Tracing evolution of 'Associated Enterprises' definition u/s 92A

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Section 92 of the Income Tax Act, 1961 ("the Act"), the charging section which triggers the provisions of Chapter X of the Act, requires income or expense arising from an "international transaction" to be computed having regard to arm's length price. Section 92B(1) of the Act defines "international transaction" as a transaction taking place between two or more "associated enterprises" ("AEs"), either or both of whom are non-residents. What follows is that the existence of AE relationship is a fundamental requirement for a transaction to be classified as "international transaction" under section 92B(1) of the Act.

The term "AEs" is defined u/s 92A of the Act. As per section 92A(1) ("sub-section (1)") of the Act, an enterprise is said to be an AE of another if:

> such enterprise participates, directly or indirectly, or through one or more intermediaries, in the management, capital, or control of the other enterprise; or
> same person(s) participate, directly or indirectly, or through one or more intermediaries, in the management, capital, or control of both the enterprises.

Furthermore, section 92A(2) ("sub-section (2)") of the Act creates a deeming fiction, enlisting thirteen scenarios in which two parties are deemed to be "AEs".

In short, while sub-section (1) lays down the broad definition of the term "AE", sub-section (2) lists down specific instances when two enterprises are deemed to be AEs. While the definition of the term "AE" appears to be simple, it gives rise to various interpretation challenges:

> A plain reading of sub-section (1) shows that sub-section (1) primarily revolves around participation in "management, capital, or control". However, what is critical is that the terms "management", "capital" or "control" have not been defined anywhere in the Act. One may resort to interpretation based on various judicial precedents, definitions provided under other statutes, legal dictionaries, and interpretation based on usual business practices.
> Another major challenge is the inter-linkage between sub-sections (1) and (2). Some possible interpretations of the term "AE" which can be inferred from the reading of the said sub-sections are:
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> **Sub-sections (1) and (2) operate independently of each other**: Such an interpretation would imply that two parties can become AEs by:
>
> satisfying any of the conditions laid down under sub-section (2); or
> being covered under the broad umbrella of sub-section (1), i.e., one party participating in "management control, or capital" of the other, or such parties having a common participant in their "management, control, or capital", although none of the parameter of sub-section (2) are satisfied.
>
> **Sub-section (1) and (2) operate jointly:** Under this scenario, two enterprises will be classified as "AEs" when the requirements of sub-section (1) as well as (2) are satisfied concurrently, i.e., there

exists participation in "management control, or capital" as well as the case falls within any one of the limbs of sub-section (2).

Sub-section (2) is exhaustive: This would imply that satisfaction of any one of the clauses of sub-section (2) by two entities is a pre-requisite to establish the AE relationship, and sub-section (2) restricts the coverage of sub-section (1) by laying down an exhaustive list of scenarios which would result in establishing AE relationship.

Finance Act, 2002 amended section 92A of the Act by inserting the words "For the purposes of sub-section (1)" at the beginning of sub-section (2). The memorandum to Finance Bill, 2002, while explaining the intent behind the said insertion, clarified that the mere fact of participation in management, control, or capital would not make two enterprises AEs, unless and until they fall in any of the clauses enlisted under sub-section (2).

Despite the clarification provided by the said amendment around the scope of section 92A of the Act, the question of interplay between sub-sections (1) and (2) has come up before the Income Tax Appellate Tribunal ("ITAT") a couple of times. Divergent opinions have been expressed by different benches on the said matter.

The Hon'ble Mumbai Bench of the ITAT analysed the said issue in the case of ***Kaybee Private Limited*** *[TS-233-ITAT-2015(Mum)-TP]* (http://www.tp.taxsutra.com/analysis/9340/Sec._92_A_%27unambigious%27%3B_Enterprises_%27independently_satisfying%27_Sec._92_A_%281%29_conditions_to_be_treated_AE). In the said case, Kaybee Exim Pte Limited ("Kaybee Singapore") and the assessee, had a common director who held 99.9% shares of the assessee, while at the same time held the position of Chief Operating Officer in Kaybee Singapore.

The assessee contended that Kaybee Singapore and the assessee cannot be classified as AEs since:

case of the assessee did not fall in any of the clauses of sub-section (2), and

post the 2002 amendment in section sub-section (2), satisfaction of any one of the clauses of said sub-section is mandatory for the entities to be so classified.

On the other hand, revenue contended that section sub-section (2) only expands the scope of sub-section (1) and creates a deeming fiction to cover only those instances which do not fall within sub-section (1).

The ITAT, relying on ***Diageo India (P) Ltd. vs. DCIT*** *[TS-507-ITAT-2011(Mum)-TP]* (http://www.tp.taxsutra.com/analysis/1558/_Transfer_Pricing_attracted_on_imports_made_by_assessee%27s_Indian_contractors_from_overseas_AE), held that:

sub-section (1) constitutes the basic rule for establishing AE relationship between two parties, i.e., two parties are AEs if any of the conditions specified under clauses (a) and (b) of sub-section (1) are satisfied;

sub-section (2) being a deeming fiction, it only enlarges the scope and meaning of expression "AE" provided under sub-section (1); and

sub-section (2) is applicable to specific cases only and has no general or universal application in respect of the term "AE".

A similar issue came up before the ITAT (Bangalore) in the case of ***M/s. Page Industries Ltd. vs. DCIT*** *[TS-382-ITAT-2016(Bang)-TP]* (http://www.tp.taxsutra.com/analysis/11327/Jockey-US_not_AE_of_Indian_licensee_absent_Sec_92A%281%29_management__control_conditions_fulfillment). In the said case, the assessee had entered into a licensing arrangement with Jockey International Inc, USA ("JII"), to become a licensee of the brand-name 'Jockey' for the exclusive manufacturing and sale of Jockey readymade garments. The assessee was liable to pay a royalty in lieu of such rights.

While the assessee denied the existence of any AE relationship with JII, the revenue contended that the case of the assessee fell within the clause (g) of sub-section (2) of section 92A of the Act. ITAT, appreciating the fact that the assessee was merely a licensee of the brand name 'Jockey', and that JII did not participate in the capital or management of the assessee, who owned/ controlled its entire manufacturing facility, capital and employees, held that:

> 2002 amendment implies that unless conditions of sub-section (2) are satisfied, sub-section (1) cannot be applied. What follows is that to establish "AE" relationship, both, sub-sections (1) and (2) are required to be satisfied;
> an opinion that AE relationship exists whenever requirement(s) of sub-section (2) are fulfilled would render the provisions of sub-section (1) otiose or superfluous; and
> it is a well settled position that a construction which renders a particular provision otiose should not be adopted while interpreting a taxing statute and a construction, which preserves the purpose of the provision, must be adopted. Therefore, since the criteria of sub-section (1) relating to participation in "management, control, or capital" were not satisfied, therefore, the assessee and Jockey USA were not "AEs".

While the Mumbai Bench held that sub-sections (1) and (2) operate independently (wider interpretation), the Bangalore Bench has laid down the requirement of joint satisfaction of both the sub-sections (narrower interpretation). What would be crucial in this regard would be the interpretation endorsed by the High Courts and the Apex Court as and when the matter travels to higher levels.

Till the time such divergent views exist and there remains ambiguity on the interplay of sub-sections (1) and (2), one may choose to follow any one of above views. However, considering the stringent penal provisions attached with non-compliance of transfer pricing compliance requirements envisaged under the Act, one may choose to adopt a conservative approach by reporting the international transactions, out of abundant caution, based on the wider interpretation as discussed above. This would safeguard the interests of the taxpayer, while at the same time ensure a sufficient opportunity to defend its positions at the higher appellate levels.

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