**TRANSFER PRICING: Where on DRP's directions to compute ALP on account of corporate charges at 1 per cent of total cost, if total cost of assessee worked out to be higher than what had been paid by assessee towards corporate charges, no adjustment to be made**

**TRANSFER PRICING: Where assessee had already charged interest at 1.5 per cent over prevailing LIBOR as per loan agreements with its AEs, adjustment on account of interest on foreign currency loan was to be deleted**

**TRANSFER PRICING: Where assessee was formed as a Special Purpose Vehicle (SPV) for purpose of giving services to group companies and made payment on account of corporate charges, since all transactions were interlinked transactions, transactional net margin method (TNMM) would be most appropriate method**

**TRANSFER PRICING: Where TPO made TP adjustment on account of reimbursement of expenses without offering any opportunity to assessee, issue to be restored to TPO**

**TRANSFER PRICING: Where assessee had not charged interest for delay in receipt of remittances from unrelated parties, no adjustment could be made on account of delay in receipt of receivables from associated enterprises**

**[2019] 109 taxmann.com 47 (Delhi - Trib.)**

**IN THE ITAT DELHI BENCH 'I-1'**

**Aricent Technologies (Holdings) Ltd.**

***v.***

**Deputy Commissioner of Income-tax, Circle-1 (1), New Delhi****

N.K. BILLAIYA, ACCOUNTANT MEMBER
AND MS. SUCHITRA KAMBLE, JUDICIAL MEMBER
I.T. APPEAL NOS. 90 DELHI OF 2013 & 2671 (DELHI) OF 2014
[ASSESSMENT YEARS 2008-09 AND 2009-10]
JULY 26, 2019

**I. Section 92C of the Income-tax Act, 1961 - Transfer pricing - Computation of arm’s length price (Adjustments - Corporate charges) - Assessment year 2008-09 - Assessee was engaged in production of computer software products and provision of software development services of communication industry - DRP directed TPO to compute Arm's Length Price (ALP) on account of corporate charges at 1 per cent of total cost - Whether, if after giving effect to such directions total cost of assessee worked out to be higher than what had been paid by assessee towards corporate charges, no adjustment was to be made - Held, yes [Para 11] [In favour of assessee]**

**II. Section 92C of the Income-tax Act, 1961 - Transfer pricing - Computation of arm’s length price (Adjustment - Interest) - Assessment years 2008-09 and 2009-10 - Assessee was engaged in production of computer software products and provision of software development services of communication industry - It earned interest income in respect**

**of loan of US dollar extended to its Japanese and Chinese based associated enterprises, (AEs) - TPO applied rate of interest at 17.26 per cent and accordingly, made TP adjustment - It was found that in loan agreement it was clearly mentioned that borrower would pay interest at 1.5 per cent over prevailing LIBOR - Similarly, agreement with its Chinese based AE showed interest at 150 basis points over prevailing LIBOR - Whether, in view of facts and agreements, since assessee had already charged interest on loan at LIBOR plus 150 basis points, impugned adjustment on foreign currency loan was to be deleted - Held, yes [Paras 19 and 94] [In favour of assessee]**

**III. Section 92C of the Income-tax Act, 1961 - Transfer pricing - Computation of arm's length price (Methods for determination of - TNM method) - Assessment year 2009-10 - Assessee in course of carrying on its software development business entered into international transaction of payment of corporate charges - It was formed as a special purpose vehicle (SPV) for purpose of giving services to group companies for which Associated Enterprise (AE) had charged cost plus 5 per cent as marker and assessee was making such payment in lieu of receiving wide scope of services from its AE - It was found that all these transactions were interlinked and could not be evaluated on separate basis - Further, Tribunal in case of BG Exploration & Production India Ltd. v. Jt. CIT (International Taxation) [2017] 82 taxmann.com 446 (Delhi - Trib.), had held that transactions of intragroup services are interlinked, therefore, they should be benchmarked together by adopting Transactional Net Margin Method (TNMM) as the Most Appropriate Method (MAM) - Whether, therefore, TNMM would be MAM for aforesaid international transaction - Held, yes [Para 89] [In favour of assessee]**

