CHAPTER

5 WHO ARE "ASSOCIATED ENTERPRISES" (AEs)?

- **Two or more enterprises are not AEs u/s 92A unless one or more clauses of section 92A(2) are attracted.**
- **Unless one of the clauses of sec. 92A(2) are attracted, two enterprises shall not be regarded as AEs even if one of them has *de facto* participation in capital or management or control of the other.**
- **Section 92A(2) governs the operation of section 92A(1) by controlling the definition of participation in management or capital or control by one of the enterprise in the other enterprise.**
- **If a form of participation in management, capital or control is not recognized by section 92A(2), even if it ends up in *de facto* or even *de jure* participation in management, capital or control by one of the enterprise in the other enterprise, it does not result in the related enterprises being treated as 'associated enterprises'.**

5.1 Mere mention in Form No. 3CEB of certain enterprises as AEs by assessee will not render them liable to be regarded as AEs

Two or more enterprises cannot be regarded as associated enterprises unless the provisions of section 92A are satisfied. This will be the case even if the assessee files Form No. 3CEB (CA report) mentioning the names of certain enterprises as its AEs as a matter of abundant caution - *Sanchez Capital Services (P.) Ltd.* v. *ITO* [2012] 26 taxmann.com 61 (Mum.).

Mere filing of Form 3CEB by the assessee does not automatically imply that section 92A conditions are satisfied and there is an AE relationship. Rather, the specific facts and circumstances of the case have to be analyzed in order to conclude whether or not an AE relationship actually exists.—*ITO* v. *Alumeco India Extrusion Ltd.* [2013] 38 taxmann.com 382 (Hyd. - Trib.)

In absence of any documentary evidence on record, Assessing Officer merely on basis of information available on website of foreign company, could not opine that Managing Director of assessee-company was also

Chairman and Managing Director of said foreign company with whom assessee had transactions worth more than Rs. 34 crores and, therefore, those international transactions were entered into with Associated Enterprise (AE) - *Oren Hydrocarbons (P.) Ltd.* v. *Asstt. CIT* [2014] 45 taxmann.com 219/31 ITR(T) 343 (Chennai-Trib.)

5.2 Definition of "associated enterprise" (AE) - Section 92A

SECTION 92A(1)(a) : LINEAR STRUCTURE

DIRECT PARTICIPATION

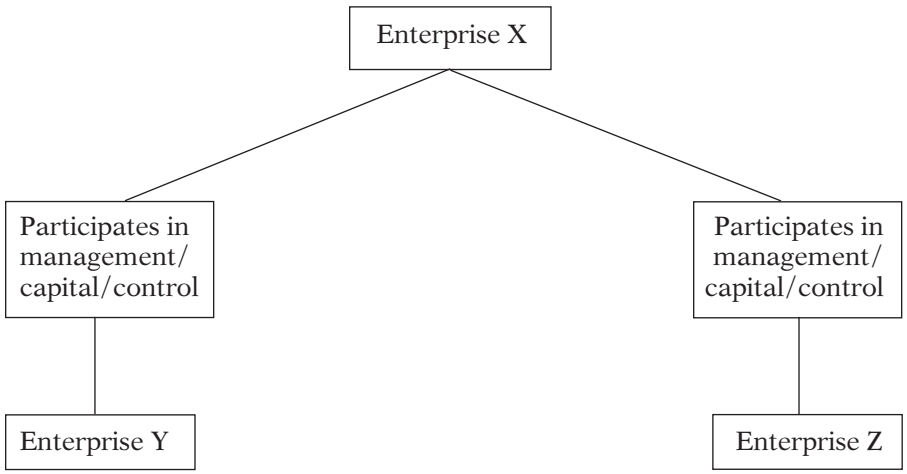
A and B are AEs

INDIRECT PARTICIPATION

A and B are AEs

SECTION 92A(1)(b) : LATERAL STRUCTURE

DIRECT PARTICIPATION IN TWO ENTERPRISES



Y and Z are AEs

Where there is no connection by way of participation in management or control or capital by entities or its subsidiaries, either directly or indirectly between two enterprises, they cannot be said to be associated enterprises and provision of Chapter X of Act cannot be applied.

