
INTERNATIONAL TAX **CASE SUMMARY**

INDIA vs ABIC INDIA

OCTOBER 2024

ACADEMY OF TAX LAW

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HEAD OF ACADEMICS



Welcome to the Academy of Tax Law's case and judgment summaries. These documents have been carefully curated to support professionals, students, and researchers navigating the complex landscape of international tax and transfer pricing. At the Academy, we understand that tax law is ever-evolving, with key rulings continuously shaping its practice.

Each summary you'll find here is designed to provide not just the facts, but the context and implications of pivotal legal decisions. These case summaries are created to serve as a valuable resource for legal teams, multinationals, revenue authorities, and academics, offering insights that go beyond the surface. Our goal is to ensure you remain informed and prepared, whether you are dealing with tax planning, dispute resolution, or risk management.

We believe that knowledge is the foundation of sound decision-making, and with these resources, we hope to empower you in your professional journey. As you delve into the analysis, remember that staying ahead in tax law requires not just understanding the rules but how to apply them in a dynamic, global environment.

Thank you for choosing the Academy of Tax Law as your partner in this ongoing learning experience.

Sincerely,
Dr. Daniel N Erasmus

PART 1

SUMMARY

JUDGEMENT SUMMARY

CASE OVERVIEW

Court:	High Court of Delhi
Case No:	ITA 514/2024
Applicant:	The Pr. Commissioner of Income Tax -7
Defendant:	SABIC India Pvt Ltd
Judgment Date:	14 October 2024
Full Judgment:	CLICK FOR FULL JUDGMENT
View Online:	CLICK TO VIEW SUMMARY ONLINE

JUDGMENT SUMMARY

The High Court of Delhi, in its judgment dated 14 October 2024, upheld the Tribunal's decision to reinstate the Transactional Net Margin Method (TNMM) as the most appropriate transfer pricing method for SABIC India Pvt Ltd. The Revenue, represented by the Principal Commissioner of Income Tax -7, challenged the Tribunal's ruling, which annulled the adjustment of ₹3,61,32,20,620/- made by the Transfer Pricing Officer (TPO) using the residual "other method" under Rule 10B(1)(f) of the Income Tax Rules, 1962.

The dispute arose over benchmarking the marketing support services provided by SABIC India to its Associated Enterprises (AEs). SABIC India, a wholly-owned subsidiary of foreign entities, facilitates the sale of fertilizers, chemicals, and polymers across India and neighbouring countries. For the financial year 2015-16 (assessment year 2016-17), SABIC India applied the TNMM to benchmark its transactions, consistent with prior years from AY 2009-10 to AY 2014-15. However, the TPO rejected TNMM, claiming it was inapplicable due to the company's functional profile as a commission agent and instead opted for the "other method."

The Tribunal overturned this adjustment on two grounds:

- 1. Inadequate Justification:** The TPO failed to provide reasons for rejecting TNMM, a method consistently applied and accepted in prior years.
- 2. Comparables Flawed:** The comparables selected by the TPO under the "other method" were deemed inconsistent and irrelevant, including agreements unrelated to SABIC India's business model.

The High Court affirmed the Tribunal's position, emphasizing that a departure from previously accepted methodologies requires substantial reasoning. Additionally, the Court criticised the TPO for failing to adhere to the OECD and ICAI guidelines, which require exhaustive justification for rejecting all five standard methods before resorting to the residual "other method."

In conclusion, the Court ruled in favour of SABIC India Pvt Ltd, reiterating the primacy of TNMM in benchmarking similar marketing support services and underlining the importance of consistency, transparency, and proper documentation in transfer pricing assessments. This decision serves as a landmark ruling for multinationals and tax authorities navigating complex transfer pricing disputes.

KEY POINTS OF THE JUDGMENT

BACKGROUND

SABIC India Pvt Ltd, a wholly-owned subsidiary of foreign entities within the SABIC Group, provides marketing support services to its Associated Enterprises (AEs). These services facilitate the sale of fertilizers, chemicals, and polymers within India and the Indian subcontinent. The company operates exclusively as a marketing support provider, earning a commission from its AEs for these services, without taking ownership of the goods or entering contracts with customers.

