MANAGEMENT SERVICE FEES – Transfer Pricing Aspects

How to defend your Management Service Fees Payment before Tax Authorities?

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By TAXWIZE

A Professional Firm founded by Ex-Big4 and Ex-IRS Professionals

About TAXWIZE

TAXWIZE is a Professional Firm of India, consisting of Ex-Big 4 Tax and Transfer Pricing professionals. We offer services in the areas of Transfer Pricing, International Tax, Tax Treaty matters, Corporate Direct Tax, and Indirect Tax. In these areas we undertake planning, transaction structuring, arm's length benchmarking, compliance, representation before Tax Authorities and appeal litigation, including arguing cases before CIT (Appeals) and Dispute Resolution Panel (DRP).

We have extensive experience of serving Corporate clients, both Indian and Foreign MNCs, from a variety of Industries, like Pharma, Specialty Chemicals, Medical Equipments, Automobiles, Engineering, IT, ITeS, Food Ingredients, etc.

Specifically, as a Professional Firm, we have helped clients - more than 30 organisations in 12+ industries - achieve success in Transfer Pricing: planning, setting prices, testing prices, benchmarking, compliance, study reports, and litigation.

On the Consulting side, we have led Transfer Pricing planning, Tax planning and structuring for more than 20 companies, including several listed companies. We have won more than 15 cases for companies in Transfer Pricing litigation, appeals and dispute resolution.

TAXWIZE has also registered its presence in the events of International Tax Review and the Institute of Chartered Accountants of India (ICAI), as well as in Articles of Professional Journals.

Our recent speaking engagements:

1. Participated as Speaker (Mr. Nilesh Patel, Senior Partner of TAXWIZE was the Speaker) at *Global Transfer Pricing Forum* organised by International Tax Review at Washington DC, USA
2. Conducted an Interactive Session on Transfer Pricing at *Program on International Taxation* organized by WIRC Mumbai

3. Conducted Seminar on Domestic Transfer Pricing at *ICAI International Tax Convention* – Baroda
4. Made Presentation on Profit Split Method and OECD BEPS Project - at RSM Astute Consulting, Mumbai
5. Conducted Workshop on Transfer Pricing Documentation - at Andheri Study Circle of ICAI

Our recent publications:

1. Package by OECD to Implement Country-by-Country Reporting: Will it enhance Transparency? – *Article on TAXSUTRA Portal*
2. OECD BEPS Action 8: OECD Recommends use of Hindsightfor pricing of Hard-To-Value-Intangibles –*Article in International Tax Journal of TAXMANN*
3. OECDBEPS Action 8 to 10:How to price intra-group transactions involving Intangibles? - *Article in International Tax Journal of TAXMANN*

In addition, Mr. Nilesh Patel, Senior Partner of TAXWIZEhas authored a Comprehensive Book on Transfer Pricing which was published in November 2014 by TAXMANN.

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Contents

How to defend your Management Service Fees Payment,in Transfer Pricing Assessment, in Appeal, in DRP hearings and in ITAT hearings?

1. Background

1.1. The payment of Management Service Fees ('MSF') is a necessary modern dayfeature of Multinational Companies ('MNCs'). Centrally coordinated services are required by MNC Group entities in order to maintain global standards, quality, competitive edge, confidentiality, etc. and also to reduce cost.

1.2. Transfer Pricing Officers ('TPO') and Assessing Officers ('AO') view the payments of MSFwith suspicion. They routinely disallow the MSF payments by determining the Arm's Length Price ('ALP') as Nil on various grounds,such as, no services were received, no benefits were received, duplicative services were received, the services were in nature of shareholder activity,or only incidental benefits were received. According to the TPO no independent third parties would be willing to make payment for availing management services, and so the ALP is determined as Nil.

2. Objective of this Article

2.1.This Article explores the issue of MSF in-depth, with the objective of empowering the Taxpayers to argue persuasively before the TPO, DRP, CIT(A) and ITAT, in support of payment of MSF to foreign affiliates.

Specifically, this article discusses the following:

I.What Documents, Agreements, and Evidences should you maintain in orderto:

- Prove the receipt of services, and
- Demonstrate ALP Benchmarking i.e. the payment made is at arm's length

II. How should you benchmark the payment of MSF?

III. Relevant Case Law - What are the relevant High Court and ITAT Cases:

- In favour of the Taxpayer and
- In favour of the Department

IV. What principles do those cases laydown,on the claim of payment of MSF to Foreign Associated Enterprises and ondetermination ofALP of such payment? *A detailed issue-wise compilation of more than 40 cases is provided in* ***Annexure I*** *of this Article.*

V. What counter-arguments can you make to rebut the TPO's arguments? [A comprehensive Chart of counter-arguments is provided a little later on Page 8 onwards]

In the following paragraphs we discuss the above points in more detail.

I. What Documents and Evidences should you maintain in order to demonstrate that management services were indeed rendered by the Associated Enterprises ('AEs') and received by the Taxpayer Entity?

Ideally, the following documents and evidences should be maintained.

a. Agreements–Clauses of the Agreement should specifically include the below mentioned information:

- Capability and Infrastructure of the AE to provide management services
- Why the Taxpayer Entity needs to avail the management services?
- Detailed description of various services, and nature of services received from AE
- Mode of rendering and receiving of services
- Fees for the services and the basis of arriving at the fees

- Working of costs-allocations (Direct as well as Indirect charges), including allocation keys. Some examples of allocation keys are given below:
  - IT: number of PCs
  - Business management software (e.g. SAP): number of licences
  - Human Resources: headcount
  - Health and safety: headcount
  - Management development: headcount
  - Tax, Accounting, etc.: turnover or size of balance sheet
  - Marketing services: turnover
  - Vehicle fleet management: number of cars
- The Agreement should clearly state these aspects: What exactly is provided by the AE? In what manner? And at what cost?

b. Wherever feasible, the following record of services received during the year may be maintained. Such record should preferably be contemporaneous i.e. as and when the services are received.

- Visits of AE's Personnel
- Trainings, Workshops, Seminars, etc. conducted by the AE
- Research Reports made available by the AE
- Expert Presentationsshared by the AE
- Access to IT Systems, Websites, Databases, Intranet, etc.
- Screenshots of login by users of taxpayer entity
- Logbook of users of IT Systems, ERP, Accounting Systems, E-learning, etc.
- Certificates of Experts of AE
- Certificates from AE's Management

c. Evidence of the AE's Capabilities, Cost Centre, Infrastructure, etc.

- AE's Profit and Loss Account and Balance Sheet
- Certificate from AE's Auditors

- Certificate from AE's Management

d. Proof that Services were rendered by the AE

- Record of Personnel employed by the AE
- Costs incurred by the AE
- Assets and Infrastructure deployed by the AE
- Mode through which services were rendered by the AE. For example, emails, expert presentations, research reports, conference-calls, workshops, trainings, site-visits, recommendations, access to databases, etc.
- Document it all:Details of services rendered by the AE? When? In what manner?
- Services rendered by the AE to other group entities

e. Proof that the services were received by the Taxpayer Entity

- Invoices
- Ledger of AE
- Benefits that accrued due to services
- No corresponding Expenditure of the same or similar nature debited to the Taxpayer's Profit and Loss account
- No corresponding Assets in the Balance Sheet
- Emails and Correspondence, linked up with the Invoices.
- Conference calls
- Visits of AE's personnel
- Screenshots of websites, databases, Intranet, etc.
- Expert Presentations and Research Reports provided by the AE
- Certificates from AE's Personnel, AE's Management, or AE's Auditors

f. Detailed Chart showing description of services, mode of receipt of services and proof of receipt of services

g. TP Study Report - Following details must be included in theTP Study Report:

- Detailed description of services, benefits from services and rationale for availing services from the AE
- ALP Benchmarking of the MSF paid to the AE

II. How should you benchmark the payment of MSF?

a. To determine the ALP you can benchmark the payment of MSF by performing aggregated Transactional Net Margin Method ('TNMM') analysis. That is, you can bunch or combine MSF with other internal transactions (sales, purchases, etc) and apply TNMM in a combined manner. Thus, all international transactions, including MSF, can be benchmarked together, by way of comparison of Taxpayer's Profit Level Indicator ('PLI') at entity level, with the PLI's of comparable companies. This approach was approved by the High Court and the ITAT in following cases:

- *N L C Nalco India Ltd vs DCIT [TS-36-ITAT-2016(Kol)-TP] (ITAT Kolkata)*
- *Ingersoll Rand (India) Ltd vs DCIT IT (TP) [TS-190-ITAT-2015(Bang)-TP] (ITAT Bangalore)*
- *DCIT vs Payne (India) Pvt Ltd, [TS-346-ITAT-2015(Bang)-TP] (ITAT Bangalore)*
- *Knorr-Bremse India (P) Ltd vs ACIT [2015] 63 taxmann.com 186 (Punjab & Haryana)*
- *McCann Erickson India (P) Ltd vsAddl CIT [2012] 24 taxmann.com 21 (ITAT Delhi)*
- *DCIT vsDanisco (India) (P) Ltd [2015] 63 taxmann.com 174 (ITAT Delhi)*
- *Fosroc Chemicals India (P) Ltd vs DCIT [2015] 58 taxmann.com 85 (ITAT Bangalore)*
- *AWB India (P) Ltd vs DCIT [2014] 50 taxmann.com 323 (ITAT Delhi)*

b. The benchmarking under TNMM can further be corroborated be using the Other Method (the 6th Method) by using quotations of third party suppliers providing same or similar kind of services.

c. Cost Plus Method - or TNMM - can also be applied by taking the Service Provider AE as the Tested Party. Of course, to do that you will have to identify Foreign Comparablesusing Foreign Databases. This approach was approved by the ITAT in the following cases:

- *AWB India (P) Ltd vsAddl CIT, ITA No. 4454/Del/2011, dated 22 March 2013 (ITAT Delhi)*
- *Gillette India Ltd vs ACIT [2015] 62 taxmann.com 57 (ITAT Jaipur)*

III. Relevant Case Law – Cases decided by the High Court and the ITAT

In a large number of cases the High Court and the ITAT have decided the Issue of MSF in favour of the Taxpayers. Below we highlight the principles laid down by the High Court and the ITAT:

i. Evidence filed by the Taxpayer should not be ignored

ii. Necessity to avail of Services from AE cannot be questioned by the TPO and the AO

iii. Taxpayer's Business Judgement and Commercial Expediency cannot be Questioned

iv. Whether the Taxpayer received any Benefit from the Services is not a relevant consideration

v. TPO cannot compute ALP of services at NIL

vi. Burden is initially on the assessee to determine the arm's length price

vii. It is the Taxpayer's burden to prove receipt of Service from the AE

viii. Cost-Allocations are acceptable; direct-charge is not required in all cases

ix. What are the Elements of TPO's Authority?

x. TPO cannot determine ALP of services under CUP method without bringing on record comparable transaction

xi. The Taxpayer can Benchmark the Management Services by applying Entity Level TNMM, by aggregating management service transactions with other transactions

xii. The Management Services can also be Benchmarked by taking AE as the Tested Party

xiii. Division of Authority between the AO and the TPO

xiv. Management Service Fee should not be taken as Expenditure to compute Assessee's PLI

xv. Principle of Year-to-Year Consistency does not allow authorities to take view which is different from the view taken in earlier or later years

For sake of reference we have provided a detailed issue-wise compilation of more than 40 relevant cases in *Annexure I*.

But before Annexure I please find - on the next few pages - a Chart of Counter Arguments that you can make against the Arguments commonly raised by the TPO.

IV. Counter Arguments which the Taxpayers can make against the Arguments commonly raised by the TPO

Below we provide the counter-arguments which the Taxpayers can make, to rebut the arguments commonly raised by the TPO while disallowing the MSF:

Transfer Pricing Officers' Arguments	Taxpayers' Counter-Arguments
1. The Taxpayer has not filed any contemporaneous documentation to prove receipt of services • Documentation of Taxpayer is too generic • Emails and correspondence submitted by the Taxpayer are routine correspondence and no services were rendered by AE/received by Taxpayer	Maintain contemporaneous documentation as discussed above in Point **"I"** on *Pages 2 - 4 of this note*
2. The Taxpayer did not need these services *at all*, as the Taxpayer had sufficient experts of his own who were competent enough to do the work • The Taxpayer company has not derived any specific benefit from the management services stated to be advanced by the AE/Parent Company, especially because the Taxpayer company in India has already incurred separate head-wise expenses for	2.1 Taxpayer has availed of only those services from AE which the Taxpayer does not perform in-house or does not procure locally 2.2 Though the Taxpayer has capabilities, manpower, and experience in India, the Taxpayer does not have these in Foreign Locations where AE renders services – AE has these in those locations 2.3 The guidance, advice and support obtained from the experienced and knowledgeable team of the AE helped in management of the operational and corporate activities, reducing significantly the level of senior personnel required locally, and also provided for a higher degree of co-ordination of the activities among Taxpayer and its foreign affiliates 2.4 Expenses paid to AE are very low (say, less than 1 %) in proportion to total

professional and consultancy services. • Enough expenditure is already incurred by the Taxpayer on various services	expenses of the Taxpayer 2.5 By virtue of receiving the services from Parent Company, the Taxpayer got the benefit of being serviced by specialized personnel who are experts in their respective fields and are well versed with the intricacies of business requirement ***As regards the benefits derived please refer to Point 3 below.***
3. The Taxpayer is unable to prove the benefits derived from services	3.1 Demonstrate tangible benefits in form of increase in sales, profit, profit margins and reduction in cost 3.2 Arguments pointing out intangible benefit can also be made on the following lines: • MNCs generally centralize services for the entire group to maintain uniformity, quality, high standards and to meet client expectations, as well as to retain competitive edge in the global market. And procuring similar high quality services from third party may prove to be expensive. • Due to globalization and specialization, the outsourcing of routine activities have become an established global business methodology due to number of business advantages 3.3 If no tangible benefit can be demonstrated, say for examplein cases of loss/continuing losses, the arguments regarding intangible benefits as mentioned above can be made. **Legal Arguments:** 3.4 It is not necessary for Taxpayer to show that any expenditure incurred by him for the purpose of business carried on by him has actually resulted in profit or income either in the same year or in any of the subsequent years. The only condition is that the expenditure should have been incurred "wholly and exclusively" for the purpose of business and nothing more.

	• *CIT vs EKL Appliances Ltd [2012] 24 taxmann.com 199 (Delhi High Court)* • *Knorr-Bremse India (P) Ltd vs ACIT [2015] 63 taxmann.com 186 (Punjab & Haryana High Court)]* • *Safran Aerospace India (P) Ltd vs DCIT [2015] 54 taxmann.com 360 (ITAT Bangalore)* • *Ericsson India (P) Ltd vs DCIT [2012] 25 taxmann.com 472 (ITAT Delhi)* 3.5 The answer to the issue whether a transaction is at an arm's length price or not is not dependent on whether the transaction results in an increase in the Taxpayer's profit.Business decisions are at times good and profitable, and at times bad and unprofitable. The question whether the decision was commercially sound or not is not relevant. The only question is whether the transaction entered into was bona fide or not or whether it was sham and only for the purpose of diverting the profits. • *Knorr-Bremse India (P) Ltd vs ACIT [2015] 63 taxmann.com 186 (Punjab & Haryana High Court)* *3.6* The benefit derived or accruing to the company must also be considered from the angle of a prudent businessman. The term "benefit" to a company in relation to its business has a very wide connotation and may not necessarily be capable of being accurately measured in terms of pound, shillings and pence in all cases. • *Hive Communication (P.) Ltd. v. CIT [2011] 201 Taxman 99 / 12 taxmann.com 287 (Delhi High Court)* • *DCIT vsDanisco (India) (P) Ltd[2015] 63 taxmann.com 174 (ITAT Delhi)*
4. If at all any benefit is accrued as a result of the services said to be rendered by the AE/Parent, the benefit accrued to the MNC Group as a whole and not exclusively to	4.1 Though the services provided at the group level benefit all the entities, including Indian Taxpayer, the cost of services are allocated to all the entities of the Group, in proportion to the services availed by each entity. So, the Taxpayer has been allocated/cross-charged only those costs incurred by the AE/Parent company

the individual Indian Company	which specifically pertained to service rendered to the Taxpayer 4.2 Detailed working of cost allocation should be filed
5. Only incidental benefits derived by the Taxpayer • Though some incidental benefits accrued to the Taxpayer, yet such benefits would not be ones for which an independent enterprise would be willing to pay	5.1 The **key benefits** to the Taxpayer by availing the Intra-Group services include, but are not limited to: - • Access to high quality services on "as and when such a need arises" basis; • The staff providing the services have unequalled knowledge of the business and the issues, compared to third party providers; • Some of the services provided by the AE would not likely be obtainable from third party service providers, and it may not be prudent from a business as well as commercial perspective to avail some of the services provided by the AEs, directly, from third party service providers; • It is practically and financially not possible for the Taxpayer to employ such experienced personnel on a stand-alone basis. Further, procuring such assistance from third party consultants would prove to be extremely costly for the Taxpayer: • Further, due to the direct involvement of administrative and executive management teams, the level of staff and management required at the recipient entity levels gets reduced. This further provides for a higher degree of coordination of the activities among the foreign affiliates. This greater degree of coordination in turn facilitates increased sales and more efficient use of the resources; • Provide operational efficiencies (e.g. better training, staff recruitment and retention and IT platforms) and promote opportunities of cross selling to maximise revenues; • Reduced costs - Many functions can be carried out centrally for the benefit *of*