In order to be associated enterprises, there should be participation, directly or indirectly or through an intermediary, in management or control or capital of two or more enterprises, as basic condition to qualify as associated enterprises.

According to section 92A(1), two enterprises are said to be associated enterprises in terms of section 92A(1) if :

(*a*) One of them participates in the control or management or capital of the other. Such participation may be direct or indirect or through an intermediary [section 92A(1)(*a*)]; or

(*b*) Same person(s) participate in the management or control or capital of both the enterprises. Such participation may be directly or indirectly or through one or more intermediaries [section 92A(1)(*b*)]. The following situations can arise under section 92A(1)(*b*) :

- ◆ Same person(s) participate directly in one and indirectly in another
- ◆ Participation by the same person(s) in both the enterprises are direct.
- ◆ Participation by the same person(s) in both the enterprises are indirect.
- ◆ Participation by the same person(s) in both the enterprises are through intermediaries.

Section 92A(1)(*a*) provides for a linear structure. For example, holding company and its subsidiary are AEs. Section 92A(1)(*b*) provides for a lateral structure. For example, fellow subsidiaries are AEs.

In *Kaybee (P.) Ltd.* v. *ITO* [2015] 57 taxmann.com 449/70 SOT 259/171 TTJ 536 (Mumbai-Trib.) it was held that where director and 99.9% shareholder of assessee-company was also director and CEO of a Singapore company and he was a part of decision making process of both companies one company could be said to be participating directly or indirectly in management or control of other enterprise and, thus, both companies were AEs of each other. In the instant case, there is no denial of the fact that 'G' was Director and 99.9 per cent shareholder of the assessee company and also was a Director and Chief Operating Officer of 'K' Limited, Singapore. Therefore, 'G' not only participated in management of both the companies but he was also holding the key position in the management of 'K' Limited, Singapore and was part of decision making process of the said company since 1996. 'G' is a common director in both the company and participating in the management of both the companies not for the name sake but he is holding the key position in taking decision

being a Chief Operating Officer of 'K' Limited, Singapore and almost the entire shareholding of the assessee company; therefore, the condition of one enterprise participates directly or indirectly or through one or more intermediaries in its management or control or capital as prescribed under clauses (*a*) & (*b*) of sub-section (1) of section 92A was satisfied and hence, the assessee and 'K' Limited, Singapore fell under the meaning of AEs as per the provisions of section 92A.

Section 92A defines the expression 'associated enterprises'. Section 92A has two sub-sections as under:

- Sub-section (1) lays down the basic rule that in order to be treated as associated enterprise one enterprise, in relation to another enterprise, participate, directly or indirectly, or through one or more intermediaries, "in the management or control or capital of the other enterprise" or when "one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise".
- Sub-section (2) provides illustrations of the cases in which such an enterprise participates in management, capital or control of another enterprise. The words "For the purpose of sub-section (1) *of section 92A*" were inserted in sub-section (2) by Finance Act, 2002. The Explanatory Memorandum to Finance Bill, 2002 explains that intent behind the insertion of these words was to clarify that the mere fact of participation by one enterprise in the management or control or capital of the other enterprise, or the participation of one or more persons in the management or control or capital of both the enterprises shall not make them associated enterprises, unless the criteria specified in sub-section (2) are fulfilled".

In *Orchid Pharma Ltd.* v. *Dy.CIT* [2016] 76 taxmann.com 63 (Chennai - Trib.), the provisions of sub-section (2) and inter-relationship between sub-sections (1) and (2) were explained by the Tribunal as under:

- Section 92A(2) governs the operation of section 92A(1) by controlling the definition of participation in management or capital or control by one of the enterprise in the other enterprise.
- If a form of participation in management, capital or control is not recognized by section 92A(2), even if it ends up in *de facto* or even *de jure* participation in management, capital or control by one of the enterprise in the other enterprise, it does not result in the related enterprises being treated as 'associated enterprises'.