For the assessment year 2016-17, SABIC India reported an income of ₹87.92 crore, benchmarked under the Transactional Net Margin Method (TNMM). This method had consistently been used and accepted for prior assessment years (2009-10 to 2014-15). However, the Transfer Pricing Officer (TPO), upon review, rejected TNMM for benchmarking the international transactions and adopted the "other method" under Rule 10B(1)(f) of the Income Tax Rules, 1962. The

TPO determined a median commission rate of 5% as the arm's length price (ALP) and made an upward adjustment of ₹3,61,32,20,620/- to the declared income.

The Dispute Resolution Panel (DRP) upheld the TPO's decision, rejecting the comparables provided by SABIC India and accepting most of the comparables selected by the TPO. Dissatisfied with this outcome, SABIC India appealed to the Income Tax Appellate Tribunal (ITAT), which ruled in its favour. The ITAT noted that the TPO had failed to justify the rejection of TNMM and the adoption of the residual method. Furthermore, the comparables selected under the residual method were found to be inappropriate.

The Revenue's subsequent appeal to the High Court of Delhi was dismissed, with the Court upholding ITAT's findings and emphasising the need for consistency in the application of transfer pricing methodologies.

KEY POINTS

OF THE JUDGMENT

CORE DISPUTE

The core dispute revolved around the Transfer Pricing Officer's (TPO) decision to reject the Transactional Net Margin Method (TNMM) and adopt the residual "other method" to benchmark SABIC India's international transactions for the assessment year 2016-17.

SABIC India, acting as a marketing support provider, received commissions from its Associated Enterprises (AEs). It applied TNMM to benchmark these transactions, supported by a detailed transfer pricing study. The selected profit-level indicators (PLIs)—Operating Profit/Value Added Expenses (OP/VAE) and Gross Profit/Value Added Expenses (GP/VAE)—showed a significantly higher margin compared to industry averages.

The TPO rejected TNMM, arguing that:

1. SABIC India's business model as a commission agent did not align with the comparables used for TNMM.
2. The company did not undertake any buy-sell activity, making TNMM unsuitable for

benchmarking.

Instead, the TPO applied the residual method under Rule 10B(1)(f) of the Income Tax Rules, determining a median commission rate of 5% based on selected comparables. This adjustment resulted in an upward revision of ₹3,61,32,20,620/- to SABIC India's declared income.

The Tribunal and the High Court found the TPO's reasoning flawed. The rejection of TNMM lacked substantial justification, and the comparables used under the residual method were inconsistent with SABIC India's functional profile. Additionally, the Tribunal noted that TNMM had been consistently applied in prior years without objection, reinforcing its appropriateness for benchmarking the company's transactions.

The High Court ruled that the TPO's approach created inconsistency and uncertainty in tax assessments, thereby reaffirming the Tribunal's decision to reinstate TNMM.

KEY POINTS

OF THE JUDGMENT

COURT FINDINGS

The High Court of Delhi concurred with the Tribunal's findings that the TPO's rejection of TNMM and adoption of the residual method under Rule 10B(1)(f) was flawed for several reasons:

Lack of Justification for Rejecting TNMM:
The TPO failed to provide adequate reasons for rejecting TNMM, which had been consistently applied for prior assessment years (2009-10 to 2014-15). The Court emphasized that any deviation from established methodologies requires a detailed explanation, especially when there has been no material change in the nature of transactions.

Improper Use of the Residual Method:
The TPO adopted the "other method" under Rule 10B(1)(f) without demonstrating that the five standard methods specified in Rule 10B(1) were inapplicable. The Court highlighted that the residual method is only permissible in cases where no other method can reliably determine the arm's length price (ALP).

Flawed Comparables:

The comparables selected by the TPO were found to be inconsistent and irrelevant to SABIC India's business model. For instance, agreements related to non-compete clauses and educational services were used as benchmarks for a marketing support entity, which the Court deemed inappropriate.