	the entire group, by reducing duplication, by providing dedicated resources and by providing the benefits of economies of scale.
6. Services are duplicative in nature	6.1 The services cannot be duplicated in India insofar as they require interaction abroad 6.2 Taxpayer does not have infrastructure, office, and manpower outside India, where AE renders services, like marketing support services. AE has the network, presence, infrastructure and manpower in foreign locations 6.3 Show direct/immediate relevance of services to the Taxpayer's business 6.4 Argue, if feasible, that the Taxpayer is in initial stages of business, and does not have expertise to meet the clients' requirements/expectations 6.5 Taxpayer has availed of only those services from AE which the taxpayer does not perform in-house or does not procure locally.
7. Services fall in the category of Shareholder services • The services rendered by Parent Company are more in the nature of directions/management decision/routine advice which were provided to the Taxpayer by the Parent Company to take care of the Parent's own interests rather than to meet the identified needs of the Taxpayer.	7.1 The types of services which can be categorized as shareholder services have been illustrated by the OECD Transfer Pricing Guidelines. In Para7.10 of those guidelines following services can be treated as shareholder services: • Costs of activities relating to the juridical structure of the parent company itself, such as meetings of shareholders of the parent, issuing of shares in the parent company and costs of the supervisory board • Costs relating to reporting requirements of the parent company including the consolidation of reports • Costs of raising funds for the acquisition of its participations 7.2 The Taxpayer should file detailed description of services to show that the services received from the AE are not of the type described above

8. No proof filed to show that AE incurred expenses required to render services	Following evidence can be filed: 8.1 Certificate of CFO/CEO of AE regarding rendering of services – Certificate should describe the infrastructure installed, manpower hired, costs incurred (certified by Independent Auditor), assets deployed (certified by Independent Auditor), nature of services (must match with Agreement), mode of delivering services, computation/basis of cost-allocation/cross-charge (with appropriate allocation keys) 8.2 Affidavits of personnel of AE stating that their activities are devoted to the work for the Indian Entity, clearly stating what kind of work they do for and on behalf of the Indian Entity. 8.3 Financial Statements of AE/Cost Centre as certified by Independent Auditor 8.4 Certificate from Finance Director of AE containing the nature of services rendered by the AE to the Taxpayer and also to other Group Entities, including the personnel/department engaged in rendering service, expenses incurred by various personnel/departments in rendering services and the intra-group service fees charged (billing) by the AE to various Group Companies, including the Taxpayer company 8.5 For cost-contributions, a detailed report (obtained by MNC Group) from the independent auditors documenting the manner and the methodology for computing the contribution made by each participating group entity.
9. ALP is Nil under CUP because no independent party would pay in similar circumstances	9.1 For determining ALP under CUP method, the TPO has to find comparables to benchmark the price of services availed of by the Taxpayer. Where the TPO has not brought any comparable company, and has instead applied the benefit test to justify the determination of ALP at Nil, the method applied by TPO is not in terms with the statutory provisions

	• *TNS India (P) Ltd vs DCIT [2015] 56 taxmann.com 268 (ITAT Hyderabad)* • *Ingersoll Rand (India) Ltd vs DCIT IT (TP) [TS-190-ITAT-2015(Bang)-TP]* • *Castrol India Ltd vsAddl CIT [2014] 45 taxmann.com 330 (ITAT Mumbai)* • *N L C Nalco India Ltd vs DCIT [TS-36-ITAT-2016(Kol)-TP]* • *DCIT vs. Diebold Software Services (P) Ltd [2014] 48 taxmann.com 26 (ITAT Mumbai)* 9.2 Unless the TPO can identify a comparable uncontrolled transaction in which such services, howsoever irrelevant he may consider these services to be, are rendered and find out consideration for the same, the CUP method cannot have any application. His perception that these services are worthless is of no relevance. It is not his job to decide whether a business enterprise should have incurred a particular expense or not. A business enterprise incurs the expenditure on the basis of what is commercially expedient and what is not commercially expedient. • *AWB India (P) Ltd vs DCIT [2014] 50 taxmann.com 323 (ITAT Delhi)* 9.3 The TPO has to work out the ALP of the international transaction by applying the methods recognized under the Act. He is not competent to hold that the expenditure in question has not been incurred by the Taxpayer or that the Taxpayer has not derived any benefits for the payment made by the Taxpayer and consequently, he cannot consider the ALP as NIL. • *Festo Controls (P) Ltd vs DCIT [2013] 30 taxmann.com 16 (ITAT Bangalore)* 9.4 In the absence of any comparable figures and in the absence of any further enquiry, the TPO cannot take the amount of ALP at NIL, ignoring the payment by Taxpayer. • *DQ Entertainment (International) Ltd vs ACIT [2015] 64 taxmann.com 360 (ITAT Hyderabad)]*

10. Cost Allocation vs Actual Usage - Cost allocation is on estimated basis regardless of actual usage of services • The remuneration was fixed not with reference to any particular service. It was at a fixed amount, calculated at a fixed percentage of sales of Taxpayer, irrespective of which services were actually received by Taxpayer or whether any services were received by it or not. • There is no comparison between the volume and quality and services and the amounts paid by the Taxpayercompany. The cost has been apportioned by the AE for different country centers on a mutual agreed basis and not on the basis of actual services rendered	10.1 The Taxpayer has, in accordance with the stipulations mentioned in the OECD TP Guidelines, adopted a rational, systematic and logical methodology for the payment of cost contribution charges. The allocation of intra-group charges by the AE to the Taxpayer adheres to the tenets of the indirect allocation mechanism provisions as stipulated under Paragraph 7.25 of the OECD TP Guidelines. • *Ingersoll Rand (India) Ltd vs DCIT IT (TP) [TS-190-ITAT-2015(Bang)-TP]* 10.2 The methodology of allocation followed is standard, uniform, harmonized and consistent across the entities of the Group. The basis of allocation followed across group companies is identical to the one adopted for allocating intra group charges to India. • *Ingersoll Rand (India) Ltd vs DCIT IT (TP) [TS-190-ITAT-2015(Bang)-TP]* 10.3 The allocation of intra group charges by the AE to the assessee adheres to the tenets of the indirect allocation mechanism provisions as stipulated under Paragraph 7.25 of the OECD TP Guidelines. It has been acknowledged in Para 8.2.2 of the OECD Guidelines that a direct-charge method for pricing of intra-group services is so difficult to apply in practicefor MNCGroups that such groups have developed other methods, for charging for services provided by Parent Companies or Group Service Centres. In such cases, according to the OECD, the MNC Groups may find that they have few alternatives but to use costallocation and apportionment methods which often necessitate some degree of estimationor approximation. Such methods aregenerally referred to as indirect-charge methods. The allocation might be based onturnover, or staff employed, or some other reasonable basis.

	10.4 OECD Guidelines referred to above have been accepted in following cases:- • *N L C Nalco India Ltd vs DCIT [TS-36-ITAT-2016(Kol)-TP]* • *Ingersoll Rand (India) Ltd vs DCIT IT (TP) [TS-190-ITAT-2015(Bang)-TP]* **Note:** Your case will be strong if the direct costs are specifically identified and cross-charged. The indirect costs may be allocated or apportioned. However, detailed workings of allocation of indirect cost should be filed specifying the appropriate allocation keys.
11. Benchmarking should be done separately, not by aggregating with other transactions under TNMM	11.1 It is infeasible and impractical to ascertain any independent value of these services. It is, therefore, desirable that the benchmarking of these services should be done on an over-all basis i.e. analyzing the net margin rate under TNMM, which would be most appropriate method to ascertain true picture of financial results of the organisation 11.2 Aggregated TNMM can be applied if it is established that each transaction is so inextricably linked to the other that the one could not survive without the other, and if the receipt of services formed a part of a composite transaction. The Taxpayer would, however, have to prove that although each sale and each provision of service is priced separately, they were all provided under one composite agreement which constitutes an international transaction. • *Knorr-Bremse India (P) Ltd vs ACIT [2015] 63 taxmann.com 186 (Punjab & Haryana)* 11.3 Aggregated benchmarking of Management Services under TNMM was accepted in following cases: • *N L C Nalco India Ltd vs DCIT [TS-36-ITAT-2016(Kol)-TP]* • *Ingersoll Rand (India) Ltd vs DCIT IT (TP) [TS-190-ITAT-2015(Bang)-TP]* • *DCIT vsPayne (India) Pvt Ltd, IT(TP)A No.446(B)/2012, dated 24-07-2015*