- An analysis of section 92A(2) shows that there are three distinct segments of this sub-section - participation in capital, participation in management and participation by way control otherwise.
- First segment consists of clauses (*a*) to (*d*). Clause (*a*) refer to shareholding with 26% of voting power in other enterprise, clause (*b*) refers to common shareholding with 26% of voting powers in both the enterprise, clause (*c*) refers to advance by one enterprise to the other to the tune of 51% or more of the books value of the assets of the latter, and clause (*d*) refers to one enterprise guaranteeing not less than 10% of borrowings of the other enterprise.
- In all the four situations above, what is clear is that role played by one of the enterprise in the capital of the other enterprise, whether equity capital or loan capital or even by guaranteeing borrowings by the other enterprise, is so significant that one enterprise has *de facto* control over the other.
- The second segment, which consists of clause (*e*) and clause (*f*), covers participation in management.
- Clause (*e*) refers to the situation in which more than half of the board of directors can be appointed by the other enterprise, and clause (*f*) enterprise refers to the situation in which more than half of the board of directors of both the enterprise can be appointed by the same person.
- The third segment, which consists of clauses (*g*) to (*l*), refers to the situations in which relationship between the two enterprises is of such a nature that one enterprise has *de facto* control over the other enterprise, and the control is not on account of participation in capital or management.
- Clauses (*g*), (*h*) and (*i*) refer to the control by one of the enterprise over the other enterprise on account of commercial relationship.

In *Veer Gems* [ITA No.1514/Ahd/2012 C.O. No.184/Ahd/2012 (In ITA No.1514/ Ahd/2012). Judgment dated 03.01.2017], the ITAT discussed the definition of "associated enterprises" given in section 92A and explained the inter-relationship between sub-section (1) and sub-section (2) of section 92A as under:

- What section 92A(1) decides is the principle on the basis of which one has to examine whether or not two or more enterprise are associated enterprise or not.
- The principle is as long as an enterprise participates in any of the three aspects of the other enterprise, *i.e.* (*a*) management; (*b*) capital; or (*c*) control, these enterprises are required to be treated as associated enterprise, as also is the position when common persons participate in management, control or capital of both the enterprises.

- However, the expression 'participation in management or capital or control' is not a defined expression. To find the meaning of this expression, one has take recourse to section 92A(2) which gives practical illustrations, which are exhaustive and not simply illustrative.
- In this sense, section 92A(2) governs the operation of section 92A(1) by controlling the definition of participation in management or capital or control by one of the enterprise in the other enterprise.
- What is thus clear that as long as the provisions of one of the clauses in section 92A(2) are not satisfied, even if an enterprise has a *de facto* participation capital, management or control over the other enterprises, the two enterprises cannot be said to be associated.

Where assessee-company entered into licence agreement with a foreign company for sale of readymade garments under a particular brand name, since licensor company did not participate in capital and management of assessee-company as required under section 92A(1), both companies could not be regarded as AE of each other. The assessee-company was engaged in business of manufacture and sale of readymade garments under license agreement with Jockey International Inc., USA ('JII'), a company incorporated in USA and owner of brand 'Jockey'. In transfer pricing proceedings, the TPO opined that expenditure incurred by the assessee on advertisement and marketing and product promotion on behalf of JII was an international transaction. He thus made certain adjustment to the assessee's ALP in respect of aforesaid expenditure by applying Bright Line Method. *Held* that in order to constitute relationship of an AE, parameters laid down in both sub-sections (1) and (2) of section 92A should be fulfilled. Since there was no participation of JII in capital and management of assessee-company, parameters laid down in sub-section (1) of section 92A were not fulfilled and, thus, there was no relationship of AE between the assessee-company and JII. In view of above, provisions of Chapter X of Act had no application and, consequently, impugned adjustment was to be set aside. - *Page Industries Ltd.* v. *Dy. CIT* [2016] 71 taxmann.com 172/159 ITD 680/181 TTJ 798 (Bang.)

In *Kaybee (P.) Ltd.* v. *ITO* [2015] 57 taxmann.com 449 (Mumbai - Trib.), a view was taken which is completely contrary to the rulings on *Orchid Pharma* (*supra*) and *Veer Gems* (*supra*).