**IV. Section 92C of the Income-tax Act, 1961 - Transfer pricing - Computation of arm's length price (Adjustments - General issues) - Assessment year 2008-09 - Whether where TPO made TP adjustment on account of reimbursement of expenses without offering any opportunity to assessee, issue to be restored to TPO for examining evidences furnished by assessee - Held, yes [Para 91] [Matter remanded]**

**V. Section 92C, read with section 92B, of the Income-tax Act, 1961 - Transfer pricing - Computation of arm's length price (Adjustments - Interest) - Assessment year 2009-10 - Assessee was engaged in production of computer software products and provision of software development services of communication industry - It was found that remittances from unrelated third parties also came with time lag exceeding agreed period and assessee had not charged any interest for delay in receipt of such remittances from unrelated third parties - Whether, therefore, no adjustment could be made on account of delay in receipt of receivables from associated enterprises - Held, yes [Paras 105 and 106] [In favour of assessee]**

## FACTS-I

- The assessee was engaged in the business of production of computer software products and provision of software development services of communication industry through the various 100 per cent export oriented units.
- During the course of the transfer pricing assessment proceedings, the TPO noticed that the assessee had paid Rs. 2.40 crore to its Associated Enterprises (AE) on account of certain services purported to have been received by the assessee.
- The assessee explained that Transactional Net Margin Method (TNMM) is the Most Appropriate Method (MAM) with OP/OC as the Profit Level Indicator and stated

since the operating profit margin of the assessee at 21.84 per cent was higher than the comparable companies at 20.36 per cent, the international transaction of payment of corporate charges was considered to be at Arm's Length Price (ALP).

- The TPO, however, rejected the TNMM method applied by the assessee and separately benchmarked the said transaction applying CIP method. Further, the TPO held that since the assessee had not received any economic and commercial benefits from such payment the ALP of said transaction was be considered to be at *nil*.
- The DRP held some costs could be attributable to the assessee but were difficult to quantify. So an *ad hoc* allowance of 1 per cent of total costs was allowed to the assessee and the remaining was to be considered for determination of ALP for transactions tested under TNMM. Thus, the TPO was directed to recompute the ALP accordingly.
- In the instant appeal, the assessee contended that if 1 per cent of the total cost of the assessee was taken then it would be higher than the amount paid by the assessee towards corporate charges.

**HELD-I**

- Since the revenue is not in appeal, the direction of the DRP has attained finality. This means that the TPO should give effect to the directions of the DRP in letter and spirit. The direction of the DRP has been mentioned elsewhere and since the DRP has directed the TPO to compute the ALP at 1 per cent of total cost the same should be followed. Accordingly, the TPO/Assessing Officer is to be directed to follow the directions of the DRP and if found that after giving effect to the directions total cost of the assessee works out to be higher than what has been paid by the assessee towards corporate charges, no adjustment on account of corporate charges need to be made. [Para 11]

**FACTS-II**

- During the year under consideration, the assessee earned interest income of Rs. 23.56 lakh in respect of loan of US dollar extended to its Japanese and Chinese based AE. It charged interest at LIBOR plus 1.5 per cent and claimed that the rate of interest charged was comparable to the prevailing rate of interest in the international market. Thus, international transaction was considered as being at Arm's Length Price (ALP) applying Comparable Uncontrolled Price (CUP) as the Most Appropriate Method (MAM) as the same was adequately benchmarked with respect to comparable uncontrolled transaction of expenses of payment of interest on similar loans.
- However, the TPO was of the opinion that the manner in which the CUP method has been applied by the assessee was erroneous. The TPO applied rate of interest at 17.26 per cent.
- The DRP upheld the adjustment made by the TPO, however imputed rate of interest at 13.25 per cent being Prime Lending Rate (PLR) of SBI.
- On the assessee's appeal before the Tribunal:

**HELD-II**

- It is to be found that the loan agreement with FSS, Japan clearly mentions that the

borrower shall pay interest rate of 1.5 per cent over prevailing LIBOR and the transaction is in US dollar. Similarly, the agreement with FSS Beijing show interest at 150 basis points over prevailing LIBOR and the transaction is in US dollar. Considering the facts of the case in the light of the agreements and in the light of the decision of DRP in assessment year 2012-13 wherein all the apprehensions raised by the revenue has been duly considered by the DRP which is also under appeal in IT Appeal No. 1944/Delhi/2017, It is to be considered that rate of interest at LIBOR plus 1.5 per cent should be taken as the rate and since the assessee has already charged the interest on loan at LIBOR plus 150 basis points, the TP adjustment in interest on loan amounting to Rs. 23 lakh deserves to be deleted. [Para 19]

**FACTS - III & IV**

- During the year under consideration, the assessee in the course of carrying on of its software development business had entered, *inter alia,* into international transaction of payment of corporate charges.
- The Associated Enterprises (AEs) allocated these corporate charges among the group companies on the basis of cost plus 5 per cent markup which are based on the report prepared by an independent consultant.
- The assessee benchmarked aforesaid international transaction applying Transactional Net Margin Method (TNMM) as the Most Appropriate Method (MAM) with OP/OC as the profit level indicator and since the operating profit margin of the assessee at the rate of 27.36 per cent is higher than that of the comparable companies at the rate of 14.24 per cent, aforesaid transaction was considered to be arm's length. In its transfer pricing report, the assessee had treated payment of administrative corporate fees payment as part of operating expenses.
- The TPO was of the opinion that Comparable Uncontrolled Price (CUP) was MAM held that the assessee had failed to demonstrate the benefits passed to the assessee by the AE on availing such services. Applying CUP, the ALP of service fee was determined at *NIL* and the additions were made. The TPO has held that this transaction is having bearing on income of the assessee, and, hence, to be analyzed separately. Further, the TPO also made TP adjustment on account of reimbursement of expenses.
- The DRP confirmed the ALP determination and the adjustment made by TPO and further, directed the TPO to treat the ALP of international transaction of legal and professional expenses, facility rental, insurance, repairs and maintenance, and training aggregating to Rs. 54.85 crore at *Nil*.
- In the instant appeal, the assessee contended that the corporate charges were related to the entire turnover/provision of services of the assessee and constituted an essential part of the cost of the sales. Referring to the enhancement in the TP adjustment by the DRP, the assessee stated that without giving any opportunity to the assessee the TPO has made an adjustment on account of reimbursement of expenses.

**HELD-III & IV**

Adjustment on account of corporate charges

- The fact is that Aricent USA was formed only to provide centralized corporate management services to all entities in the group and it does not have any other

business activity or sources of revenue. This means that Aricent USA was formed as a Special Purpose Vehicle (SPV). This has to be further considered with the agreement between the assessee and the AE. The evidences placed are copies of Emails exchanged between the appellant and the associated enterprises to substantiate that significant services were rendered by the AE. It is the prerogative of the assessee to decide as to whether or not the services are required. This view find support from the decision of the High Court in the case of *Sony Ericsson Mobile Communication India (P.) Ltd.* v. *CIT* [2015] 55 taxmann.com 240/231 Taxman 113/374 ITR 118 wherein High Court has held that once the expenditure is incurred for business purposes, the Assessing Officer cannot question requirement and quantum of expenditure. [Para 81]