	(ITAT Bangalore) • *McCann Erickson India (P) Ltd vs Addl CIT [2012] 24 taxmann.com 21 (ITAT Delhi)* • *DCIT vs Danisco (India) (P) Ltd [2015] 63 taxmann.com 174 (ITAT Delhi)* • *Fosroc Chemicals India (P) Ltd vs DCIT [2015] 58 taxmann.com 85 (ITAT Bangalore)* • *AWB India (P) Ltd vs DCIT [2014] 50 taxmann.com 323 (ITAT Delhi)*
12. Service Fee paid to the AE is more than the service fee charged by comparable service providers in India	12.1 Ask for data of comparable service providers gathered by the TPO. 12.2 Scrutinise the data of those comparable service providers: analyse the business model and FAR profile as well as the nature and quality of the services provided by comparable Indian service providers, to establish that their services are different and not of the same standards as the services provided by the AE
13. The comparables, identified by the Taxpayer company,under TNMM have not paid any management service fees	13.1 Items of expenditure incurred isnot a criterion to judge comparability. So, it is not necessary that the comparables should also incur similar types of expenses as the Taxpayer. If, otherwise, the comparables meet the criteria of comparability (i.e. comparable FAR profile), no adverse inference can be drawn on the ground that payment of management service fees is not reflected in the financials of the Comparables. 13.2 Even after considering the expenditure on account of management service fees, the PLI of Taxpayer is better than the PLI of the comparables
14. How can the AE which renders the services have knowledge about the Indian market and Indian business conditions?	14.1 The Taxpayer may argue that because of presence in the Indian Market the Taxpayer might be aware of the local market conditions, including competitive companies and client expectations. Such knowledge would enable the Taxpayers to make an evaluation about the type of services needed to maintain competitive edge in the market and also to meet client expectations.

	However, the Taxpayer is free to avail of the required services from its own AE, so that uniformity, quality, best global practices and standardization can be achieved. Further, the services provide by the AE may not have any direct relevance to the Indian market conditions.

We hope you find the above chart of counter-arguments useful in defending your management service fees, before the TPO, AO, DRP, CIT(Appeals) and the ITAT.

If you have limited documentary evidence, you may rely on sample evidence and argue that –

Income Tax Proceedings are Civil Proceedings, not Criminal Proceedings; and the Standard of Proof required in Civil Proceedings is **'Preponderance of Probability'** which is much lenient compared to the stricter Standard of Proof **'Beyond Reasonable Doubt'** required in Criminal Proceedings.

In addition, you can also show, if facts support, that TDS was deducted by the Indian Entity on the Service Fees paid to the Service Provider AE, and that the AE has paid Tax in India on the Service Fees received from the Indian Entity - this fact can indeed tilt the scale in your favour.

- ❖ You can further support your arguments by placing reliance on case law in Taxpayers' favour. **A detailed issue-wise compilation of more than 40 cases is provided in Annexure I which follows after the next Page.**

Summing up

Payment of Management Service Fee (MSF) is widely prevalent in MNC Groups. That is because centralisation of management services provides distinct advantages, in the form of global best practices and competitive edge. Despite sound commercial rationale, TPO's and AOs routinely disallow the payment of MSF on various grounds, as discussed in this Article. The Taxpayers can, however, defend the claim of MSF, by maintaining appropriate documentation; and by presenting their case in a persuasive manner with the help of sound arguments supported by favourable caselaws. There are a number of ITAT and High Court cases that have decided the issue of MSF in favour of the Taxpayers. Those cases have been highlighted in this Article.

A detailedissue-wise compilation of more than 40 such cases hasalso been provided in Annexure I.

Annexure I

MANAGEMENT SERVICE FEES

Case Law Compilation: Principles laid down by High Court/ITAT

1. On Evidence filed by the Taxpayer

1.1 TPO cannot ignore evidence (data, information, documents, etc.), filed by the Taxpayer to prove receipt of services, withoutpointing out how such evidence is inadequate, without pointing out any flaw, or without stating what sort of evidence would satisfy the TPO. And if no flaw is found in the evidence filed by the assessee it is the duty of the TPO and the AO to consider that evidence, before coming to any conclusion on merits

- *Bentley Systems India (P) Ltd vs ACIT [2012] 26 taxmann.com 10 (ITAT Delhi)*
- *Safran Aerospace India (P) Ltd vs DCIT [2015] 54 taxmann.com 360 (ITAT Bangalore)*
- *TNS India (P) Ltd vs ACIT [2014] 48 taxmann.com 128 (ITAT Hyderabad)*

1.2 It cannot be accepted that assessee should provide even the scratches of information about rendering of services which is otherwise discernible from the facts.

- *Gillette India Ltd vs ACIT [2015] 62 taxmann.com 57 (ITAT Jaipur)*

1.3 It may not be possible for the Taxpayer to document every record of receipt of services when the services are received in the form of directions and recommendations through e-mails, phone calls, reports, etc.

- *AWB India (P) Ltd vsAddl CIT, [TS-67-ITAT-2013(DEL)-TP] (ITAT Delhi)*

1.4 The business of the Taxpayer required rendering of technical services to clients. It was the first full year of business operations. As the Taxpayer was not having qualified technical manpower it sought technical services from AE. The nature of business activity of the Taxpayer itself demonstrates the requirement of technical design engineer in the field. When the Taxpayerwas not having such experienced design engineers in its own organization, then availing of the services for performing its own business activity is otherwise part and parcel of the business activity of the Taxpayer.

- *PERI India (P) Ltd vs DCIT [2015] 57 taxmann.com 37 (ITAT Mumbai)*

1.5 In the form of a detailed Chart, theassessee enumerated in detail the description of type of services received, how these services were received, and in what manner benefits were derived from those services by the assessee company. In the Charts, the assessee has given detailed functions, explanation and references to various evidences. As the Revenue did not bring anything on record to negate the details provided in the Chart, the claim of the assesse was allowed.

- *McCann Erickson India (P) Ltd vsAddl CIT [2012] 24 taxmann.com 21 (ITAT Delhi)*

1.6 The business of the Taxpayer required rendering of technical services to clients. The assessee produced the relevant record including the following –

- the technical drawings and designs made available by the AE,
- nature of work done by the AE,
- the design of work to be performed for clients,
- the technical nature of the services rendered by assessee to its clients,
- assessee's inability to execute such a service on its own,
- actual work executed by AE's engineers at the site of the client, and
- invoices raised by the AE for providing the services which were based on the total number of hours spent by the engineers of the AE at the site of the clients of the assessee in providing the services.

When the assessee has filed such relevant record, then determination of ALP of the expenditure, by the TPO at Nil, is totally contrary to the facts as well as evidence produced by the assessee.

- *PERI India (P) Ltd vs DCIT [2015] 57 taxmann.com 37 (ITAT Mumbai)*

1.7 The assessee produced the invoices which were based on per hour charges actually spent by the AE's engineer for providing the services to the assesse. Thus, the assessee was charged specifically for the hours spent by the AE's engineer for providing the services.It is not a case where the assessee and AE shared the costs of composite activities, performed by a common staff. Rather, the cost was incurred by the AE exclusively for providing services to the assesse. So, the principle and test related to Cost Sharing Arrangement sought to be invoked by the revenue would not be applicable.

The assessee has also produced the comparative cost charged by the AE from other group concerns. The TPO/AO have not brought anything contrary on record, to show that the price paid by the assessee is not at arm's length. The claim of the assessee is, therefore, allowed.

- *PERI India (P) Ltd vs DCIT [2015] 57 taxmann.com 37 (ITAT Mumbai)*

1.8 For the advice given by various group centers to the group companies in day-to-day manner it is difficult to place on record by way of concrete evidence but the way business is conducted, one can perceive the same. Assessee has given a detailed write-up as well as the services provided and benefit obtained which were not contradicted. The Assessing Officer did not believe the same in the absence of concrete evidence. Unless the Assessing Officer steps into assessee's business premises and observes the role of these companies/ assessee's business transactions, it will be difficult to place on record the sort of advice given in day-to-day operations.

- *TNS India (P) Ltd vs ACIT [2014] 48 taxmann.com 128 (ITAT Hyderabad)*

1.9 To substantiate the claim of payment for management services, the assessee not only has to file the copies of Agreement with the AE, to show that there is a liability on the assessee to pay. It is also essential for the assessee to prove that the AE has rendered services to the assessee, for which management fee is being paid.