Guidelines Not Followed:

The Court noted that both the OECD Guidelines and ICAI Guidelines emphasize the necessity of exhaustive justification for rejecting standard methods before resorting to the residual method.

Ultimately, the High Court upheld the Tribunal's ruling that the TPO's adjustments were unsustainable. It reaffirmed the TNMM as the most appropriate method for determining the ALP in this case, emphasizing consistency and transparency in transfer pricing assessments.

KEY POINTS

OF THE JUDGMENT

OUTCOME

The High Court of Delhi dismissed the Revenue's appeal and upheld the Tribunal's decision in favour of SABIC India Pvt Ltd. The key outcomes of the judgment are as follows:

Reinstatement of TNMM:

The Court endorsed the Tribunal's conclusion that the Transactional Net Margin Method (TNMM) was the most appropriate method for benchmarking the marketing support services provided by SABIC India to its Associated Enterprises (AEs). The consistent application of TNMM in prior years supported its reliability.

Invalidation of Residual Method:

The Court found that the TPO had failed to justify the rejection of TNMM or the selection of the residual method. The lack of reasoning for rejecting the standard methods specified under Rule 10B(1) was a critical flaw in the TPO's approach.

Rejection of Flawed Comparables:

The comparables used by the TPO under the residual method were deemed irrelevant and inappropriate for benchmarking SABIC India's transactions. This further undermined the validity of the TPO's adjustments.

Consistency in Transfer Pricing Assessments:

The judgment emphasized the importance of consistency in applying transfer pricing methodologies across assessment years to maintain certainty and reliability in tax compliance.

The decision reinforced the principle that transfer pricing adjustments must be based on sound reasoning and relevant comparables, ensuring fairness and transparency in international tax assessments.

TP METHOD

HIGHLIGHTED (IF ANY)

The core issue in the SABIC India Pvt Ltd case revolved around the rejection of the Transactional Net Margin Method (TNMM) and the adoption of the residual "other method" by the Transfer Pricing Officer (TPO).

Why TNMM was Used

SABIC India had historically applied the TNMM to benchmark its international transactions. The TNMM determines the arm's length price (ALP) by comparing the net profit margins relative to a particular base (e.g., operating expenses) of the tested party with those of comparable uncontrolled transactions. It is widely recognised for its flexibility, particularly for service-based functions like marketing support. For the assessment year in question, SABIC India used profit-level indicators (PLIs) such as Operating Profit/Value Added Expenses (OP/VAE) and Gross Profit/Value Added Expenses (GP/VAE), which showed a significantly higher margin than the industry average.

Rejection of TNMM

The TPO rejected TNMM, citing that SABIC India operated as a commission agent and

did not undertake any buy-sell activities. This, according to the TPO, made TNMM unsuitable. The TPO instead opted for the "other method" under Rule 10B(1)(f), which allows flexibility in cases where standard methods cannot be applied. Using this method, the TPO benchmarked the transactions based on a median commission rate of 5% derived from selected comparables.

Flaws in Adopting the Residual Method

The High Court found the TPO's rejection of TNMM unjustified for the following reasons:

1. No explanation was provided for rejecting TNMM despite its consistent application in prior years.
2. The comparables used for the "other method" were irrelevant to SABIC India's functional profile.
3. The residual method should only be used when all five standard methods fail, which the TPO did not demonstrate.

The judgment reaffirmed the TNMM as the most appropriate method, emphasizing its reliability for marketing support services.

PART 2

SIGNIFICANCE

MAJOR ISSUES

AREAS OF CONTENTION

Several critical issues and areas of contention were identified in the case:

Rejection of TNMM Without Justification

The TPO rejected TNMM, which had been consistently applied in prior years, without providing substantive reasons. The High Court noted that deviations from established methodologies should be supported by compelling evidence, particularly when there are no material changes in the functional profile of the taxpayer.

