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Transfer Pricing: The Invalidity Of Contentions Devoid Of Any Justification

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Introduction

In the recent case of *Sabic India Pvt Ltd Gurgaon vs DCIT* Circle 22(2) New Delhi, the Income Tax Appellate Tribunal (ITAT) was instructive that the tax administrator must provide a justifiable reason for discarding the use of the Transactional Net Margin Method (TNMM) adopted by the taxpayer and subsequently relying on the "other method" as the most appropriate method.

The Indian Tribunal held that methods such as the TNMM cannot be discarded without any valid justification as the method was widely accepted by the Indian revenue since 2009. In the *Sabic India* case, the Tribunal concluded that the tax administrator was not able to provide any justification for its decision that the methodology was not suitable.

Brief Facts

The taxpayer in the *Sabic India* case was primarily engaged in providing marketing support services to facilitate the selling of fertilizers and chemicals in India on behalf of the Sabic Group holding company. In this regard, the taxpayer does not hold any title to inventories and all products sold are directly invoiced to the holding companies of the taxpayer.

Therefore, the taxpayer had used the TNMM to benchmark the international transactions in relation to the provision of the support services. Due to the nature of the taxpayer's role in facilitation of sales and acting as a support service provider, the taxpayer has adopted the position that TNMM is the most appropriate method for benchmarking purposes. However, the tax administrator disagreed with the taxpayer and had adopted the view that "other methods" are more appropriate than the TNMM. However, the tax administrator did not provide any justification for its views.

REIMAGINING TAX SOLUTIONS

The Tribunal's Findings

It is pertinent to note that in *Sabic India*, the taxpayer had undertaken elaborate analysis in their transfer pricing report to justify the use of TNMM as the most appropriate methodology and further, to adopt the "berry ratio" as the profit level indicator. The Tribunal acknowledged the detailed analysis of the taxpayer's transfer pricing documentation and emphasised the reliability of the taxpayer's transfer pricing report – much weight was given to the taxpayer's detailed transfer pricing documentation.

On the other hand, the Tribunal had stated that the tax administrator had failed to provide any justification which had not only weakened the tax administrator's averments but was in fact, fatal to the tax administrator's case. It can be observed that the Tribunal's decision is consistent with the proposed approach in paragraph 4.13 of the Organisation for Economic Co-Operation and Development Transfer Pricing Guidelines 2012 (OECD Transfer Pricing Guidelines) which stipulates that the burden of proof may shift from the taxpayer to the tax administrator after the taxpayer had provided reasonable arguments.

The Legal Position In Malaysia

It is not uncommon for the Inland Revenue Board (IRB) to raise assessment against the taxpayer despite having provided detailed contemporaneous transfer pricing documentation in support of the taxpayer's case. This not only creates uncertainty for the taxpayers but also dissuades large multinational corporations from investing in the local market as the provision of detailed transfer pricing documentation by top tier tax advisory firms does not seem to be sufficient in the eyes of the IRB.

Recently, several Malaysian cases have adopted the approach in *Sabic India* in imposing an evidential burden on the tax administrator to produce countervailing transfer pricing report and/or documentation when alleging the shortcomings of the taxpayer's report. It is apparent that the mere raising of issues pertaining to the taxpayer's transfer pricing report is no longer sufficient to support the tax administrator's case. The courts have required the tax administrator to put forward its

case and the relevant justifications for its contention to the Appellant's material witness.

OM Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri

The Special Commissioners of Income Tax (SCIT) opined that the tax administrator did not provide sufficiently strong basis to deploy the TNMM as opposed to the taxpayer's choice of benchmarking methodology. In this regard, the SCIT emphasised that in the *OM Sdn Bhd* case, the tax administrator had failed to perform any of the required analysis to justify the use of TNMM and accordingly erred in raising the assessments against OM Sdn Bhd.

In *OM Sdn Bhd*, the IRB claimed that the transaction undertaken by the taxpayer was not at arm's length as the taxpayer was regarded as a normal distributor. In this regard, no further evidence and/or transfer pricing documentation was adduced to support this contention. The SCIT held that no contemporaneous documentation was provided to justify the tax administrator's contention and instead due weight was given to the robust transfer pricing documentation prepared by the taxpayer.

EG (M) Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri

In *EG (M)*, the High Court has remarked that the failure to provide countervailing transfer pricing reports of the tax administrator breeds unfairness and, in this regard, constitutes a breach of natural justice. In this regard, the High Court commented:

> *"In the circumstances, it is of the considered view that the Respondent had acted arbitrarily by not proffering any reasons and evidence to support its Decisions and as such the Decisions amount to a breach of the principles of natural justice and procedural fairness."*

The High Court in *EG (M)* had endorsed the views taken upon by the SCIT in the landmark transfer pricing case of *MM Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri* (2013) MSTC 10-046.

In the *MM* case, the SCIT had stated that it is not sufficient for the tax administrator to merely point out the shortcomings of the taxpayer's transfer pricing report but instead, the tax administrator is required to produce countervailing transfer pricing documentation to justify its contention. The SCIT applied the evidential rule and principles in *Aik Ming (M) Sdn Bhd v Chang Ching Chuen* [1995] 2 MLJ 770 in arriving at its conclusion. The Court of Appeal held that:

> *"The content of the second rule may be stated thus. It is essential that a party's case be expressly put to his opponent's material witnesses when they are under cross-examination. A failure in this respect may be treated as an abandonment of the pleaded case and if a party, in the absence of valid reasons, refrains from doing so, then he may be barred from raising it in argument. It is quite wrong to think that this rule is confined to the trial of criminal causes. It applies with equal force in the trial of civil causes as well."*

In this regard, the SCIT in the *MM* case applying the principle laid out in *Aik Ming*, arrived at the following conclusion:

> "… *we the Special Commissioners are aware of the Respondent's version of the shortcomings in the Appellant's transfer pricing reports, but we do not know what is the Respondent's version of what the transfer pricing reports ought to be in this case, not to mention that such Respondent's version (if it existed) of the reports were not put to the Appellant's witness*…"

The judicial remarks above are indicative that the tax administrator can no longer shelter behind the argument that legislation does not expressly require the tax administrator to produce transfer pricing documentation.

In *Pembinaan Batu Jaya Sdn Bhd v Pengarah Tanah dan Galian, Selangor & Anor* [2016] 2 MLJ 495**,** the Federal Court held that every exercise of statutory power cannot be arbitrarily exercised and must comply with all legal requirements stipulated under the law.

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At this juncture, it is clear that when the taxpayer had reasonably argued and provided justification for its transfer pricing analysis, the onus is on the IRB to adduce evidence to prove the contrary. It is difficult to envisage that the tax administrator had undertaken a holistic assessment without first conducting due benchmarking analysis and the preparation of the relevant transfer pricing documentation. Recently, the courts have been uncompromising in emphasising the need for the tax administrator to produce its version of the transfer pricing documentation and/or analysis when addressing the alleged shortcomings in the taxpayer's transfer pricing documentation.

Conclusion

It goes without saying that transfer pricing is not an exact science and tax administrators like the IRB should not impose unduly harsh burden on taxpayers in producing transfer pricing documentation. Therefore, it is fair that when the tax administrator avers that there are shortcomings in the taxpayer's transfer pricing documentation or report, it must be supported with the production of its own analysis and transfer pricing documentation. Recently, it can be observed that the Malaysian and the Commonwealth courts have held that the tax administrator's inability to produce transfer pricing documentation is fatal to its pleaded case – as a contention devoid of justification is no better than bare averments.

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