- *CISCO Systems Capital (India) (P) Ltd vsAddl CIT [2014] 52 taxmann.com 155 (ITAT Bangalore)*

1.10 The assessee hadfiled the copies of invoices raised by the AEs, along with respective allocation keys. Keeping this in view as well as on perusal of the relevant details available on record, there is no justification in the action of the TPO in ignoring all these details and taking the ALP of the relevant transactions at Nil. It is incumbent upon the TPO to work out the ALP of the relevant transactions by following some authorized method; the entire cost borne by the assessee cannot be disallowed by taking the ALP at Nil.

- *Castrol India Ltd vs ACIT [2013] 29 taxmann.com 62 (ITAT Mumbai)*
- *Castrol India LtdvsAddl CIT [2014] 45 taxmann.com 330 (ITAT Mumbai)*

1.11 Multinationals have a long-standing practice of providing certain services from a central point to one or more affiliates. The parent company provides centralized services or one affiliate provides services on a central basis to several other affiliates. In these situations, cost contribution (or shared-service) arrangements can be constructed to charge the costs of the service providers to the affiliates that benefit from the services they provide. As the unique bundle of services provided may vary significantly between taxpayers, it may be difficult to find a comparable price for such services or to evaluate the benefit received. Tax authorities therefore regard the area of cost sharing arrangement as prone to potential abuse. At the same time, the increasingly competitive global marketplace is demanding greater efficiency from multinational businesses. They must take every opportunity to minimise costs, so there is an ever greater need to

arrange for the centralisation of business functions where possible. It is vital to establish the following:

- The exact nature of the services that are to be performed;
- Which entities are to render the services;
- Which entities are to receive the services; and
- What costs are involved in providing the services.

Once these facts are known, consideration can be given to selecting the basis for charging the recipient group companies. Sufficient evidence of costs involved and services actually rendered should be provided.

- *Festo Controls India (P) Ltd vs DCIT [2013] 30 taxmann.com 16 (ITAT Bangalore)*

1.12 The cost of providing SAP charges by 'F', Germany to all entities of the 'F' group worldwide and the basis of allocation of cost by 'F', Germany to various group entities across the world should be submitted by the assessee with a view to enable the TPO to ascertain as to whether there has in fact been any profit element involved or was it a case of mere reimbursement of actual cost incurred for the assessee by the parent-company.

- *Festo Controls (P) Ltd vs DCIT [2013] 30 taxmann.com 16 (ITAT Bangalore)*

1.13 Certificate from Finance Director of AE containing the nature of services rendered by the AE to the Taxpayer and also to other Group Entities including, the personnel/department engaged inrendering service, expenses incurred by various personnel/departments in renderingservices and the intra-group servicefees charged (billing) by the AE to various Group Companies including the assessecompany, was accepted by the ITAT.

- *N L C Nalco India Ltd vs DCIT [TS-36-ITAT-2016(Kol)-TP] (ITAT Kolkata)*

1.14 Where the invoices regarding nature of services rendered, were are in the form of invoices supported by emails exchanged between the assessee and the AE, the ITAT Bangalore held that such invoices per se do not demonstrate the nature of services rendered. According to the ITAT the invoices have to be linked to the emails in support of the invoices.

- *Quintiles Research (India) (P) Ltd vs DCIT [2014] 44 taxmann.com 425 (ITAT Bangalore)*

1.15 The evidence on record needs to be presented in a proper form, so that the nature of services rendered can be discerned with reasonable accuracy.

- *Quintiles Research (India) (P) Ltd vs DCIT [2014] 44 taxmann.com 425 (ITAT Bangalore)*

1.16 The assessee can demonstrate on a sample basis the items of expenditure comprised in the management service fee.

- *Quintiles Research (India) (P) Ltd vs DCIT [2014] 44 taxmann.com 425 (ITAT Bangalore)*

1.17 The function of the TPO is to compare the payments made bythe assessee company for services received, if any, and to see whetherthose payments are comparable. In a given scenario, the TPO has toexamine whether the payments are at ALP. Therefore, it isvery imperative on the part of the assessee to establish before the TPOthat the payments are made commensurate to the volume and qualityof services, and that such costs are comparable.

- *Gemplus India Pvt Ltd vs ACIT, ITA No.352/Bang/2009, dated 21 October 2010*

1.18 **(Against the Assessee) -** Under Sec. 92D read with Rule 10D (1) it is the duty of the assessee to maintain documents which will show the details, including the quantum and value, of each of services received.In this case, not only had the assessee failed to maintain any of the documents of the nature mentioned above, but the assessee did not

even suggest a method for determination of the ALP of the services which it claimed to have received from the AEs. The assessee produced the agreements. Certain invoices raised by an AE on the assessee, were also produced. What were the services rendered by the AE the assessee, nature of such services, and comparable international transactions of independent parties, were never brought on record by the assessee.

The invoices, therefore, do not show that any services were actually rendered by the AE to the assessee. When assessee is not able to bring on record anything to show that any services to have been rendered by the AE, and there are no documents to show that any services were received from that AE, it will be fair conclusion that no services were in fact rendered by AEs to the assessee. There was considerable onus on the assessee to show that actual services were rendered by its subsidiaries.

- *Cranes Software International Ltd vs DCIT [2014] 52 taxmann.com 19 (ITAT Bangalore)*

2. Necessity to avail of Services from AE cannot be questioned by the TPO and the AO

2.1 The basic reason why the TPO determined the ALP of services received under cost contribution arrangement as 'NIL' is his perception that the assessee did not need these services at all, because the assessee had sufficient experts of his own who were competent enough to do this work.In so deciding, the TPO was not only going much beyond his powers in questioning commercial wisdom of assessee's decision to take benefit of expertise of its AE, but also beyond the powers of the Assessing Officer. This approach of the revenue authorities cannot be approved of.

- *Dresser-Rand India (P.) Ltd. v. Addl. CIT [2011] 47 SOT 423/13 taxmann.com 82 (ITAT Mumbai)*

2.2 Whether it is commercially prudent or not to employ outsiders to conduct an activity is a matter that lies within the assessee's exclusive domain, and cannot be second-guessed by the Revenue.

- *CIT vs Cushman and Wakefield (India) (P.) Ltd [2014] 46 taxmann.com 317 (Delhi High Court)*

2.3 It is not necessary for assessee to show that any legitimate expenditure incurred by him was also incurred out of necessity. It is also not necessary for assessee to show that any expenditure incurred by him for the purpose of business carried on by him has actually resulted in profit or income either in the same year or in any of the subsequent years. The only condition is that the expenditure should have been incurred "wholly and exclusively" for the purpose of business and nothing more.

- *CIT vs EKL Appliances Ltd [2012] 24 taxmann.com 199 (Delhi High Court)*
- *Safran Aerospace India (P) Ltd vs DCIT [2015] 54 taxmann.com 360 (ITAT Bangalore)*
- *Ericsson India (P) Ltd vs DCIT [2012] 25 taxmann.com 472 (ITAT Delhi)*

2.4 Even Rule 10B(l)(a) does not authorise disallowance of any expenditure on the ground that it was not necessary or prudent for assessee to have incurred the same, or that in the view of the Revenue the expenditure was unremunerative, or that in view of the continued losses suffered by assessee in his business, he could have fared better had he not incurred such expenditure. These are irrelevant considerations for the purpose of Rule 10B.

- *CIT vs EKL Appliances Ltd [2012] 24 taxmann.com 199 (Delhi High Court)*
- *SC Enviro Agro India Ltd vs DCIT [2013] 34 taxmann.com 127 (ITAT Mumbai)*

2.5 It is not even the TPO's case that the payments for these services were not made for specific services under the contract but he is of the view that either the services were useless or there was no evidence of actual services having been rendered. As for the

services being useless, it is a call taken by the assessee whether the services are commercially expedient or not and all that the TPO can see is at what price similar services, whatever be the worth of such services, are actually rendered in the uncontrolled conditions.

- *AWB India (P) Ltd vs DCIT [2014] 50 taxmann.com 323 (ITAT Delhi)*

3. Taxpayer's Business Judgement and Commercial Expediency cannot be Questioned

3.1 The TPO held that the assessee had sufficient local help to allow it to overcome the legal challenges at the local level. The TPO held that there was no reason to believe that the AEs provided assistance that the assessee could not obtain at the local level in India.

That, however, cannot be a ground for rejecting a claim for deduction. Nor can that be a ground for assuming that the consideration paid for the same is not the genuine arm's length price. In absence of any law, an assessee cannot be compelled to avail the services available in India. It is for the assessee to determine whose services it desires availing of and whose goods it intends purchasing. It is certainly understandable if the assessee prefers to deal with its Group Entities/AEs. This is for a variety of reasons which are far too obvious to state. So long as there is no bar in law to the assessee availing the services of a particular party, the authorities under the Act must determine whether the consideration paid for the same is at an arm's length price or not.