- The Delhi High Court in the case of *CIT* v. *Cushman and Wakefield (India) (P.) Ltd.* [2015] 60 taxmann.com 168/233 Taxman 250 has held that the authority of the TPO is to conduct a TP analysis to determine the ALP and not to determine whether the taxpayer derives any benefit from the service. The Delhi High Court has opined that the determination of benefit to the taxpayer is in the domain of the Assessing Officer. [Para 82]
- In the light of the aforestated judicial discussion, it is to be considered that the TPO/DRP grossly erred in examining the impugned corporate charges in the light of benefits and necessity. [Para 83]
- The undisputed fact is that the OPM of the assessee is at the rate of 27.36 per cent whereas that of all the comparable companies is at the rate of 14.24 per cent. As mentioned elsewhere the AE was created as a SPV for the purpose of giving services to the group companies for which the AE has charged cost plus 5 per cent as a marker and the assessee is making such payment in lieu of receiving *vide* scope of services from its AE. These are all interlinked transactions and therefore, should not be evaluated on a separate basis. This is also supported by the OECD guidelines which provide for evaluation of combined transactions where such transactions are closely linked or continues and cannot be evaluated separately. [Para 85]
- The coordinate bench of Tribunal in the case of *BG Exploration and Production India Ltd.* v. *JT. CIT (IT)* [2017] 82 taxmann.com 446 (Delhi - Trib.) has deleted the adjustment on account of payment made for intragroup services. Holding that transactions of intragroup services are interlinked, therefore, they should be benchmarked together by adopting TNMM as the most appropriate method. [Para 87]
- It would not be out of place to refer to the decision of the Delhi High Court in the case of *Magneti Mareli Powertrain India (P.) Ltd*. v. *Dy.CIT* [2016] 75 taxmann.com 213/389 ITR 469 wherein the High Court held that technical know-how fee paid by the assessee is to be benchmarked applying TNMM at the entity level. The said decision has been affirmed by the Supreme Court in *Dy.CIT* v. *Magneti Marcli Powertain India (P.) Ltd.* [2018] 89 taxmann.com 8/252 Taxman 385 [Para 88]
- Considering the judicial decisions discussed hereinabove in the light of the underlying facts in the issue, it is to be held that TNMM is the most appropriate method for this international transaction and since the OPM of the assessee is higher than the OPM of the comparable companies, the benefit and the necessity test applied by the TPO/ DRP is uncalled for and, accordingly, the TPO/Assessing Officer is to be directed to delete the addition of Rs.48.39 crore. [Para 89]

***Adjustment on account of reimbursement of expenses***

- The TP adjustment of Rs.54.85 crore which was made pursuant to the directions of the DRP on account of reimbursement of expenses, it is to be considered that the transaction of reimbursement of expenses is closely linked with the entire business of the assessee. However, a careful perusal of the additional evidences shows that some of the evidences are not from third party. However, since the TPO has made the addition without offering any opportunity to the assessee, this issue is to be restored to the TPO. The assessee is to be directed to furnish all the related evidences and the TPO is to be directed to examine such evidences and decide the issue afresh as per the provisions of the law. [Para 91]

**FACTS - V**

- The assessee was engaged in the business of production of computer software products and provision of software development services of communication industry through the various 100% export oriented units set up in software technology parks
- The TPO observed that the assessee had provided benefit to its AE by way of advancing of interest free loan in the garb of delay in receipt of receivables and finally concluded by charging interest at the rate of 15.77 per cent and made adjustment
- In the instant appeal, the assess contended that the delay of remittances cannot be re-characterized as unsecured loans advanced to the AE's and imputing of the notional interest thereon, is not in accordance with law.