The Tribunal explained the deeming fiction in section 92A(2) as under :

- The meaning of AEs is provided under sub-section (1) of section 92A and if the condition provided in clauses (*a*) & (*b*) of sub-section (1) are independently satisfied then the two enterprises for the purpose of sections 92B to 92E of will be treated as AEs.
- Sub-sec. (2) of section 92A is a deeming fiction and therefore, it expands/enlarges the scope and meaning of expression 'AE' provided under sub-section (1) of section 92A.

- Since sub-section (2) is a deeming fiction, therefore, it can be applied only in the specific facts of the case where any of the conditions stipulated in the clauses of this sub-section are fulfilled. It has no general application in respect of the meaning 'AE'. Even otherwise, sub-section (1) of section 92A does not begin with the subjective clause 'subject to sub-section (2)'.
- Sub-section (2) is a deeming fiction and, therefore, the condition/ criteria specified therein is required to be fulfilled.
- As it is clear from the criteria enumerated in clauses (*a*) to (*m*) of sub-section (2) of section 92A that none of the clauses prescribed any criteria in respect of one enterprise participate directly or indirectly or through one or more intermediaries in the management which is one of the conditions prescribed under clauses (*a*) & (*b*) of sub-section (1) of section 92A of the Act.
- Therefore, even if, for the sake of argument it is presumed that the meaning of AE in terms of sub-section (1) of section 92A has to be understood as per the criteria provided in clauses (*a*) to (*m*) of sub-section (2), the condition of participating in the management directly or indirectly or one or more intermediaries as per clause (*a*) of sub-section (1) does not get affected by the criteria prescribed under sub-section (2).

5.2-1 Definition of 'enterprise'

According to section 92F(*iii*), "enterprise" means a person (including a permanent establishment of such person) who is, or has been, or is proposed to be, engaged in any of the following activities :

- any activity, relating to the production, storage, supply, distribution, acquisition or control of articles or goods, or know-how, patents, copyrights, trade-marks, licences, franchises or any other business or commercial rights of similar nature, or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights, or
- the provision of services of any kind, or
- in carrying out any work in pursuance of a contract, (*e.g.* construction contract), or
- in investment, or
- providing loan, or
- in the business of acquiring, holding, underwriting or dealing with shares, debentures or other securities of any other body corporate.

It does not matter whether such activity or business is carried on, directly or through one or more of its units or divisions or subsidiaries.

Also, it does not matter whether such unit or division or subsidiary is located at the same place where the enterprise is located or at a different place or places.

According to section 92F(*iiia*) of the Act, "permanent establishment" includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.

If one were to go by the rulings of ITAT in *Orchid Pharma* (*supra*) and *Veer Gems* (*supra*), no hair splitting required as to what is 'participation in capital' or 'participation in management' or 'participation'. 'Participation in Capital' shall be understood in the light of clauses (*a*) to (*d*) of sub-section (2) of section 92A. 'Participation on management' has to be understood in terms of clauses (*e*) and (*f*) of sub-section (2) of section 92A. The expression 'participation in control' is to be understood as '*de facto* control' in terms of clauses (*g*) to (*l*) of sub-section (2).

5.3 Exhaustive illustrations of cases where one enterprise is deemed to participate in the capital or management or central of another

In terms of section 92A(2), for the purposes of section 92A(1), two enterprises will be deemed to be associated enterprises ***if any of the conditions in clauses (a) to (m)*** in section 92A(2) are ***fulfilled any time during the previous year.*** The CBDT has *vide* Circular No. 8/2002 clarified section 92A(2) as under:

> **"50.3.1** The Finance Act, 2002 has amended sub-section (2) of section 92A to clarify that where any of the criteria specified in sub-section (2) is fulfilled, two enterprises shall be deemed to be associate enterprises."