- *Knorr-Bremse India (P) Ltd vs ACIT [2015] 63 taxmann.com 186 (Punjab & Haryana High Court)*

3.2 In the arena in which the assessee company is functioning, it will be difficult to imagine a successful business entity in the global environment without receipt of the services which carries huge intrinsic and creative value. It is only a particular business expert who can evaluate the true intrinsic and creative value of such services. The value of

these services cannot be taken at nil which the AO as well as TPO originally sought to do.

It is not for the AO to dictate what the business needs of the company should be. It is the businessman who alone can judge the legitimacy of the business needs of the company, from the point of view of a prudent businessman. The benefit derived and occurring to the company must also be considered from the angle of a prudent businessman. The term "benefit" to a company in relation to its business has a very wide connotation. It is difficult to accurately measure these benefits in terms of money value separately.

- *McCann Erickson India (P) Ltd vsAddl CIT [2012] 24 taxmann.com 21 (ITAT Delhi)*

3.3 The legitimate business needs of the company must be judged from the view point of the company itself and must be viewed from the point of view of a prudent businessman. It is not for the Assessing Officer to dictate what the business needs of the company should be. He is only to judge the legitimacy of the business needs of the company from the point of view of a prudent businessman. The benefit derived or accruing to the company must also be considered from the angle of a prudent businessman. The term "benefit" to a company in relation to its business, it must be remembered, has a very wide connotation and may not necessarily be capable of being accurately measured in terms of pound, shillings and pence in all cases.

- *Hive Communication (P.) Ltd. v. CIT [2011] 201 Taxman 99 / 12 taxmann.com 287 (Delhi High Court)*

- *DCIT vsDanisco (India) (P) Ltd[2015] 63 taxmann.com 174 (ITAT Delhi)*

3.4 Unless the TPO can identify a comparable uncontrolled transaction in which such services, howsoever token or irrelevant services as he may consider these services to be, are rendered and find out consideration for the same, the CUP method cannot have

any application. His perception that these services are worthless is of no relevance. It is not his job to decide whether a business enterprise should have incurred a particular expense or not. A business enterprise incurs the expenditure on the basis of what is commercially expedient and what is not commercially expedient.

- *AWB India (P) Ltd vs DCIT [2014] 50 taxmann.com 323 (ITAT Delhi)*

4. Whether the Taxpayer received any Benefit from the Services is not a relevant consideration

4.1 It is not necessary for assessee to show that any expenditure incurred by him for the purpose of business carried on by him has actually resulted in profit or income either in the same year or in any of the subsequent years. The only condition is that the expenditure should have been incurred "wholly and exclusively" for the purpose of business and nothing more.

- *CIT vs EKL Appliances Ltd [2012] 24 taxmann.com 199 (Delhi High Court)*
- *Safran Aerospace India (P) Ltd vs DCIT [2015] 54 taxmann.com 360 (ITAT Bangalore)*
- *Ericsson India (P) Ltd vs DCIT [2012] 25 taxmann.com 472 (ITAT Delhi)*

4.2 The assessee's claim of payment of service fee to AEs cannot be disallowed, evenif the assessee fails to establish that it has benefited from the services provided by the AEs. The TPO's conclusion that assessee cannot escape its responsibilities of having to show the actual benefit it has received; and that the assessee will also have to demonstrate that independent parties would be inclined to make such a payment in similar circumstances does not follow from the OECD Guidelines quoted by him. The OECD Guidelines merely state that the result must be consistent with what comparable independent enterprises would have been prepared to accept.

- *Knorr-Bremse India (P) Ltd vs ACIT [2015] 63 taxmann.com 186 (Punjab & Haryana High Court)*

4.3 The answer to the issue whether a transaction is at an arm's length price or not is not dependent on whether the transaction results in an increase in the assessee's profit. This would be contrary to the established manner in which business is conducted by people and by enterprises. Business decisions are at times good and profitable and at times bad and unprofitable. Business decisions may and, in fact, often do result in a loss. The question whether the decision was commercially sound or not is not relevant. The only question is whether the transaction entered into was bona fide or not or whether it was sham and only for the purpose of diverting the profits.

- *Knorr-Bremse India (P) Ltd vs ACIT [2015] 63 taxmann.com 186 (Punjab & Haryana High Court)*

4.4 The TPO observed that regular increase in profits is a normal incidence in business. This is entirely incorrect. All businesses are not profitable. All decisions do not enhance profitability. Losses are also an incidence of business. Many are the failed business ventures of people and enterprises.Every business venture is not necessarily profitable or successful. All business ventures do not succeed equally or uniformly. Indeed, if an assessee is able to establish financial or other commercial benefits arising from a transaction, it would further strengthen its case. But if it cannot do so, it does not weaken it.

- *Knorr-Bremse India (P) Ltd vs ACIT [2015] 63 taxmann.com 186 (Punjab & Haryana High Court)*

4.5 Enterprises, businessmen and professionals constantly experiment with different business models, theories and ventures. The aim indeed is to further the business, to enhance their profits. So long as that is the aim, it is sufficient for the purpose of the Income-tax Act.

- *Knorr-Bremse India (P) Ltd vs ACIT [2015] 63 taxmann.com 186 (Punjab & Haryana High Court)*

4.6 The profit earned by an assessee could be for reasons other than those relating to the international transactions or by virtue of international transactions as well as by virtue of other factors. In that event, the assessee having profited from the venture involving the international transactions, obviously, would not establish that the arm's length price was correct or justified. Mere profitability does not indicate that the transaction which was responsible for the enhancement of the profits was at an arm's length price.

- *Knorr-Bremse India (P) Ltd vs ACIT [2015] 63 taxmann.com 186 (Punjab & Haryana High Court)*

4.7 Merely because an assessee profits by the use of the goods supplied or the services rendered, it does not follow that the same were sold or supplied at an arm's length price. Conversely, merely because an assessee does not profit from the use of the goods or services, it does not follow that they were not sold at an arm's length price.

- *Knorr-Bremse India (P) Ltd vs ACIT [2015] 63 taxmann.com 186 (Punjab & Haryana High Court)*

4.8 The benefit derived or accruing to the company must also be considered from the angle of a prudent businessman. The term "benefit" to a company in relation to its business, it must be remembered, has a very wide connotation and may not necessarily be capable of being accurately measured in terms of pound, shillings and pence in all cases.

- *Hive Communication (P) Ltd vs CIT [2011] 201 Taxman 99 / 12 taxmann.com 287 (Delhi High Court)*
- *DCIT vsDanisco (India) (P) Ltd[2015] 63 taxmann.com 174 (ITAT Delhi)*

4.9 Whether or not to enter into the transaction is for assessee to decide. The quantum of expenditure can no doubt be examined by the TPO as per law but in judging the allowability thereof as business expenditure, he has no authority to disallow the entire expenditure or a part thereof on the ground that assessee has suffered continuous losses. The financial health of assessee can never be a criterion to judge allowability of an expense; there is certainly no authority for that.

So long as the expenditure or payment has been demonstrated to have been incurred or laid out for the purposes of business, it is no concern of the TPO to disallow the same on any extraneous reasoning.

- *CIT vs EKL Appliances Ltd [2012] 24 taxmann.com 199 (Delhi High Court)*

4.10 The authority of the TPO is to conduct a transfer pricing analysis to determine the ALP and not to determine whether there is a service or not from which the assessee benefits. That aspect of the exercise is left to the AO.

- *CIT vs Cushman and Wakefield (India) (P) Ltd [2014] 46 taxmann.com 317 (Delhi High Court)*

4.11 The benefit derived and occurring to the company must also be considered from the angle of a prudent businessman. The term "benefit" to a company in relation to its business has a very wide connotation. It is difficult to accurately measure these benefits in terms of money value separately.

- *McCann Erickson India (P) Ltd vsAddl CIT [2012] 24 taxmann.com 21 (ITAT Delhi)*

4.12 Whether a particular expense on services received actually benefits an Assessee in monetary terms or not even a consideration for its being allowed as a deduction in computation of income, and, by no stretch of logic, it can have any role in determining arm's length price of that service. When evaluating the arm's length price of a service, it is wholly irrelevant as to whether the assessee benefits from it or not; the real question which is to be determined in such cases is whether the price of this service is what an independent enterprise would have paid for the same.

- *Dresser-Rand India (P) Ltd vs Addl. CIT [2011] 47 SOT 423/13 taxmann.com 82 (ITAT Mumbai)*
- *DCIT vsDanisco (India) (P) Ltd[2015] 63 taxmann.com 174 (ITAT Delhi)*

5. TPO cannot compute ALP of services at NIL

5.1 The computation of ALP by the TPO at Nil is contrary tothe provisions of Transfer Pricing as well as rules providedunder the Act. The only issue before the TPO is to considerthe arm's length price of the services received by theassessee. Once the receipt of services by the assessee is notin dispute, then the dispute can be about the ALP of such services.Such dispute about ALP will further narrow down only inrelation to the mark-up charged by the AE on the cost.

