



Transfer pricing :
Based on pre-depreciation profits: ITAT, Delhi.

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Before the Hon'ble Income-tax Appellate Tribunal, Delhi

Between

**Schefenacker Motherson, a JV between Motherson Sumi Sumi
Systems India and Schefenacker International, Germany**

And

Transfer Pricing Officer, New Delhi

Brief gist of the Order:

Transfer Pricing analysis should be based on pre-depreciation profits in the case where the company can demonstrate that higher depreciation has affected its profitability, according to an order passed by the Delhi Income-Tax Appellate Tribunal (ITAT).

The tribunal, which pronounced the order in a case filed by Delhi-based Schefenacker Motherson, a JV between Motherson Sumi Systems India and Germany-based Schefenacker International, sent the adjustment back to the transfer pricing officer for re-examination.

The ITAT held that such an approach would help avoid complications arising from huge variations in depreciation claims. This has come as a relief to companies when depreciation is high due to relatively new machines, high-end technology use and Capacities are grossly underutilised.

ITAT president Vimal Gandhi, who is an expert in cross-border taxation and is also involved with the United Nation's transfer pricing

programmes, said that transfer pricing analysis needs comparisons of profit of two or more similarly positioned companies to ensure that the profit figure is not manipulated by the taxpayer company.

Hence, a proper comparison of profits of companies in the same industry would be difficult, if depreciation is included in the calculation of profits as depreciation varies from company to company.

Depreciation would be higher in the companies that use state-of-art technology, while it is less in units that operate older machines. Hence, an ideal solution to this problem is to analyse the profitability of companies on the basis of cash profit on sales, the tribunal observed. Profits of units are compared in transfer pricing analysis to ascertain the profits are in accordance with industry norms and are not manipulated through internal transactions at artificial prices.

TPOs routinely find variations in depreciation to reject the claim of lower profits. In the case of Schenfenacker Mothersons, the I-T department argued that the depreciation is an element of cost that cannot be ignored and, since financial impact of variations cannot be quantified, no adjustments can be made.

The ITAT did not agree with the I-T department's contention. The tribunal ruled that computation of profits depends on the context and for that purpose depreciation is to be computed. It stated that there is no formula that apply universally. The ITAT pointed out that the contention that depreciation levels have "vitiating the comparison", remains uncontested by the I-T department.

OECD guidelines and norms of the Institute of Chartered Accountants of India are for exclusion of such depreciation, the tribunal said, before concluding that depreciation should be excluded in the present case to make any comparison meaningful.

Based on this analysis, the transfer pricing adjustment of Rs 1.97 crore was sent back to the TPO for re-examination.