

Sec. 92CA only empowers TPO to determine ALP of transaction; he can't reject payment made to AE

Summary – The Chandigarh ITAT in a recent case of DSM Anti-Infectives India Ltd., (the Assessee) held that in transfer pricing proceedings, role of TPO is to determine arm's length price of a transaction but he cannot reject entire payment made to AE under provisions of section 92C.

Facts

- The assessee-company was wholly owned subsidiary of DSM International B.V., the Netherlands. During the year under consideration the assessee was engaged in manufacturing of intermediaries and bulk drugs.
- The assessee had entered into an agreement with its principal, *i.e.*, DSM International B.V., titled as Corporate Services Contract.
- In terms of contract, the AE agreed to place access to all the available know-how experience and information relating to corporate research.
- The Assessing Officer made a reference to TPO under section 92CA(1) in respect of various international transactions entered into by the assessee with its AE on account of purchase of raw material, consumables and/or finished goods, export of material, on account of services received, reimbursement of expenses and interest paid on loan.
- For the purpose of determining the arm's length price of the said international transaction all the transactions except interest on loan were grouped together and the profitability had been determined for the company as whole.
- As per the TPO, under Act while applying arm's length pricing method, the same should be applied on transaction by transaction basis and separate analysis for the international transaction of payment towards service fees to the AE should have been carried on by the assessee.
- The TPO segregated the payment of service fee as per the transfer pricing study report totalling Rs. 3,30,72,526.
- The TPO was of the view that the assessee had not been able to demonstrate that the payment of service fee was at arm's length and also that no independent party would have made such payment. Thus, by application of CUP method certain adjustment was made to assessee's ALP in respect of corporate service fee paid to its AE.
- The DRP confirmed adjustment made by TPO
- On appeal:

Held

- The first aspect raised is whether the assessee should have benchmarked each of the transactions separately. Admittedly, the assessee had entered into series of transactions with its AE, *i.e.*, purchase of raw material, consumables, finished goods, etc., export of material corporate services, reimbursement of expenses and interest paid on loan, which it had aggregated in order to

determine the arm's length price of the transactions except interest on loan. The Mumbai Bench of the Tribunal in *Star India (P.) Ltd. v. ACIT* [IT Appeal No. 3585 (Mum.) of 2006 dated 28-5-2008] held that for determining the arm's length price each of the assessee's independent activities have to be segregated. In line with the ratio laid down by the Tribunal, it is held that the TPO is empowered to apply appropriate method for each of the international transactions and as the service fee paid by the assessee was a separate class of transactions, the same is to be analyzed separately, then from the other related party transactions. The revenue has placed reliance on various paras of OECD guidelines in this regard and the said principle is applied *vis-à-vis* different transactions entered into by the assessee with its AE.

- The second aspect of the issue raised by the TPO is that under the head intro group services also, the assessee should have segregated the transactions and charges paid for each transaction should have been bifurcated in order to determine whether the said transactions were at arm's length price. The issue of intra group services is also addressed by the OECD guidelines wherein under para 7.20 of OECD guidelines it is provided that where there is a direct charge method, then the associated enterprises are to be charged for specific services. However, under para 7.22 of OECD guidelines it is recognized that the direct charge method for charging for intra group service was difficult to apply in practice and where the groups have developed other methods for charging for services provided by parent companies or group service centre, then such method is to be applied. Under para 7.23 of OECD guidelines recognition of cost allocation and apportionment method involving same degree of estimation or approximation is recognized. Further under para 7.24 of OECD guidelines, an indirect charge method is recognized under which charges cannot be quantified except on approximate or estimate basis where there is rendering of service to various members of the group and there is recording of relevant service activity for each of the beneficiary. Applying the abovesaid guidelines to the issue in hand, it is held that the assessee has benchmarked the intra group services as a whole and the payments have been made to the AEs on the basis of the corporate service contract entered into between the parties and there is no requirement to identify each and every service availed under Intra Group Services.
- Though the assessee has made payments under different heads for services availed from the AE, however, the TPO had accepted the payments made on account of technical assistance and training.
- Coming to the individual items considered by the TPO, the list includes ICT services of Rs. 58,01,076 and Aurora charges of Rs. 5,29,125. The payments had been made by the assessee in the succeeding year which had been allowed by the TPO and it has been held that the transaction was at arm's length price. During the year under consideration the said amounts were not allowed as the assessee had not given any basis for computing the cost. On the perusal of the details furnished in this regard, it is opined that the factum of incurring the said expenses is not doubted. However, the TPO had not accepted the arm's length price of the said transaction but similar expenses were allowed in the succeeding year. Following the principles of consistency and as the facts of the case for the year under appeal are similar to the facts in assessment year 2008-09 it is held that the

payments made towards ICT services and Aurora charges are at arm's length and are duly allowable in the hands of the assessee. Similarly, the next two items are on account of services of Rs. 69,238 and technical and professional charges of Rs. 36,898. The TPO had disallowed the said expenditure as in the form No. 3 CEB audit report, the said payments had been shown to have been made to DSM. However, in the transfer pricing study report, the same was shown to SM. The assessee has clarified that the same are group entities and there is no discrepancy in the Audit Report and transfer pricing report. There is no merit in the report of the TPO in this regard and dismissing the same it is held that both the expenses of Rs. 69,238 and Rs. 36,898 are at arm's length price and no adjustment is to be made on this account.