- *Essentra India Pvt Ltd vs DCIT, ITANo.446/Bang/2012, dated 24/7/2015 (ITAT Bangalore)*
- *DCIT vs Payne (India) Pvt Ltd, [TS-346-ITAT-2015(Bang)-TP] (ITAT Bangalore)*

5.2 The assessee hadfiled the copies of invoices raised by the AEs, along with respective allocation keys. Keeping this in view as well as on perusal of the relevant details available on record, there is no justification in the action of the TPO in ignoring all these details and taking the ALP of the relevant transactions at Nil. It is incumbent upon the TPO to work out the ALP of the relevant transactions by following some authorized method; the entire cost borne by the assessee cannot be disallowed by taking the ALP at Nil.

- *Castrol India Ltd vs ACIT [2013] 29 taxmann.com 62 (ITAT Mumbai)*
- *Castrol India LtdvsAddl CIT [2014] 45 taxmann.com 330 (ITAT Mumbai)*

5.3 The TPO has to work out the ALP of the international transaction by applying the methods recognized under the Act. He is not competent to hold that the expenditure in question has not been incurred by the assessee or that the assessee has not derived any benefits for the payment made by the assessee and consequently, he cannot consider the ALP as NIL.

- *Festo Controls (P) Ltd vs DCIT [2013] 30 taxmann.com 16 (ITAT Bangalore)*

5.4 Similarly, whether the AE gave the same services to the assessee in the preceding years without any consideration or not is also irrelevant. The AE may have given the same service on gratuitous basis in the earlier period, but that does not mean that arm's length price of these services is 'nil'.

- *Dresser-Rand India (P) Ltd vs Addl. CIT [2011] 47 SOT 423/13 taxmann.com 82 (ITAT Mumbai)*

5.5 We have observed from the facts of the casethat in the instant case, the TPO determined the arm's length prices of the intra-groupservices claimed to have been received by assessee from Nalco Pacific at 'NIL' valuewithout applying any of the transfer pricing methods prescribed under section 92C of theAct read with rule 10B and 10C of the Rules.

- *N L C Nalco India Ltd vs DCIT [TS-36-ITAT-2016(Kol)-TP] (ITAT Kolkata)*
- *DCIT vs. Diebold Software Services (P) Ltd [2014] 48 taxmann.com 26 (ITAT Mumbai)*

5.6 In the absence of any comparable figures and in the absence of any further enquiry and having the fact that services have been rendered to assessee as accepted by DRP also, TPO cannot take the amount of ALP at NIL, ignoring the payment by assessee.

- *DQ Entertainment (International) Ltd vs ACIT [2015] 64 taxmann.com 360 (ITAT Hyderabad)*

6. Burden is initially on the assessee to determine the arm's length price

6.1 The burden is initially on the assessee to determine the arm's length price.

- *Delloite Consulting India (P) Ltd vs DCIT/ITO [2012] 137 ITD 21/22 taxmann.com 107 (ITAT Mum)*

6.2 The function of the TPO is to compare the payments made bythe assessee company for services received, if any, and to see whetherthose payments are comparable. In a given scenario, the TPO has toexamine whether the payments are at ALP. Therefore, it isvery

imperative on the part of the assessee to establish before the TPOthat the payments are made commensurate to the volume and qualityof services, and that such costs are comparable.

- *Gemplus India Pvt Ltd vs ACIT, ITA No.352/Bang/2009, dated 21 October 2010*

6.3 In this case the payment terms to AE were independent of the nature or volume ofservices. Further, there were no details available on record in respect of thenature of services rendered by the AE to the assesse company. So, the ITAT Bangalore held that the TPO was justified in making a pertinent observation that theexpenses were apportioned by the AE among differentCountry Centres on the basis of their own Agreements and not on thebasis of the actual services rendered to the individual units. This was held to be a fundamental flaw, and the ITAT held that the TPO wasjustified in holding that the assessee did not prove anycommensurate benefits against the payments of service charges to the foreign affiliate. **[The case was decided against the assessee.]**

- *Gemplus India Pvt Ltd vs ACIT, ITA No.352/Bang/2009, dated 21 October 2010*

6.4 As far as the determination of ALP under the Act is concerned, the provisions lay down that the assessee has to adopt one of the methods laid down in section 92C(1). So, the assessee has to substantiate that the price paid to AE for services is at Arm's Length within one of the methods prescribed in section 92C(1).

- *Festo Controls (P) Ltd vs DCIT [2013] 30 taxmann.com 16 (ITAT Bangalore)*

6.5 The assessee must make attempts to demonstrate the ALP of the management service transaction with the AE. To demonstrate the ALP of the transaction with the AE, the assessee has to choose a method in accordance with the Act and the Rules.

- *Quintiles Research (India) (P) Ltd vs DCIT [2014] 44 taxmann.com 425 (ITAT Bangalore)*

7. It is the Taxpayer’s Burden to prove receipt of Service from the AE

7.1 When the assessee claims that the assessee has paid management fee to the AE, no doubt the burden is on the assessee to prove that it has received services from its AE.

- *Safran Aerospace India (P) Ltd vs DCIT [2015] 54 taxmann.com 360 (ITAT Bangalore)*

8. Cost-Allocation accepted by the ITAT

8.1 In this case, OECD TP Guidelines on Intra-Group Services referred to and relied upon.

- *N L C Nalco India Ltd vs DCIT [TS-36-ITAT-2016(Kol)-TP] (ITAT Kolkata)*

8.2 In these cases, Cost Allocation (indirect charge) accepted in view of OECD TP Guidelines.

- *N L C Nalco India Ltd vs DCIT [TS-36-ITAT-2016(Kol)-TP] (ITAT Kolkata)*
- *Ingersoll Rand (India) Ltd vs DCIT IT (TP) [TS-190-ITAT-2015(Bang)-TP] (ITAT* Bangalore)

8.3 There is no reason why the OECD guidelines should not be taken as a valid input in the present case in judging the action of the TPO.

- *CIT vs EKL Appliances Ltd [2012] 24 taxmann.com 199 (Delhi High Court)*

9. Elements of TPO's Authority

9.1 It is not proper for the TPO to go for an ALP ascertainment without finding any fault with the assessee'sALP working. The TP provisions provide that the TPO/AO himself must first record his objections on the merits of the ALP working of the assessee. Without doing so, the ALP determination by AO/ TPO becomes a questionable exercise.

- *Gillette India Ltd vs ACIT [2015] 62 taxmann.com 57 (ITAT Jaipur)* – **In this case the AE had done benchmarking by doing an economic analysis**

9.2 The authority of the TPO is to conduct a transfer pricing analysis to determine the ALP and not to determine whether there is a service or not from which the assessee benefits. That aspect of the exercise is left to the AO.

- *CIT vs Cushman and Wakefield (India) (P) Ltd [2014] 46 taxmann.com 317 (Delhi High Court)*

9.3 The TPO went beyond his jurisdiction in denying the payment out-rightly, whereas, his role is limited to determining the ALP. In the guise of determination of ALP, the TPO cannot question the business decision of payment and determine that no services were rendered.

- *TNS India (P) Ltd vs ACIT [2014] 48 taxmann.com 128 (ITAT Hyderabad)*

10. TPO cannot determine ALP (as Nil) of services under CUP method without bringing on recordcomparable transaction

10.1 For determining ALP under CUP method, the TPO has to find comparables to benchmark the price of services availed of by the assessee. Where the TPO has not brought any comparable company, and has instead applied the benefit test to justify the determination of ALP at Nil, the method applied by TPO is not in terms with the statutory provisions.

- *TNS India (P) Ltd vs DCIT [2015] 56 taxmann.com 268 (ITAT Hyderabad)*
- *Ingersoll Rand (India) Ltd vs DCIT IT (TP) [TS-190-ITAT-2015(Bang)-TP] (ITAT Bangalore)*

10.2 One of the very basic pre-condition for use of CUP method is availability of the price of the same product and service in uncontrolled conditions. It is on this basis that ALP of the product or service can be ascertained. It cannot be a hypothetical or imaginary value, but a real value on which similar transactions have taken place. Thus, the application of CUP is dependent on the market value of the service arrangements.

Unless the TPO can identify a comparable uncontrolled transaction in which such services, howsoever token or irrelevant services as he may consider these services to be, are rendered and find out consideration for the same, the CUP method cannot have any application. His perception that these services are worthless is of no relevance. It is not his job to decide whether a business enterprise should have incurred a particular

expense or not. A business enterprise incurs the expenditure on the basis of what is commercially expedient and what is not commercially expedient.