Improper Selection of Comparables

The comparables selected by the TPO under the residual method were found to be irrelevant. For instance:

- Agreements involving non-compete clauses and educational services were used as benchmarks, which had no connection to SABIC India's marketing support services.
- Transactions related to royalty payments were also included, despite their inapplicability to SABIC India's business model.

Inconsistent Approach by TPO

The TPO failed to follow established guidelines, including those from the OECD and the Institute of Chartered Accountants of India (ICAI). These guidelines mandate a step-by-step analysis and justification for rejecting standard methods before adopting the residual method.

Lack of Consideration for Historical Consistency

The TNMM had been applied successfully in prior assessment years (2009-10 to 2014-15). The abrupt rejection of TNMM created uncertainty and inconsistency, undermining the reliability of the transfer pricing framework.

Implications of Residual Method

The residual method, while offering flexibility, is meant for cases where standard methods cannot be reliably applied. The TPO did not demonstrate why none of the other five methods were suitable, making the adoption of the residual method premature.

The Court found these issues significant enough to invalidate the TPO's approach and reaffirm the Tribunal's ruling in favour of SABIC India.

EXPECTED OR CONTROVERSIAL?

The decision in the SABIC India case was largely expected, given the Tribunal's detailed reasoning and the High Court's emphasis on consistent application of transfer pricing methods. However, the case highlighted several controversial aspects:

Why It Was Expected

1. Adherence to Precedents: The judgment aligns with prior rulings, such as the *Li & Fung India Pvt Ltd vs. CIT* (2014) and *Sumitomo Corporation India Pvt Ltd vs. CIT* (2016), which upheld the TNMM as the most appropriate method for service-oriented functions like marketing support.
2. Consistency Across Years: The consistent application of TNMM in prior assessment years without objections strengthened SABIC India's position. The High Court reiterated that changes in methodology must be substantiated, especially when the taxpayer's functional profile remains unchanged.

Why It Was Controversial

1. Flawed Adoption of the Residual Method: The TPO's reliance on irrelevant comparables and inadequate reasoning for rejecting TNMM raised questions about the robustness of the Revenue's approach. This highlighted the risk of arbitrariness in transfer pricing adjustments.
2. Challenges to Established Guidelines: The case revealed gaps in the practical implementation of the OECD and ICAI guidelines, particularly the lack of systematic reasoning for rejecting standard methods.

The case serves as a reminder for both taxpayers and tax authorities to ensure adherence to established guidelines and principles in transfer pricing assessments. While the decision may not be groundbreaking, it underscores the importance of transparency, consistency, and accountability in international taxation.

SIGNIFICANCE FOR MULTINATIONALS

The SABIC India judgment holds significant implications for multinationals operating across jurisdictions, particularly in India. It reinforces the importance of consistency, transparency, and adherence to global transfer pricing guidelines in managing cross-border transactions.

Key Takeaways for Multinationals:

1. Reliability of Established Methods:

The case emphasizes the importance of consistently applying transfer pricing methodologies. For service-driven transactions, such as marketing support, the Transactional Net Margin Method (TNMM) remains a reliable and globally accepted approach. Abrupt changes to alternative methods without proper justification can lead to disputes, increasing compliance and litigation risks.

2. Need for Robust Documentation:

Multinationals must ensure their transfer pricing policies are supported by robust documentation, including detailed functional analyses, benchmarking studies, and comparables aligned with their business model. SABIC India's meticulous documentation played a critical role in the Court's decision to uphold TNMM.

3. Implications for Tax Disputes:

The case serves as a precedent for resisting arbitrary adjustments by tax authorities. Multinationals can use this judgment to challenge transfer pricing adjustments that lack substantial reasoning or rely on inappropriate comparables.

4. Global Consistency in Compliance:

Multinational enterprises (MNEs) operating in multiple jurisdictions must align their transfer pricing policies with OECD guidelines to minimize disputes. The judgment underscores the importance of adhering to international standards while accommodating local regulatory requirements.

