



Tax Insights

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Comparability issues in TP can give rise to ‘substantial question of law’ – Supreme Court

In brief

Comparability analysis is fundamental to a transfer pricing (TP) analysis, and the Indian judiciary has been mired with issues pertaining to the selection of comparables, application of filters and consequent determination of the arm’s length price (ALP). One of the key questions for deliberation has been whether comparability issues in TP, as decided by the Income-tax Appellate Tribunal (Tribunal) gives rise to any ‘substantial question of law’, which is a prerequisite for the High Court to admit and thereafter adjudicate an appeal. Several High Courts in the past had held that the selection of comparables and application of filters is a fact-finding exercise and does not give rise to a substantial question of law unless any perversity is demonstrated in the order of the Tribunal.

In a significant decision¹, the Supreme Court has overturned a batch of High Court decisions to hold that the determination of ALP must follow the guidelines stipulated under Chapter X of the Income-tax Act, 1961 (the Act) and the relevant rules thereunder, and any deviation from these guidelines can be considered perverse and subject to scrutiny by the High Courts. Therefore, the High Courts can examine whether the guidelines under Chapter X of the Act are followed or not, and whether the findings recorded by the Tribunal while determining ALP are perverse or not.

In detail

Facts

The taxpayers, in the present case, were subject to TP adjustments during TP audits conducted by the tax authorities. The TP adjustments were primarily made by selecting different sets of comparable data and applying different filters as compared to what was adopted by the taxpayers in their TP documentation. Pursuant to the order of the Tribunal on these matters, appeals were filed by both the taxpayer and the tax authority before the relevant jurisdictional High Court.

As per section 260A of the Act, an appeal against an order of the Tribunal, is admitted by the High Court only if the case involves a ‘substantial question of law’. In these cases, relying on a previous order of the Karnataka High Court in the case of *Softbrands India (P) Limited*², the High Courts held that comparability issues in TP are

¹ Civil Appeal No. 8463 of 2022 & Ors.

² *PCIT v. Softbrands India (P) Limited* [2018] 406 ITR 513 (Karnataka)

essentially a question of fact, and as perversity in the Tribunal's order was neither pleaded nor argued nor demonstrated by placing material to that effect, no 'substantial question of law' arises for consideration under section 260A of the Act.

Issue before the Supreme Court

The short question for consideration before the Supreme Court was whether in every case where the Tribunal determines the ALP, the same will attain finality, and whether the High Court is precluded from examining the correctness of ALP determination by the Tribunal in exercise of the powers under section 260A of the Act.

Supreme Court's decision

In a significant decision, the Supreme Court has overturned a batch of High Court decisions and laid down the following broad principles on the admissibility of TP appeals by the High Courts.

- Determination of ALP must follow the guidelines stipulated under Chapter X of the Act (namely sections 92, 92A to 92CA, 92D, 92E and 92F of the Act and rules 10A to 10E of the Income-tax Rules, 1962). Any deviation from these guidelines can be considered as perverse and 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 ALP, the same is final and cannot be subject matter of scrutiny by the High Court under section 260A of the Act. It is always open for the High Court to examine whether or not the guidelines under Chapter X of the Act are followed, and whether or not the findings recorded by the Tribunal while determining ALP are perverse.
- The High Court can also examine whether the comparability of two companies or selection of filters has been done judiciously and whether non-comparable transactions have been wrongly considered as comparable transactions or not within the parameters of section 260A of the Act.

In the present batch of appeals, the Supreme Court finally remitted the matters back to the respective High Courts for disposing the appeals afresh considering the above-mentioned observations, preferably within a period of nine months from date of receipt of the order. The Supreme Court has specifically not ruled on the merits of the cases or expressed any opinion on the determination of ALP.

The takeaways

Comparability-related issues have been among the most-litigated TP issues in Indian judicial forums. This decision has been long-awaited, and while it brings clarity on the aspect that comparability issues in TP can give rise to a 'substantial question of law', leaving High Courts with the power to scrutinise appeals involving TP matters, it is likely to increase the time involved in reaching finality on controversies relating to TP under the Indian tax appellate process. This decision will certainly have wide ramifications on existing and future appeals, and taxpayers will need to reconsider their strategies for TP controversy management in India. Moreover, considering the significant number of appeals involving TP matters and huge backlog of cases at the High Court level, taxpayers could also evaluate alternative options of dispute prevention or resolution such as the Advance Pricing Agreements and Mutual Agreement Procedures.

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