- *AWB India (P) Ltd vs DCIT [2014] 50 taxmann.com 323 (ITAT Delhi)*

10.3 In the absence of pre-requisites for application of CUP method, it is not open to the TPO to disregard the TNMM employed by the assessee, especially when no defects have been pointed out in application or relevance of TNMM.

- *AWB India (P) Ltd vs DCIT [2014] 50 taxmann.com 323 (ITAT Delhi)*

10.4 The TPO determined the arm's length price of services at 'NIL' value, based on his main allegation that the benefits claimed to have beenreceived by the assesse under the Service Agreement would not be ones forwhich an independent enterprise would be willing to pay.

The ITAT Kolkata did not approve of such action of the TPO.

- *N L C Nalco India Ltd vs DCIT [TS-36-ITAT-2016(Kol)-TP] (ITAT Kolkata)*

11. The Taxpayer can Benchmark the Management Services under Entity Level TNMM, by aggregating management service transactions with other transactions

11.1 In following cases, aggregated benchmarking of Management Services under TNMM was accepted:

- *N L C Nalco India Ltd vs DCIT [TS-36-ITAT-2016(Kol)-TP] (ITAT Kolkata)*
- *Ingersoll Rand (India) Ltd vs DCIT IT (TP) [TS-190-ITAT-2015(Bang)-TP] (ITAT Bangalore)*
- *DCIT vs Payne (India) Pvt Ltd, [TS-346-ITAT-2015(Bang)-TP] (ITAT Bangalore)*

11.2 Aggregated TNMM can be applied if it is established that each transaction was so inextricably linked to the other that the one could not survive without the other, and if the receipt of services formed a part of a composite transaction. The assessee would,

however, have to prove that although each sale and each provision of service is priced separately, they were all provided under one composite agreement which constitutes an international transaction.

- *Knorr-Bremse India (P) Ltd vs ACIT [2015] 63 taxmann.com 186 (Punjab & Haryana)*

11.3 However, it cannot be accepted that as the services and goods are utilized by the assessee for the manufacture of the final product, they must be aggregated and considered to be a single transaction and the value thereof ought to be computed by the TNMM. Merely because the purchase of each item and the acceptance of each service is a component leading to the manufacture/production of the final product sold, or service provided by the assessee, it does not follow that they are not independent transactions for the sale of goods or provision of services. The end product requires several inputs. The inputs may be acquired as part of a single composite transaction or by way of several independent transactions.

The question, however, in each case must first be whether the sale of goods or the provision of services was a separate independent agreement or whether they formed part of an international transaction, *i.e.*, a composite transaction.

- *Knorr-Bremse India (P) Ltd vs ACIT [2015] 63 taxmann.com 186 (Punjab & Haryana High Court)*

11.4 The assessee is engaged in one class of business that is advertising and its allied services. In the business of the assessee. There are no segments or different activities which can be said independent of each other. In such a case, due to the peculiar nature of the business of the assessee and the nature of services received from the AE, the entity level benchmarking on TNMM method shall be most appropriate for all international transactions with AE.

- *McCann Erickson India (P) Ltd vsAddl CIT [2012] 24 taxmann.com 21 (ITAT Delhi)*

- *DCIT vsDanisco (India) (P) Ltd[2015] 63 taxmann.com 174 (ITAT Delhi)*

11.5 The Assessee in the present case has chosen TNMM at the entity level and has not provided any other method for determination of ALP in respect of the transaction of "Payment of Technical and Management cost" individually. This will take us to the question as to whether the TNMM at the entity level will be the MAM or should the ALP determined using CUP. This will depend on the question whether all the activities, manufacture and trading etc., carried on by the assessee are closely linked, so that benchmarking its overall results with comparable company using TNMM would be appropriate.

This will again depend on the ultimate explanation furnished by the assessee with regard to the nature of services received by the assessee and as to how the different segments of the assessee benefitted from the services received. The test whether to adopt a combined transaction approach or to evaluate international transaction on a transaction-by-transaction basis is to see whether the transaction can be evaluated adequately on a separate basis.

- *Fosroc Chemicals India (P) Ltd vs DCIT [2015] 58 taxmann.com 85 (ITAT Bangalore)*

11.6 When the TPO does not makeanyadverse comments in his order upon the arm's length analysis carried out by assessee underthe TNMM, the TPO cannot determine the ALP of services at Nil.

- *N L C Nalco India Ltd vs DCIT [TS-36-ITAT-2016(Kol)-TP] (ITAT Kolkata)*

11.7 In the absence of pre-requisites for application of CUP method, it is not open to the TPO to disregard the TNMM employed by the assessee, especially when defects have been pointed out in application or relevance of TNMM.

- *AWB India (P) Ltd vs DCIT [2014] 50 taxmann.com 323 (ITAT Delhi)*

12. The Management Services can also be Benchmarked by taking AE as the Tested Party

12.1 TNMM by taking AE as Tested Party was accepted

- *AWB India (P) Ltd vsAddl CIT, [TS-67-ITAT-2013(DEL)-TP] (ITAT Delhi)*

12.2 In this case the AE had done benchmarking by doing an economic analysis. The ITAT Jaipur held that it is not proper for the TPO to go for an ALP ascertainment without finding any fault with the assessee'sALP working.

- *Gillette India Ltd vs ACIT [2015] 62 taxmann.com 57 (ITAT Jaipur)*

13. Division of Authority between the AO and the TPO

13.1 The jurisdiction of the AO, under Section 37, and the TPO, under Section 92CA, are distinct. The TPO is to conduct a Transfer Pricing analysis to determine the arm's length price (ALP) and not to determine whether there is a service, from which assessee has derived benefit or not. The exercise to determine whether assessee had derived any benefit or not from payment of management fee is to be examined by the AO and appropriate disallowance under Section 37 may be called for.

- *CIT vs Cushman and Wakefield (India) (P) Ltd [2014] 46 taxmann.com 317 (Delhi High Court)*
- *Rockwell Automation India (P) Ltd vs DCIT [2015] 54 taxmann.com 218 (ITAT Delhi)*

13.2 The AO can determine under Section 37 that the expenditure claimed was not for the benefit of the business, and thus, disallow that amount. This does not restrict or in any way bypass the functions of the TPO. Quite to the contrary, it represents the correct division of jurisdiction between the two entities.

- *CIT vs Cushman and Wakefield (India) (P) Ltd [2014] 46 taxmann.com 317 (Delhi High Court)*

13.3 The AO cannot reassess the quantum of payment, i.e. the value of transaction, confirmed by the TPO in the ALP determination. The AO can, however, in his assessment under Section 37 decide whether work or services were actually rendered as claimed by the assessee. In other words, the AO may determine whether the stated transactions are real and genuine. This, as part of the broader exercise to determine whether the expenditure was for the purposes of the business, lies unquestionably within the domain of the AO.

- *CIT vs Cushman and Wakefield (India) (P) Ltd [2014] 46 taxmann.com 317 (Delhi High Court)*

14. Management Service Fee, if disallowed, cannot be taken as Expenditure to compute assessee's PLI

14.1 The TPO analysed other transactions by applying TNMM method, and accepted that assessee's Profit Level Indicator (PLI)was more than the PLI of comparables. While determining the PLI, the TPO also considered payment of management fees as an expenditure. In that sense, even after paying the management fee, the PLI of assessee is more. Therefore, assessee's other transactions were deemed to be at arm's length. Considering thatpayment of management fees was taken as an expenditure to work out PLI of assessee, denial of management fees is not proper on the part of the TPO.

- *TNS India (P) Ltd vs ACIT [2014] 48 taxmann.com 128 (ITAT Hyderabad)*

14.2 When the TPO disallows the payment of management fees, it cannot be considered for the purpose of computation of operating margin, otherwise, it will amount to double addition.

- *TNS India (P) Ltd vs Addl. CIT [2014] 48 taxmann.com 80 (ITAT Hyderabad)*

15. Principle of Year-to-Year Consistency

15.1 Although the principle of *res judicata* is not applicable to the income-tax proceedings, something material or adverse in nature, which has a direct bearing on the peculiar

facts and circumstances of the case for the year under consideration, must be brought on record, to draw adverse inference. Therefore, if the TPO or the AO has accepted the payment of management service fees, in earlier or later years, then that view cannot be changed, unless any adverse material is brought on record by the revenue.

- *McCann Erickson India (P) Ltd vsAddl CIT [2012] 24 taxmann.com 21 (ITAT Delhi)*
- *Also see RadhasoamiSatsang vs CIT [1992] 193 ITR 321 / 60 Taxman 248 (SC)*

~ The End ~

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