**HELD - V**

- Every indebtness cannot be construed to have arisen out of a loan transaction and interest is involved only in relation to a debt created out of loan transaction. For this proposition, support is to be drawn from the decision of Supreme Court in the case of *Bombay Steam Navigation Co. [1953] (P.) Ltd.* v. *CIT* [1965] 56 ITR 52. This view further find support from the decision of High Court of Delhi in the case of *Pr. CIT* v. *Kusum Health Care (P.) Ltd.* [2018] 99 taxmann.com 431/[2017] 398 ITR 66 wherein High court in the context of receivable held that not every item of receivable will be considered as an international transaction of receivable and each receivable has to be seen on case to case basis. [Para 101]
- It is not the case of the revenue that the impugned transaction is sham or bogus transaction, therefore, the re-characterization of the receivables as unsecured loans is uncalled for. [Para 102]
- There is no dispute that remittances from unrelated third parties have also come with a time lag exceeding the agreed period and the undisputed fact is that the assessee has not charged any interest for delay in receipt of such remittances from unrelated parties. In the light of such undisputed fact, any delay in remittances from associated enterprises should not be re-characterized as unsecured loans. This support is to be drawn from the decision of High Court of Bombay in the case of *CIT* v. *Indo American Jewellery Ltd* . in [2014] 44 taxmann.com 310/223 Taxman 8 (Mag.) [Para 103]
- There is no dispute that the OPM of the assessee at the rate of 27.36 per cent is higher than the average working capital adjusted margins of the comparable companies at the rate of 12.97 per cent, this being so, no adjustment is called for in the light of the

decision of the High Court of Delhi in the case of *Kusum Health care* (*supra*). [Para 104]

- It is to be considered that since the receivables have been received by the assessee within ordinary time period, it cannot be re-characterized as unsecured loans and, accordingly, no adjustment on account of delay in receipt of receivables can be made in the income of the assessee considering the fact that the similar delay is there in respect of receivables from unrelated third parties. [Para 105]
- Considering the facts of the case in hand in totality in the light of the factual matrix discussed herein above *vis-a-vis* judicial decisions on the point of issue it is to be considered that resorting to *Explanation (1)(c)* to section 92B is uncalled for. Accordingly, the Assessing Officer/TPO is to be directed to delete the transfer pricing adjustment of Rs. 97.78 crores. [Para 106]

**CASE REVIEW**

*Sony Ericsson Mobile Communications India (P.) Ltd*. v. *CIT Reebok India Company* [2015] 55 taxmann.com 240/231 Taxman 113/374 ITR 118 (Delhi) (para 81); *CIT* v. *EKL Appliances Ltd* . [2012] 24 taxmann.com 199/209 Taxman 200/345 ITR 241 (Delhi) (para 82); *CIT* v. *Lumax Industries Ltd*. [IT Appeal No. 102/2014] (para 82); *CIT* v. *Cushman and Wakefield (India) (P.) Ltd* . [2015] 60 taxmann.com 168/233 Taxman 250 (Delhi) (para 82); *BG Exploration and Production India Ltd.* v. *Dy. CIT* [2017] 82 taxmann.com 446 (Delhi - Trib.) (para 87); *Magneti Mareli Powertrain India (P.) Ltd*. v. *Dy. CIT* [2016] 75 taxmann.com 213/389 ITR 469 (Delhi) (para 88); *Dy.CIT* v. *Magneti Marelli Powertain India (P.) Ltd.* [2018] 89 taxmann.com 8/252 Taxman 385 (SC) (para 88); *Pr. CIT* v. *Kusum Helath Care (P.) Ltd.* [2018] 99 taxmann.com 431/[2017] 398 ITR 66 (Delhi) (para 101) and *CIT* v. *Indo American Jewllery Ltd.* [2014] 44 taxmann.com 310/223 Taxman 8 (Mag.) (Bom.) (para 103) *followed*.

