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### SUPREME COURT RULES THAT ARM'S LENGTH PRICE DETERMINATION BY TAX TRIBUNAL CAN BE SUBJECT TO JUDICIAL REVIEW BEFORE THE HIGH COURT

21 April 2023

#### *Introduction*

Determination of arm's length price of an 'International transaction' between two associated enterprises is at the heart of Transfer Pricing regime.

In the context of Transfer Pricing (TP) disputes, various High Courts have held that in a TP case, aspects related to choice of comparable companies, choice of filters used, correctness of application of filters, choice of method, etc are factual exercises and the HC cannot admit an appeal arising from these, unless perversity is demonstrated. This ratio decidendi was challenged before the Hon'ble Supreme / Apex Court (SC) by various persons.

Hon'ble SC in the lead case of Sap Labs India Private Limited vs ITO and others (Civil appeal no 8463 of 2022), considered around 200 special leave petitions both of the taxpayer and the tax authorities which particularly arose out of the decision in the case of the Hon'ble Karnataka High Court (HC) in Pr. CIT vs Softbrands India (P) Ltd, [2018] 406 ITR 513 (Softbrands).

#### *Background*

Hon'ble HC while dealing with determination of Arm's Length Price (ALP) held that whether comparables had been rightly selected, or whether filters for arriving at correct list of comparable had been rightly selected are issues that do not give rise to any substantial question of law unless a perversity in findings of fact in these matters is demonstrated before HC.

Hon'ble HC had further ruled that the entire exercise of making Transfer Pricing Adjustments on the basis of the comparables is nothing but a matter of estimate of a broad and fair guesswork of the tax authorities based on relevant material brought on record. The Income Tax Appellate Tribunal is the final fact-finding authority and unless the Hon'ble HC is satisfied that a substantial question of law arises from the order of the Tribunal, an appeal under section 260A of the Act cannot be entertained by the HC. The exercise of fact-finding or 'Arm's Length Price' determination or 'Transfer Pricing Adjustments' should be allowed to become final at the hands of the final fact-finding authority, i.e. the Income Tax Appellate Tribunal.

## *Supreme Court Judgement*

The Hon'ble SC reversed the Karnataka HC judgment on the issue of comparables selection and whether it constitutes a 'substantial question of law'.

SC held that the determination of ALP without consideration of the relevant provisions of law and rules could be considered 'perverse', and thus, would give rise to a substantial question of law. The Court remarked that there cannot be any absolute proposition of law that in all cases where Tax Tribunal has determined arm's length price, the same is final and cannot be a subject matter of scrutiny by the High Court in an appeal under section 260A of the Act.

SC further held that the HC can also examine the comparability of two companies or the selection of filters and examine whether the same is done 'judiciously' and based on the relevant material / evidence on record. A HC can also examine whether the comparable transactions have been appropriately considered or non-comparable transactions have been considered comparable.

Accordingly, the SC remitted the cases back to the concerned High Courts to decide on the respective appeals afresh in light of this ruling and to examine in each and every case whether the Tax Tribunal has followed the guidelines laid down under the Act and the Rules while determining the ALP.

The SC has clarified that it has not expressed any opinion on the merits of ALP determination in specific cases.

## *Comment*

This is a significant ruling from the SC in the context of Transfer Pricing disputes. With the Apex Court now holding that appeal can be filed before a High Court against ALP determination by the Tax Tribunal, a taxpayer will have an added comfort / assurance that any erroneous or wrong determination of ALP could now be challenged before a High Court.

This judgement is important from a dispute resolution perspective in the transfer pricing (TP) arena. While the ruling is expected to provide better clarity to taxpayers as well as tax authorities on the admissibility of TP appeals by a HC, it is also likely to result in proliferation of appeals.

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