This, is turn, gives rise to the following implications :

- For every previous year, deemed associated enterprise will have to be identified afresh.
- If at any time during the previous year any of the conditions in clauses (*a*) to (*m*) are satisfied, the enterprises will be deemed to be associated enterprises.
- If conditions in section 92A(2) for treating enterprises as AEs are fulfilled at any time during the previous year, enterprise would be AE for the entire period and ALP has to be determined for the entire period.
- The direct relationship between two enterprises is relevant in clauses (*c*) to (*m*) of section 92A(2). This because the words directly or indirectly is not used anywhere in clauses (*c*) to (*m*)—ICAI's *Revised Guidance Note on Report on International Transactions under section 92E of the Income-tax Act, 1961* (hereinafter referred to as "Revised Guidance Note on Transfer Pricing").

Two enterprises shall be deemed to be associated enterprises, if at any point during the previous year, if any of the following conditions [Paras 5.3-1 to 5.3-13] are satisfied :

5.3-1 26% shareholding with voting rights

If one enterprise holds, directly or indirectly, shares carrying 26% or more of the total voting power of the other enterprise [section 92A(2)(*a*)], both enterprises are AEs.

According to Revised Guidance Note on Transfer Pricing issued by ICAI:—

(*a*) In view of the words "shares" and "voting power" used in this clause, this clause applies only when the investee enterprise is a company. This view is further supported by the fact that clause (*j*) refers to individuals, clause (*k*) to HUFs and clause (*l*) to firms/AOPs/BOIs.

(*b*) The shareholding can be direct or indirect (*i.e.* through intermediary).

While the investee has to be a company, it is not required that the investor-enterprise should also be a company.

Example 1 - ABC Inc of USA holds 30% of voting power in XYZ (India) Pvt. Ltd. Both these companies are AEs in terms of section 92A(2)(*a*).

Example 2 - ABC Ltd. of India holds 27% of voting power in PQR plc of UK. Both companies are AEs.

5.3-2 Same person or enterprise holds 26% voting right in both enterprises

If any person or enterprise holds, directly or indirectly, shares carrying 26% or more of voting power in both enterprises, then both are associated enterprises [section 92A(2)(*b*)].

For this clause to apply—

- both the investee enterprises have to be companies.
- one person or enterprise simultaneously holds shares carrying 26% or more voting power in each of them.
- both the enterprises need not hold any shares in each other if they have common 26% or more voting right holders.
- shareholding may be direct or indirect.

It would appear that section 92A(2)(*b*) would equally apply to cases where any person or enterprise holds 26% or more voting power in two or more companies - *Diageo India (P.) Ltd.* v. *Dy. CIT* [2011] 13 taxmann.com 62 (Mum.)

Example 1 - ABC Inc of USA holds 30% of voting power in ABC India Ltd. and 34% of voting power in ABC Plc of UK. ABC India Ltd. and ABC Plc. are AEs by virtue of section 92A(2)(*b*). ABC Inc of USA and ABC India Ltd. are AEs as per section 92A(2)(*a*). ABC Inc and ABC Plc. are AEs as per section 92A(2)(*a*).

Example 2 - ABC Inc of USA holds 30% of voting power in ABC India Ltd., 34% of voting power in ABC Plc of UK and 32% of voting power in ABC Co. of Netherlands. ABC India Ltd., ABC Plc and ABC Co. are AEs by virtue of section 92A(2)(*b*) even though section 92A(2)(*b*) refers to only "both companies". This is in view of ITAT's ruling in *Diageo India* (*supra*).

5.3-3 Lender who advances loan to the extent of 51% or more of the book value of assets of the borrower

A loan advanced by one enterprise to the other is 51% or more of the book value of the total assets of the other at any time during the previous year, then the borrowing enterprise and lender enterprise are associated persons [section 92A(2)(*c*)]. The test is whether the loan advanced is 51% or more of the book value of assets of the borrower enterprise and not 51% or more of the market value of assets of the borrower-enterprise. In this case, 2 independent enterprises are deemed to be AEs.