- The only payment now left to be considered is corporate service charges. The plea of the assessee was that the said payments were made to the AE under an agreement and the said decision of the assessee in making the aforesaid payments could not be questioned by the authorities below. The assessee further submitted that various documents with regard to the nature of corporate services provided by the AE to the assessee, against which the assessee had paid the corporate service fee to its AE were furnished before the TPO and copies of which were also placed on record. The plea of the assessee was that the said documents have not been considered in entirety by the authorities below. In the synopsis submitted the assessee had enlisted various benefits realized from the payment of corporate service fee to its AE.
- The first reference made was to the Corporate Operational Audit 2006 report. It was carried out by the AE for detailing its findings, significance and proposed action to be taken by the assessee. The assessee has also placed on record a letter received from AE with regard to corporate operational audit conducted, which in turn contains scope of audit functions covered in the audit along with name of the personnel conducting audit.
- The second set of items were in relation to presentation of safety, health and environment audit (SHE audit). The assessee has also further placed tabulated details in which it has enlisted date-wise schedule with respect to SHE audit conducted by the associated enterprises containing the name of the personnel conducting the audit and also the name of the employees of the assessee who were interviewed or participated in the said audit. Another benefit arising from the said arrangement was the procedure to set up DSM Anti Infectives Energy Utility Net Work with the object of saving of energy and utility goods. As per the assessee, the said project was a global initiative of the DSM group for operation, maintenance with the aim to reduce the energy and utility cost. The assessee has further furnished details of benefits derived by it as a result of the corporate operational audit and other energy saving projects undertaken by AE. The assessee has further tabulated the list of documents/particulars filed before the Tribunal and also before the TPO and pointed out that the services provided by the AE helped the assessee in carrying on their day-to-day business, which in turn also encouraged energy savings and also safety, health and environment manufacturing and good manufacturing practices.

- The next set of services provided by the AE was in relation to health conference outside India where participation fee was not paid but the travelling expenses of the personnel travelling abroad were incurred by the assessee. In addition, there was a newsletter started by the AEs called SHE Flyer, which covered various facilities to be checked in respect of explosion of boilers and fire facilities.
- Further there was exchange of e-mail between AE and the assessee regarding negotiations with bankers on account of finance and treasury services. The first set of negotiations was in respect of better terms of financial charges due to global relationship under which there was a rate correction *vis-à-vis* rate of interest payable on loan in the year under consideration and also in the succeeding year. Further there was issuance of letter of credit of facilities of Euro 10 millions, *i.e.*, approximately Rs. 63 crore by the AE in favour of the assessee. The assessee pointed out that in the succeeding year the AE had granted a letter of credit facility of Euro 30 million approximately Rs. 190 crore and also AE had provided a corporate guarantee amounting to INR 52.63 crore to the Bank. As a result of guarantee provided by AE the assessee was able to borrow funds at cheaper rate of interest. In the financial year 2006-07, there was interest saving of Rs. 1.40 crore, while in financial year 2007-08 there was cumulative saving of Rs. 9.29 crores
- The case of the assessee was that on the basis of allocation used by the group to allocate cost incurred in relation to services rendered, the total amount had been allocated among group companies in a systematic manner, which in turn leaves no scope for arbitrary allocation of cost. The formula worked out by the parties safeguarded that the cost are charged to various members, depending on their contribution to the total invested capital and gross value added, which represented appropriate share of cost to be borne by each member. The gross value added over invested capital was the formula adopted whereunder which GVA was given more importance and the formula worked out to $GVA \times 2 + \text{invested capital of company} \div GVA \times 2 + \text{invested capital of group}$ is to be applied to corporate costs. The assessee brought to it record that the total cost to the assessee was 0.27 per cent of the total cost incurred by DSP group for providing corporate services. The TPO, on the other hand, had disallowed the claim of the assessee as it had not provided the break-up of the amounts attributable to each service and he had also challenged as to what were the economic and commercial benefits derived by recipient of intra group service and whether comparable independent enterprise would have paid for the services in comparable circumstances. As per the TPO, from the details available it was not clear whether the assessee had actually received services of same value that would justify such huge payment.
- There is no merit in the plea of the Assessing Officer/TPO with reference to the services provided by the AE. The assessee in terms of agreement entered into in the earlier year had been paying the said fees as corporate service charges. The assessee was a part of world wide group and some governance is required for running various units across the globe. The group as a whole had decided to fix certain norms for running the manufacturing unit and cost incurred by the members, to streamline the functioning of different entities of the group and also for providing financial assistance by way of rate correction of the interest rate payable on the borrowings and also in the

case of the assessee by providing guarantee in the form of actual money consideration, which in turn has resulted in monetary benefits to the assessee along with benefits of the research and development carried on by the members in the field of business. For availing the above said benefit, the assessee had entered into an agreement with its members in the preceding years and corporate services charges had been paid from year to year i.e. both in the preceding years and also in the succeeding years and there is no merit in the order of the Assessing Officer/TPO in holding that the assessee had not received any benefits under the said agreement and hence the payments made by it to its AE's were not at arm's length price.

