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Shipping magazines rates accepted as CUP for charter hire payment for vessels after suitable comparability adjustments

In brief

In a recent ruling by the Mumbai Income-tax Appellate Tribunal (the Tribunal) in the case of Reliance Industries Ltd¹ (the taxpayer), the Tribunal has accepted rates published by shipping magazines as an appropriate comparable for time charter hire charges paid by the taxpayer to its associated enterprise (AEs). The Tribunal has directed that suitable comparability adjustments for weight, capital cost, risk, etc., need to be made to such rates. The guidance by the Tribunal comes as a relief to the oil and gas industry where taxpayers have been undertaking similar approaches to benchmark their related party transactions.

Facts

- The taxpayer hired a vessel from its AE and paid time charter hire charges based on per day rate (PDR). In order to establish the arm's length price (ALP) of the transaction, the taxpayer relied on the approval received by the Director General of Shipping (DG Shipping) and contended the same as comparable uncontrolled price (CUP). Further, the taxpayer also relied on monthly charter hire rate indicated in Drewry Monthly Report² by contending that the PDR paid by the taxpayer were reasonable taking into account that the vessel provided by the AE was of less capacity i.e. 2,242 cubic meters, as against the

¹ Reliance Industries Ltd v. ACIT [TS-368-ITAT-2012(Mum)]

² Published by the Drewry Shipping Consultants Ltd., UK

rate published in Drewry Monthly Report which was for a capacity of 3,000 cubic meters.

- The transfer pricing officer (TPO) considered published prices in the shipping publications, the Shipping Intelligence Weekly³ and the Drewry Monthly Report and arrived at their arithmetic mean. Further, the TPO made a prorated adjustment for the difference in capacity and determined the ALP, without considering any technical and commercial factors.
- Before the Tribunal, the taxpayer submitted that that while determining ALP of the charter hire charges vis-a-vis the market rate given in the two publications, adjustment was required to be made on account of various factors surrounding the uniqueness of the vessel⁴. The taxpayer proposed enhancement/adjustment to account for the following differences:
 - Vessel having carrying capacity of LPG vis-a-vis vessel having carrying capacity of LPG as well as chemicals
 - Additional cost towards certification of vessel
 - Additional cost towards higher salaried staff due to specialised work
 - Cost towards mobilization and de-mobilization of similar vessel
 - Extra-ordinary wear and tear expenses and extra-ordinary expenses towards salary of officers and crew.

³ Published by Clarkson Research Studies

⁴ The vessel was modified to make it suitable for specific operations requirement and was fitted with several sophisticated equipments so that it is in a position to carry LPG as well as chemicals and petrochemicals at the Jetties in low draft of 2.8 meters to 3.5 meters.

Tribunal ruling

The Tribunal ruled that neither the taxpayer nor the TPO has followed any of the method prescribed in the Income-tax Act, 1961 and Income-tax Rules, 1962, for arriving at the ALP.

The Tribunal rejected the taxpayer's contention of approval by the DG Shipping as CUP. Further, the Tribunal also rejected the TPO's approach of determining the ALP by taking arithmetic mean of the rates published by the two publications, without making any adjustment for variation in capacity, cost, finance, risk, etc.

The Tribunal held that in the absence of comparable transaction (i.e. in view of the unique vessel, with no comparable ship available), the matter be set aside to the file of the assessing officer for the limited purpose of re-computing the ALP by taking the data available in the public domain in the form of publication of Shipping Intelligence Weekly and Drewry Monthly as a 'comparable price', and adjusting it for differences in weight, capital cost, risk, etc.

PwC's comments

The ruling reiterates important principles to be considered by taxpayers and the revenue authorities for applying the CUP method. The Tribunal held that in the absence of actual transaction which can be considered as CUP, the data available in the public domain in the form of publication of Shipping Intelligence Weekly and Drewry Monthly can be considered as a 'comparable price'.

On application of the CUP method, the Tribunal held that adjustments to the aforesaid 'comparable price' need to be undertaken towards weight, capital cost, risk, etc., to ensure comparability. While this acknowledges that the CUP method requires a high degree of similarity between the tested transaction and the uncontrolled transaction, it is also important to note that the nature and complexity of adjustments should not dilute the comparability of the transaction.

It is also interesting to note an earlier Tribunal decision in the case of Essar Shipping Ltd⁵. In this case, the CUP method was used by the taxpayer for bare boat charter hire charges after making a comparability adjustment for the difference in age of the vessel being hired (around 22 years old), whereby the arm's length charter hire rate was determined to be around 25% of the published rate in Clarkson Report for new ships (i.e. ships which were not more than 10 years old). The Tribunal did not support the same on the basis that there was absolutely no substantive material by which the reduction of 75% from the published rate due to age factor of the ship could be justified. The Tribunal reiterated that for applying CUP method, the compared transactions should be substantially similar in characteristics.

Taxpayers should accordingly, document the various comparability adjustments and substantiate the same with reference to verifiable evidence.

⁵ Essar Shipping Ltd v. DCIT [2009] 27 SOT 209 (Mum)

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