3956/DEL/2014)
[2] Under section 10A of the Act
[3] iGate Global Solutions Ltd. vs/ ACIT (2008) 24 SOT 3 (Bang)

- no deduction for exports is allowable in respect to income enhanced due to Transfer Pricing adjustment as per the provisions[4] of the Income-tax Act, 1961 ('Act');
- the voluntary TP adjustment is not recorded in the profit and loss account of the taxpayer and not offered for calculating Minimum Alternate Tax;
- tax provisions related to deduction of export profits are to encourage the foreign inward remittance on account of export of goods and services. However, in the present case, the deduction is claimed against TP adjustment which has not resulted in actual inward remittance.

Taxpayer's arguments

- The taxpayer relied on the rulings of the Hon'ble Pune ITAT in the case of Approva Systems Private Limited[5] and Bangalore ITAT and HC ruling[6] in case of iGate (supra), which held as follows:
  - the tax payer has suo-moto offered to tax additional income on account of transfer pricing adjustment, i.e. it is not an enhancement of income by tax officer. Thus, it is not hit by the provisions of the Act, which restrict tax holiday on TP adjustment made by the tax officer;
  - once the additional income as computed by the assessee has been offered to tax, it forms part of profits of business and while computing the deduction, the said profits have to be taken into consideration and the deduction so computed.

ITAT findings and ruling

- The ITAT found that the taxpayer has clarified as follows:
  - it does not have any business other than the unit which is eligible for exemption for export profits and the voluntary TP adjustment has been made in respect of international transaction involving export of engineering design services;
  - voluntary TP adjustment made through a disclosure in Form 3CEB filed during the year is not an ad hoc addition in the income tax return;
  - the taxpayer has excluded voluntary TP adjustment from 'export turnover' in line with the computation mechanism prescribed under the Act;

[4] First proviso to section 92C(4) of the Act
[5] Approva Systems Private Limited v/s DCIT (ITA No. 1051/PUN/2015)
[6] The Commissioner Of Income Tax vs M/S I Gate Global Solutions Ltd (ITA No. 452/2008)

- the Transfer Pricing Officer (TPO) has not made any adjustment in taxpayer's case in the year under consideration;
- tax provisions[7] relied upon by Revenue are not applicable in taxpayer's case as taxpayer has voluntarily determined the total income in the return with regard to ALP; and
- the facts of the taxpayer's case are exactly similar to the facts in the case of iGate (supra)

- Based on the above findings, the ITAT, following the decision of ITAT Bangalore in case of iGate, held that the taxpayer is eligible for deduction for export profits in respect of income declared in the return of income on the basis of computation of ALP.

Our comments

This ruling adds to the strength of taxpayers who have ongoing litigation involving similar matter(s). However, with effect from FY 2017-18, the Act has introduced secondary adjustments[8] in case of suo-moto TP adjustments made by the taxpayer in excess of rupees one crore. Where the taxpayer fails to repatriate into India the amount equal to suo-moto adjustment within 90 days of due date of filing of tax return, the said amount would be treated as an advance and interest would be imputed on the said deemed advance. Accordingly, in today's scenario, one may be less vulnerable if the said adjustment is routed through the books of account itself.

[7] First proviso to Section 92C(4) of the Act
[8] As defined under Section 92CE of the Act read with Rule 10CB of the Rules