CASE STUDY 1

To take an example, borrower enterprise has assets totalling to ₹ 100 crores (book value) while market value of these assets is ₹ 500 crores as immovable property ₹ 2 crores (book value) which were purchased long time back actually have market value of ₹ 402 crores. Suppose loan of ₹ 51 crores is advanced to the enterprise, the lending enterprise and borrowing enterprise become associated enterprises since loan advanced is 51% of book value of assets, even though loan advanced is only 10.2% of the market value of assets. Had these assets been revalued and appeared at revalued amounts as per opening balance sheet and then loan was advanced, the lender and borrower might have been outside the pale of the relationship of "associated enterprises". So, suitably timed revaluation of assets (where there is upward increase) can keep borrowing and lending enterprises out of the pale of section 92A(2)(*c)* and Chapter X.

How to calculate numerator - i.e. loan advanced - Suppose Enterprise A gives a loan of $10 million to Enterprise B on 1-4-2017. At that time, the book value of assets of enterprise B was $20 million. On 26-4-2017, enterprise B repays $ 1 million. On 30-4-2011, due to booking of impairment losses, the book value of assets of enterprise B is $ 18 million. At that time, loan outstanding is $ 9 million (*i.e.* $ 10 million *minus* $ 1 million repaid). Is the loan of enterprise A constituting $9/18 = 50\%$ of book value of total assets of enterprise B or is it constituting $10/18 \times 100 = 55\%$ of total book value of assets of enterprise B. It appears that it is the latter *i.e.* 55% since words used in the clause are "loan advanced" (i.e., the original loan of $10 million) and not "loan outstanding" (*i.e.* $ 9 million).

How to calculate denominator - i.e. book value of assets - The Act has not defined the expression "book value of assets". There will naturally be questions about whether intangible assets, accumulated losses, deferred revenue expenditure should be included or not. Revised Guidance Note on Transfer Pricing is also silent on this issue. The term 'book value' has been defined by ICAI in its *Guidance Note on Terms used in Financial Statements* as the amount at which an item of asset is shown in the books

of account or financial statements. It is simply the amount at which asset is shown in books or balance sheet. The method of valuation adopted *i.e.* cost, replacement value etc. is immaterial. Also it is not relevant whether valuation is as per Accounting Standards or not.

The term asset is defined in the *Framework for Preparation and Presentation of Financial Statements* (hereafter referred as "the Framework") issued by ICAI. The following are the required essentials of an asset :

- It is a resource.
- It arises out of past transactions or events.
- It is controlled by the enterprise.
- Future economic benefits are expected from it.

Obviously if the above tests are applied, the following points emerge :

- Intangible assets, as defined in AS-26 *Intangible assets,* are assets. So, they must be included in book value of assets.
- Since no future economic benefits will arise from accumulated losses (that they are shown in assets side only because they have debit balance), it is not an asset and will not be included in book value of assets.
- The enterprise does not control the expected future economic benefits from deferred revenue expenditure. Hence, they are not assets.
- All the items on asset side of balance sheet which satisfy the definition of 'assets' in the Framework should be taken at 'book value'.
- Moreover, the book value of assets only should be taken without deducting book value of liabilities.

CASE STUDY 2

XYZ Private Limited, a recently incorporated entity, has obtained a loan of ₹ 5 crores from PQR Bank for setting up the manufacturing facility. The book value of total assets of XYZ Private Limited is ₹ 9 crores. XYZ Private Limited is not related to PQR Bank in any way. The loan advanced by PQR Bank (one enterprise) to XYZ Private Limited (the other enterprise) constitutes 55.55% (*i.e.* more than 51%) of the book value of the total assets of XYZ Private Limited (the other enterprise). Thus, PQR Bank and XYZ Private Limited are deemed to be Associated Enterprises because the extent of loan exceeds 51% of the book value of the assets of XYZ Private Limited.

5.3-4 Substantial guarantor of other enterprise [Section 92A(2)(d)]

If at any time during the previous year, one enterprise guarantees 10% or more of the total borrowings of the other enterprise, both enterprises are associated enterprises.

5.3-5 Appoints more than 50% of the Board/Governing body of the other enterprises [Section 92A(2)(e)]

If any of the following two conditions are satisfied, both enterprises are associated enterprises :

- One enterprise appoints more than 50% of directors or members of the Board/Governing body of the other.
- One enterprise appoints one or more executive directors/executive members of the board/governing body of the other.