**CASES REFERRED TO**

*CIT* v. *Cotton Naturals India (P.) Ltd* . [2015] 55 taxmann.com 523/231 Taxman 401 (Delhi) (para 17), *Flextronics Software System Ltd.* v. *CIT* [2009] 28 SOT 371 (Delhi) (para 24), *Aricent Technologies (Holding) Ltd*. v. *Dy. CIT* [2011] 9 taxmann.com 287 (Delhi) (para 24), *NTPC Ltd*. v. *CIT* [1998] 229 ITR 383 (SC) (para 36), *CIT* v. *Smifs Securities Ltd.* [2012] 24 taxmann.com 222/210 Taxman 428/348 ITR 302 (SC) (para 37), *United Breweries Ltd*. v. *Addl. CIT* [2016] 76 taxmann.com 103 (Bang. - Trib.) (para 60), *Hindustan Coca Cola Beverages (P.) Ltd* . [2011] 9 taxmann.com 104/198 Taxman 104/331 ITR 192 (Delhi) (para 62), *Sony Ericsson Mobile Communications India (P.) Ltd.* v. *CIT* [2015] 55 taxmann.com 240/231 Taxman 113/374 ITR 118 (Delhi) (para 81), *CIT* v. *EKL Appliances Ltd.* [2012] 24 taxmann.com 199/209 Taxman 200/345 ITR 241 (Delhi) (para 82), *CIT* v. *Lumax Industries Ltd.* [IT Appeal No. 102 of 2014] (para 82), *CIT* v. *Cushman & Wakefield (India) (P.) Ltd.* [2015] 60 taxmann.com 168/233 Taxman 250 (Delhi) (para 82), *BG Exploration and Production India Ltd.* v. *Jt. CIT* [2017] 82 taxmann.com 446 (Delhi - Trib.) (para 87), *Magneti Mareli Powertrain India (P.)* v. *Dy. CIT* [2016] 75 taxmann.com 213/389 ITR 469 (Delhi) (para 88), *Dy. CIT* v. *Magneti Mareli Powertrain India (P.) Ltd.* [2018] 89 taxmann.com 8/252 Taxman 385 (SC) (para 88), *Pr. CIT* v. *Kusum Health Care (P.) Ltd.* [2018] 99 taxmann.com 431/[2017] 398 ITR 66 (Delhi) (para 99), *Pitney Bowes Software India (P.) Ltd.* v. *Addl. CIT* [2019] 101 taxmann.com 350 (Delhi - Trib.) (para 99), *Bombay Steam Navigation Co. [1953] (P.) Ltd.* v. *CIT* [1965] 56 ITR 52 (SC) (para 101) and *CIT* v. *Indo American Jewellery Ltd* . [2014] 44 taxmann.com 310/223 Taxman 8 (Mag.) (Bom.) (para 103).

**Ajay Vohra**, Sr. Adv. **Anshul Sachhar**, Adv. **Ramit Katiyal**, CA and **Neeraj Jain**, Adv. *for the Appellant.* **Sandeep Kumar Mishra**, Sr. DR, *for the Respondent.*

## ORDER

**N.K. Billaiya, Accountant Member. -** These two appeals by the assessee are preferred against the two separate orders framed u/s. 143 (3) r.w.s. 144 C of the Act. Since common issues are involved in both these appeals they were heard together and are being disposed of by this common order for the sake of convenience.

**2.** The appellant company was formerly known as Flextornics Software Systems Ltd. (FSS) which was formerly known as Hughes House Software Services Ltd. (HSS) and is a company incorporated under the companies Act. 1956. FSS is closely held public limited company and is subsidiary company of Flextronics Sales and Marketing Limited. The appellant is engaged in the business of production of computer software products and provision of software development services of communication industry through the various 100% export oriented units set up in software technology parks at Gurgaon and Bangalore.