5. Tax Risk Management:

This case highlights the importance of proactive tax risk management. MNEs should establish frameworks, such as tax steering committees, to ensure compliance, monitor regulatory changes, and respond effectively to audits and disputes.

For multinationals, the judgment is a reminder of the value of maintaining consistency in methodologies and documentation while navigating the complexities of international taxation.

SIGNIFICANCE

FOR REVENUE SERVICES

For revenue authorities, the SABIC India case underscores the need for consistency, transparency, and accountability in transfer pricing assessments. The judgment provides critical insights into how tax authorities can improve their approach to international taxation.

Key Lessons for Revenue Services:

1. Importance of Justifying Adjustments:

The judgment reinforces that any departure from established methodologies must be accompanied by substantial reasoning. The failure of the Transfer Pricing Officer (TPO) to justify the rejection of TNMM undermined the Revenue's position. Revenue authorities must ensure that adjustments are supported by robust analyses and detailed justifications.

2. Adherence to Guidelines:

The Court highlighted the importance of following OECD and ICAI guidelines. Tax authorities must systematically evaluate all five standard methods before resorting to the residual "other method" under Rule 10B(1)(f). Clear documentation of this process is critical to ensure fairness and avoid disputes.

3. Relevance of Comparables:

The selection of comparables must align with the taxpayer's functional and economic profile. In this case, the TPO's reliance on irrelevant comparables weakened the Revenue's argument. Ensuring the selection of appropriate comparables is vital for accurate benchmarking and credible assessments.

4. Promoting Certainty for Taxpayers:

Consistency in applying transfer pricing methodologies across assessment years provides taxpayers with certainty and predictability, fostering a conducive business environment. Arbitrary changes in methodology, as seen in this case, create uncertainty and can discourage investment.

5. Building Capacity and Expertise:

The case highlights the need for capacity-building within tax authorities to handle complex transfer pricing issues. Specialized training and access to better tools and databases can improve the quality of assessments.

The SABIC India case serves as a benchmark for revenue services to refine their approach to transfer pricing and build trust with taxpayers.

RELEVANT CASES

SUMITOMO CORP VS CIT (2016)

In this case, the Delhi High Court addressed the applicability of the Transactional Net Margin Method (TNMM) using the Berry ratio as the profit-level indicator (PLI). Sumitomo Corporation India, a service-oriented entity facilitating trade for its Associated Enterprises (AEs), applied TNMM with Berry ratio (Operating Profit to Selling, General, and Administrative Expenses) as the PLI. The TPO rejected TNMM, citing its limited applicability in cases involving significant intangibles or fixed assets.

The Court, however, upheld TNMM as the most appropriate method, given the entity's functional profile, and ruled that the Berry ratio was valid in instances where value creation depended directly on operating expenditure. The case set a precedent for using TNMM in service-oriented business models, affirming its suitability for benchmarking functions with minimal value-added assets.

LI & FUNG INDIA VS CIT (2014)

Li & Fung India provided sourcing and buying services to its AEs and benchmarked its transactions using TNMM. The TPO contested this, arguing that TNMM did not capture the full value of Li & Fung's activities and adopted the Comparable Uncontrolled Price (CUP) method. The Tribunal and High Court rejected the TPO's approach, emphasizing that TNMM remained appropriate for service providers with limited risk and no ownership of goods.

The Court further clarified that if TNMM is applied, distortions in the data must be addressed within its framework, rather than abandoning the method altogether. This case reinforced the robustness of TNMM for limited-function entities and highlighted the need for consistency in transfer pricing assessments.

RADHASOAMI SATSANG VS CIT (1992)

Although this case primarily concerned the principle of res judicata, it has been widely referenced in transfer pricing disputes for its emphasis on consistency. The Supreme Court ruled that when a methodology is consistently applied across assessment years without material changes, the tax authorities must substantiate any deviations.

In the context of transfer pricing, this principle supports the taxpayer's right to rely on previously accepted methods unless the Revenue provides compelling reasons to change them. This case underscores the importance of consistency and predictability in tax assessments, aligning with the judgment in SABIC India.