- In assessment year 2008-09 under the head corporate service charges, in addition to the charges paid as in the preceding year, the assessee has also paid royalty for specific purposes to use trademark and patent, which admittedly is a business expenditure and is to be allowed as an expenditure in the hands of the assessee. In any case, the role of the TPO is to determine the arm's length price of a transaction and he cannot reject the entire payment under the provisions of section 92CA.
- The TPO in the present case had similarly denied the payment to the assessee while determining the arm's length price of the said transactions of the assessee with the AE. Following the ratio laid down by the Delhi High Court in *CIT v. EKL Appliances Ltd.* [2012] 345 ITR 241/209 Taxman 200/24 taxmann.com 199 and Hyderabad Bench of the Tribunal in *TNS India (P.) Ltd. v. Asstt. CIT* [2014] 48 taxmann.com 128, it is held that the TPO exceeded its jurisdiction in denying the said payment while determining the arm's length price of the said transactions and holding that no services were rendered by the AEs.
- In the entirety of the abovesaid evidence produced by the assessee, it cannot be said that no services were provided by the AE. The TPO has disregarded the documents filed before him. Further the DRP, relating to assessment year 2008-09 has held that some benefits were allowable to the assessee. In addition to various services provided certain financial benefits in terms of savings were also made available to the assessee on account of the following:
 - (i) Better terms for financial charges.
 - (ii) Issuance of letter of credit of € 10 million (approximately 63 crore in assessment year 2007-08).
 - (iii) Guarantee in assessment year 2008-09.
 - (iv) Reduction in fees charged by Banks from the assessee.
- In the totality of the facts and circumstances, the total cost incurred by various entities of the group incurred in relation to services rendered has been allocated amongst the group companies in systematic manner. Under the formula agreed upon between the parties, costs were charged to various members, depending on their contribution to the invested capital and gross value added and appropriate share of cost to be borne by each entity was worked out. This practice was adopted to achieve business efficiency in order to meet the demands of customers and to run basic operations more efficiently in globalized and competitive market.

- There is nothing to show that the transactions entered into by the assessee were not at arm's length price. It is irrelevant as to what benefit the assessee eventually derived from the said services but what is actually determinative factor, so far as ALP adjustment is concerned, as to what the assessee would have paid for these services in a situation in which these services were rendered by a non-AE. As is clearly evident from the material produced before us, the services were indeed rendered by AE in earlier years, in respect of which no adjustment was made, as action of the TPO in applying CUP method without there being any valid comparable was patently incorrect. The findings of the TPO in this regard were reversed.
- The revenue further pointed out that the direct cost allocation is to be made where services given by the AE are quantified on the cost with a markup value. There is no merit in the said stand of the revenue as the assessee while conducting his business is the best person in charge of the benefits arising to it and the cost of such benefits had to be considered from the angle of a prudent businessman. The revenue has failed to bring on record any evidence to negate the claim of the assessee *vis-à-vis* the services received on various accounts and in view of the evidence referred to and considering the nature of business and in view of the facts and circumstances, there is merit in the claim of the assessee and there is no justification to sustain the addition made by the TPO.
- In view of the abovesaid principles laid down, there is no merit in the adjustments made by the TPO. Another aspect is to be kept in mind while deciding the issue. The plea raised by the assessee was that savings to the assessee as result of services provided by the AE should be considered while holding the transaction to be at arm's length. It was fairly conceded by the assessee that under internationally accepted norms, savings are to be shared between the parties in the ratio of 50 : 50. The assessee further pointed out that the savings on account of guarantee fee in assessment year 2007-08 were Rs. 1.40 crore and the total savings in assessment year 2008-09 were Rs. 9.29 crore. The TPO in assessment year 2007-08 has made an adjustment of Rs. 2,91,95,471 and in the assessment year 2008-09 has made an adjustment of Rs. 6,14,13,983. In view of the admission of the assessee, it is opined that 50 per cent of the benefits arising to the assessee on account of financial benefits is to be retained by the assessee in independent party transactions. However, in the facts of the present case, the assessee has transferred 100 per cent of the said benefits to the AE by way of paying the Corporate Service Charges. Accordingly, the TPO/Assessing Officer is directed to disallow 50 per cent of the benefits arising on account of guarantee fee and interest cost as being not on arm's length and the balance payment is allowable in the hands of the assessee as being on arm's length against which no adjustment is to be made.
- The grounds of appeal raised by the assessee are thus, partly allowed.