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### ACCEPT-REJECT OF COMPARABLES-WHEN CAN IT CONSTITUTE A 'SUBSTANTIAL QUESTION OF LAW'?

Comparability analysis is one of the most critical aspects of Transfer Pricing benchmarking and therefore it comes as no surprise that selection of comparables has been one of the highly litigated issues before Indian Courts. In a landmark judgment of *Softbrands India Pvt Ltd*<sup>[1]</sup>, Hon'ble Karnataka High Court ruled that Indian Tribunals are the final fact-finding authority; therefore, issue of comparable selection, application of filters, etc cannot give rise to a 'substantial question of law' to maintain an appeal before High Court unless some ex-facie 'perversity' is demonstrated in the Tribunal Order.

#### ***Ground for admissibility of appeal before the HC***

Under section 206A of the Income-tax Act, 1961 ('Act'), an appeal shall lie before the High Court against an order passed by Tax Tribunal only if the Court is satisfied that the case involves a 'substantial question of law'.<sup>[2]</sup> The Court can also frame additional 'substantial questions of law' at a later stage, if such 'substantial questions of law' are involved.

#### ***Substantial question of law***

Existence of a 'substantial question of law' is an essential condition for admission of an appeal to High Court. Following questions can constitute 'substantial question of law':

1. A finding of fact may give rise to a 'substantial question of law', only if it is perverse<sup>[3]</sup>.
2. A question of law having a material bearing on the decision of the case (i.e. something which affects the rights of parties to the suit) will be a 'substantial question of law'.
3. A question not covered by any specific provision, principle or precedents and involves a debatable legal issue.
4. A question wherein lower Courts decided the issue upon either ignoring or acting contrary to legal principle.
5. Any decision by lower Court wherein material evidence has been ignored or where the Courts have wrongly cast the burden of proof.

#### ***Ratio-decidenti of Karnataka High Court Ruling (Softbrands)***

The Karnataka High Court observed that the entire exercise of making Transfer Pricing adjustments on the basis of comparability analysis is a matter of estimation. The Tribunal being the final fact finding authority, adjudicates on the Transfer Pricing issues based on relevant material/facts produced. In this regard, the Court held that the taxpayer must demonstrate 'perversity' in the findings of the tribunal to give rise to a 'substantial question of law'.

The Hon'ble Supreme Court in a detailed judgment in *Arulvelu vs. State represented by the Public Prosecutor and Ors.*<sup>[4]</sup>, observed that the expression 'perverse' means that the findings of the subordinate authority are not supported by evidence bro

law or suffer from the vice of procedural irregularity.

'Perversity' implies a finding of the lower authority based on no evidence and/or while arriving at the said finding, relevant admissible evidence has not been taken into consideration or inadmissible evidence has been taken into consideration or legal principles has not been applied in appreciating the evidence, or when the evidence has been misread.<sup>[5]</sup>

The Karnataka High Court further elucidated that questions on interpretation of domestic law or tax treaties, share transfer in Tax Havens (like in the case of Vodafone etc.) , and Base Erosion and Profit Shifting (BEPS) would be considered as 'substantial question of law'.

Ultimately, the Court dismissed the appeal stating that the appellant (Revenue) has not appealed on the perversity of the Tribunal's order and nor was there any 'perversity' in the order of the Tribunal.

### ***Recent Delhi High Court Ruling (Pyramid IT Consulting)***

A recent Delhi High Court ruling in the case of Pyramid IT Consulting<sup>[6]</sup> constitutes an exception. In view of the specific facts of the case, the Court held that even though the subject matter involved selection of comparables, a 'substantial question of law' arose.

The Court noted that while it was correct that mere exclusion/ inclusion of comparables may not *per se* give rise to any 'substantial question of law' but in the present case there was only one comparable on the basis of which the Transfer Pricing Adjustment had been undertaken; other two of assessee's comparables had been excluded by tax authorities - therefore there was a 'substantial question of law' on the specific facts of the case.

The Court further noted that Tribunal overlooked Assessee's objections to inclusion of a comparable HCCA Business Services Ltd ('HCCA') which undertook payroll processing services in contrast to staffing services provided by assessee. The difference in functionality of the Assessee and HCCA was not discussed by Tax Tribunal.

Similarly, the Tribunal also overlooked a decision of the coordinate bench in the case of LG Chemicals<sup>[7]</sup> wherein HCCA Business Services Ltd was excluded on the ground that it owned intangibles.

### ***Comments***

In transfer pricing disputes, comparability analysis and application of quantitative filters has been one of the highly litigated issues. The impact of the Karnataka High Court ruling has been clearly visible in the form of a large number of Transfer Pricing Appeals landing up in the Apex Court via Special Leave Petition ('SLP') route. The Supreme Court is now expected to pronounce its final verdict and put the controversy to rest.

In the meantime, Delhi High Court ruling in the case of Pyramid IT Consulting<sup>[8]</sup> comes across as a silver lining in the clouds. Delhi High Court held that there was a 'substantial question of law' since the case turned upon one comparable which was in dispute and there were material facts that had escaped Tribunal's attention. Similarly there can be other cases as well wherein the inclusion or exclusion of comparable(s) may be the game changer and the Tribunal may have failed to take cognizance of material facts vitiating the fin

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- [1] [PCIT v. M/s. Softbrands India Pvt. Ltd. I.T.A. No. 536/2015, \(2018\) 102 CCH 0086 KarHC](#)
- [2] [Section 260-A in Income Tax Act, 1961 and Section 100 r/w. S. 103 of Code of Civil Procedure.](#)
- [3] [Vijay Kumar Talwar v. CIT, Delhi \(2010\) 78 CCH 0963 ISCC : \[2011\] 1 SCC 673.](#)
- [4] [Arulvelu and Ors. vs. State represented by the Public Prosecutor and Ors. \(2009\) 10 SCC 206](#)
- [5] [Vijay Kumar Talwar vs. Commissioner of Income Tax, Delhi \(2010\) 78 CCH 0963 ISCC : \(2001\) 1 SCC 673](#)
- [6] [Pyramid IT Consulting v. Additional Commissioner of Income-tax \(2019\) 105 CCH 0004 DelHC](#)
- [7] [LG Chemicals India Pvt. Ltd. vs. ACIT, Circle-15\(1\) ITA No. 1819/Del/2015, \(2016\) 47 CCH 0954 DelTrib](#)
- [8] [Supra](#)

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