PART 3

PREVENTION

ENGAGING EXPERTS

The SABIC India case highlights the complexities of transfer pricing and the critical role of transfer pricing experts in managing disputes and ensuring compliance. Here's why their involvement is essential:

Expertise in Documentation:

Transfer pricing experts assist in preparing robust documentation that aligns with international standards, such as the OECD Guidelines. Proper documentation ensures that methodologies, comparables, and benchmarking analyses withstand scrutiny during audits and disputes.

Defence Against Adjustments:

Experts play a vital role in defending taxpayers against arbitrary adjustments by tax authorities. They provide technical analyses and legal arguments, as seen in SABIC India, where meticulous documentation and analysis led to the reinstatement of TNMM.

Mitigating Risks:

Engaging experts helps multinationals

identify and address potential risks before they escalate into disputes. Proactive compliance strategies, such as preemptive audits and risk assessments, reduce exposure to penalties and litigation.

Navigating Complex Jurisdictions:

Transfer pricing laws vary across jurisdictions. Experts bring the necessary global perspective to ensure compliance with local and international regulations, minimizing conflicts with tax authorities.

Strategy Development:

Experts help multinationals structure their operations efficiently, ensuring that transfer pricing policies reflect economic realities and meet regulatory requirements.

The SABIC India judgment serves as a reminder that the involvement of transfer pricing experts is not just advantageous—it is essential for navigating the complexities of global taxation.

PREVENTATIVE

MEASURES TO AVOID SIMILAR CASES

TAX RISK MANAGEMENT PROCESS

The SABIC India case underscores the importance of proactive measures to manage tax risks and prevent disputes. Here's how multinationals can implement effective strategies:

Implementing Robust Documentation:

Comprehensive documentation, aligned with OECD and ICAI guidelines, is critical to justifying transfer pricing policies.

Regular Compliance Reviews:

Conducting periodic reviews of transfer pricing policies ensures alignment with evolving regulations.

Advance Pricing Agreements (APAs):

Entering into APAs with tax authorities provides certainty and minimizes disputes.

Training and Capacity Building:

Equipping internal teams with knowledge of transfer pricing regulations ensures accurate implementation and compliance across jurisdictions.

By adopting these measures, multinationals can mitigate risks, foster trust with tax authorities, and avoid the pitfalls highlighted in the SABIC India case.

DOWNLOAD FREE BOOK

[**TAX INTELLIGENCE: THE 7 HABITUAL TAX MISTAKES MADE BY COMPANIES**](#)

Tax Intelligence: The 7 Habitual Tax Mistakes Made by Companies” by Dr. Daniel N. Erasmus is a must-read for businesses seeking to navigate the intricate world of tax compliance and risk management. By highlighting common pitfalls and offering strategic solutions, Erasmus equips companies with the knowledge to improve their tax practices and secure financial stability.

PREVENTATIVE

MEASURES TO AVOID SIMILAR CASES

TAX STEERING COMMITTEE

Establishing a tax steering committee can help ensure that tax policies are aligned with the broader business strategy and that transactions are vetted for both commercial and tax implications. A tax steering committee can:

- Review all significant cross-border transactions before they are executed.
- Ensure that tax decisions are made in the context of overall business objectives, not solely for tax savings.
- Monitor changes in international tax laws to ensure ongoing compliance and avoid disputes like this case.

DOWNLOAD FREE E-BOOK

[**DRIVING TAX COMPLIANCE: THE ESSENTIAL ROLE OF THE TAX STEERING COMMITTEE**](#)

The eBook “Driving Tax Compliance: The Essential Role of a Tax Steering Committee” by Prof. Dr. Daniel N. Erasmus, Renier van Rensburg, and Gilbert Ferreira, emphasizes the critical importance of establishing a Tax Steering Committee (TSC) within multinational corporations to ensure tax compliance and manage tax-related risks effectively.

INTERNATIONAL TAX **CASE SUMMARY**

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