ICAI's Revised Guidance Note on Transfer Pricing clarifies as under :

- If one enterprise appoints even one person as executive director/executive member in the Board/Governing body of the other, both enterprises are associated enterprises.
- The term "governing board" would be understood in the same sense as 'board of directors' - *i.e.* a body or council that has the authority to manage the affairs of enterprise other than company. The entities in question could be artificial non-corporate bodies.

The following points are important :

- Merely having the power to appoint (50% of directors/one or more executive directors) is not enough. Actual exercise of the power is necessary to make both enterprises associated enterprises.
- It is the enterprise which appoints directors/executive director(s)/member(s) in the other enterprise here. One of the directors of one enterprise does not make these appointments in the other.

***Example* 1** - If enterprise A appoints 5 directors on the Board of Enterprise B Ltd. The Board strength of enterprise B Ltd. is 9 directors. Then Enterprise A and Enterprise B Ltd. are associated enterprises.

But if enterprise A only has the power to appoint 50% or more directors in B Ltd. but does not actually exercise that power, then enterprises A and B Ltd. are not associated enterprises.

5.3-6 Same persons appoint more than 50% of directors or any executive director in both enterprises [Section 92A(2)(f)]

If, at any time during the previous year, if same person or persons appoint—

(*a*) More than 50% of the directors or members of the governing body in each of the two enterprises; or

(*b*) One or more executive directors or executive members of governing body in each of the two enterprises.

In either case, both the enterprises are associated enterprises.

The above gives rise to the following possibilities :

(*a*) Same person(s) appoint 50% or more of the directors or members of governing body in each of the two enterprises.

(*b*) Same person(s) appoint one or more executive directors or executive members in the board/governing body of each of the two enterprises.

(*c*) Same person(s) appoint one or more executive directors or executive members in one enterprise and 50% or more of the directors/members in the other.

Obviously, possibilities (*a*) and (*b*) are covered in section 92A(2)(*f*). In ICAI's view, possibility (*c*) is also covered in section 92A(2)(*f*) and both enterprises are associated enterprises.

The deeming fiction in section 92A(2)(*f*) is equally applicable when the same person or persons appoint—

(*a*) More than 50% of the directors or members of the governing body in three or more enterprises; or

(*b*) One or more executive directors or executive members of governing body in each of 3 or more enterprises.

In *Diageo India (P.) Ltd.* v. *Dy. CIT* [2011] 13 taxmann.com 62 (Mum.), the ITAT interpreted this clause as under:

- A literal interpretation to section 92A(2)(*f*) will mean that if this relationship is between two enterprises, these two enterprises are required to be treated as 'associated enterprises' but when the same basis extends to more than two enterprises, these enterprises will not be associated enterprises. That is clearly an incongruous result.
- As all clauses of deeming fictions set out in section 92A(2) are only illustration of the manner in which this *de facto* control on decision making exists, it is necessary that, while interpreting these deeming fictions, one interprets the same in such a manner as to make them workable rather than redundant (*ut res magis valeat quam pereat*).
- The same test of effective control on decision making as are implicit in deeming fiction under section 92A(2) would also apply to the situations of more than two associated enterprises envisaged in section 92A(1)(*b*).

5.3-7 One enterprise is 100% dependent on the exclusive rights of the other [Section 92A(2)(g)]

Both enterprises are deemed to be AEs in relation to each other if :

- at any time during the previous year,
- the manufacturing or processing of goods or articles or business of one enterprise is wholly dependent on the intangible assets of the other.

In other words, one enterprise is wholly dependent on the use of knowledge, patents, copyrights, trade mark, licenses, franchises or *similar business or commercial rights* or any data, documentation, drawings or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or over which the other enterprise has exclusive rights. Section 92A(2)(*g*) applies only if the manufacture or processing of or business carried out by one enterprise is wholly dependent upon the intangible assets of the other. That is, if an enterprise manufactures more than one article or thing and it uses the know-how of the other for one article or thing, manufacture of all the articles or goods carried out by the first enterprise is not wholly dependent on the intangible asset of the other enterprise and hence section 92A(2)(*g*) does not apply here.

