

Sum paid to AE to make good its forex losses can't be treated as management fee

Summary – The Hyderabad ITAT in a recent case of DQ Entertainment (International) Ltd., (the Assessee) held that Payment making good foreign exchanges losses in hands of AE due to unexplained delay in payment could not be considered as payment for management and consultancy services

Facts

- The assessee was one of the leading producers of animation, visual effects, game art and entertainment content for India as well as global media and entertainment industry.
- During relevant year, the assessee made payment of management consultancy service fee to its AE namely DQE Mauritius.
- In transfer pricing proceedings, the TPO came to the conclusion that the assessee could not substantiate the queries raised by him and could not prove the services rendered by Associated Enterprise (AE). Applying the benefit test, he determined the Arm's Length Price (ALP) value of the services at NIL. Accordingly, certain addition was made to the assessee's ALP.
- The DRP confirmed the order passed by TPO.
- On appeal:

Held

- It was seen from records that the TPO analysed the accounts of DQ Entertainment Plc and DQE Mauritius in analyzing the nature of payment. Out of the total amount of US \$7,99,000 paid, the actual Management Consultation Charges were only US \$4,27,000 along with administrative and audit fee of US \$14,000. As per the agreement, there is a markup of 5 per cent. This expenditure only can be considered, as the Management Consultancy Service Fee, whereas the foreign exchange loss of US \$3,21,000 cannot be considered as intra group service. From the documents placed on record, it is noticed that instead of quarterly bills being raised as per the agreement, DQE Mauritius has raised only one bill for the whole of the year.
- As can be seen from the details of payments made, the amount of US \$799,174 charged on 31-3-2008 was paid in three instalments. It is noticed that even though invoice was raised on 31-3-2008 for whole year instead of quarterly billing, the payments were made from September, 2010 to January, 2011 with substantial delay. The reasons for such delayed payments were not explained. Therefore, in the given circumstances, the foreign exchanges losses or gains in the hands of DQE Mauritius cannot be considered as services rendered by the DQE Mauritius to assessee which should be on its own account. To the extent of the above amount, the observation of the TPO that foreign exchange loss does not pertain to any management and consultancy services is accepted. To that extent his order has to be approved.

- What the TPO has missed is with reference the amounts other than foreign exchange loss. 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 of US \$4,27,000. As per the agreement, all the costs incurred by the DQE Mauritius with 5 per cent markup had to be charged to assessee. Therefore, as per the details furnished by assessee before the TPO, the actual management fee of US \$4,27,000 with administration charges of US \$ 14000 and markup of 5 per cent, at the exchange value as on the date of 31-3-2008, can be considered as 'service charges' for the intra group services rendered. This can be taken as ALP. Therefore, the order of TPO is modified accordingly.
- In the result, appeal is partly allowed.