The ICAI's Revised Guidance Note on Transfer Pricing clarifies as under :

- If an Indian enterprise wholly depends on the license granted by a non-resident enterprise for the manufacture or processing of goods or articles or business carried out by the Indian enterprise, both the enterprises will be deemed to be associated enterprises.
- The other enterprise should be the owner of intangible rights or should have exclusive rights over such assets. If the other is a mere non-exclusive licensee with a right to sub-license and accordingly sub-licensed to the other enterprise, section 92A(2)(*g*) will not apply as the first enterprise is neither the owner nor does it have exclusive rights over intangible assets.

5.3-8 90% supply coupled with price influence [Section 92A(2)(h)]

Both enterprises are deemed to be AEs in relation to each other if, at any time during the previous year, 90% or more the raw materials and consumables required by one enterprise for manufacturing/processing carried out by it are supplied by the other enterprise or by persons specified by the other enterprise and prices and other conditions relating to supply are influenced by the other enterprise. For this clause to apply, both conditions must be fulfilled :

(*a*) 90% or more of the raw materials and consumables required for manufacturing or processing by an enterprise are supplied by :
  - the other enterprise or
  - persons specified by the other enterprise; and

(*b*) the other enterprise influences prices and other conditions related to supply.

The following points are noteworthy

- The 90% criteria should be applied only to raw materials and consumables used for manufacturing and processing.—Revised Guidance Note on Transfer Pricing.

5.3-9 Customer who influences the price and other conditions [Section 92A(2)(i)]

Both enterprises are deemed to be AEs in relation to each other if, at any time during the previous year : (*i*) the goods or articles manufactured or processed by one enterprise, are sold to the other enterprise or persons specified by the other enterprise, and (*ii*) ***the prices and other conditions*** relating thereto are influenced by such other enterprise.

Sale of manufactured or processed goods is only covered by this clause. Sale of traded goods is not covered [ICAI's Revised Guidance Note on Transfer Pricing].

If the enterprise, which buys the goods manufactured or processed by another, influences the price and other terms of the transaction, both enterprises are associated enterprises.

The plain language of clause (*i*) of sub-section (2) would suggest that the proportion of output which the first mentioned enterprise buys is irrelevant since no minimum criteria such as 90% is laid down in this clause unlike section 92A(2)(*h*). However, it has been held that Seller and buyers are deemed AEs u/s 92A(2)(*i*) only if buyer's influence on terms of sale is "dominant influence". For deeming buyer and seller enterprises to be AEs under section 92A(2)(*i*), buyer must have dominant influence over prices and other conditions of sale amounting to *de facto* control of buyer over seller. Mere influence or dictating terms or "take it or leave it" is not sufficient to deem buyer and sellers as AEs under section 92A(2)(*i*) absent participation in management or control or capital of buyer in seller. Where due to business compulsions, seller chooses to accept accepts buyer's terms does not make both AEs. The dominant influence of buyer should be such that the seller has to accepted dictated terms and has no choice. Where export sales to buyer is less than 5% of sellers exports, obviously section 92A(2)(*i*) can't be invoked. - *Orchid Pharma Ltd.* v. *Dy. CIT* [2016] 76 taxmann.com 63 (Chennai - Trib.). One thing which is immediately discernible is that if this clause is interpreted literally, even when sales of one enterprise to the other enterprise constitute less than one per cent and that other enterprise can influence the prices at which the goods are sold, these two enterprise will be treated as associated enterprises on account of commercial relationship. That is clearly incongruous and infact absurd because the level of commercial relationship, in such a situation, will be so insignificant that there cannot be any "control" by one of the enterprise over the other, which is a *sine qua non* for invoking the status of associated enterprises under third limb of test laid down by section 92A(1).

It is, therefore, important that the expression 'influence' is given a sensible meaning so as to make the provisions of section 92A(2)(*i*) workable rather than adopting a literal meaning which will lead to wholly incongruous results.