**3.** The international transactions entered into by the assessee are tabulated below:—

| *Name of transaction* | *Method selected* | *Total value (Rs.)* | |
|---|---|---|---|
| | | Paid | Received |
| Sales of services | CPM | | 508,306,589 |
| Sales of products | CUP | | 27,096,734 |
| Interest income | CUP | | 2,428,061 |
| Product Relates Services | CPM | | 2,096,906 |
| Purchase of services | CPM | 198,33,524 | |
| Reimbursement of travel cost | CPM | 107,536 | |
| Recharge of courier charges | CPM | 98,759 | |
| Legal and Professional Expenses | CPM | 241,398 | |
| Facility Rental | CPM | 19,333,061 | |
| Insurance Expenses | CPM | 23,484,987 | |
| Corporate Expenses | CPM | 24,022,522 | |
| Marketing Services | CPM | | 49,565,029 |

**4.** The reference u/s. 92CA (1) of the Act was received by the TPO for determination of arms length price for the international transactions under taken by the appellant company. During the course of the transfer pricing assessment proceedings the TPO noticed that the assessee has paid Rs.24022522/- to its AE Aricent US market Inc on account of certain services purported to have been received by the assessee. The TPO found that this amount has been bench marked by including it in the cost base while comparing arms length margin using TNMM. The assessee was asked to furnish all the agreements entered into by the assessee company related to the Intra Group services obtained by the assessee company from the AE. The assessee was also asked to explain the rate of payment for Intra Group Services and whether any cost benefit analysis was done while entering into the agreement. The assessee was asked to furnish all the evidences in relation to such payments. Assessee filed a detailed reply vide submissions dated 17.08.2011 and 09.09.2011 and also filed the relevant agreement. The services listed in the agreement are as under:—

3. SCOPE OF SER VICES

Aricent shall provide following Services to

Recipient: *i.* Accounting and Finance

(*a*) Audit liaison

(*b*) Consolidations

(*c*) Financial reviews

(*d*) Reporting to investors

(*a*) Undertaking group financial projects and providing forecasts

*ii.* Executive Management

(*a*) Development of corporate strategy for the business as a whole

(*b*) Deciding organizational structure

(*c*) Operating procedures to ensure efficient operations

(*d*) Anticipation of competitors' actions, customers' preferences in order to increase market share as well as revenues and margins.

*iii.* Tax

(*a*) Regulatory compliance

(*b*) Minimizing overall effective tax cost.

*iv.* Legal

(*a*) Formulating worldwide customer selling terms ana conditions

(*a*) Providing documentation and review of customer contracts;

(*b*) Assuring global compliance

*v.* Treasury

(*a*) Global cash management

(*b*) Global credit collection

(*c*) Banking (loan syndication)

(*d*) Debt management

(*e*) Foreign exchange

*vi.* Corporate Marketing

(*a*) Developing marketing strategies and content

(*b*) Developing public relations

(*c*) Conducting road shows, campaigns as well as organizing public events and trade shows

*vii.* Insurance

(*a*) Obtaining and continuing in force the business insurance policies pertaining to global Operations of Recipient

(*b*) Formulating insurance strategy and oversight

**5.** It was explained that TNMM is the most appropriate method with OP/OC as the profit level indicator and since the operating profit margin of the assessee at 21.84% is higher than that all the comparable companies at 20.36%, the international transaction of payment of corporate charges was considered to be at arms length price.

**6.** The TPO however rejected the TNMM method applied by the assessee and separately bench marked the said transaction allegedly applying CUP method. The TPO further held that since the assessee has not received any economic and commercial benefits from such payment and the evidence of incurring

such expenditure by the AE has also been not placed on record, the arms length price of such international transaction shall be considered to be at nil.

**7.** The assessee raised objections before the DRP. Before the DRP it was strongly contended that Aricent Inc USA was created solely for the purpose of rendering the corporate management services to the group companies which related to the entire group. It was brought to the notice of the DRP that the costs are charged on a rational basis in proportion to benefit accruing to each entity. The basis of cost share between the assessee and AE was furnished. After considering the facts and the submissions and after going through the TPO's report the DRP held as under:—

> "3.6 Thus in our view bits and pieces of work may benefit the Indian entity and there is no real way of quantification of such benefits. For example some costs of insurance premium and by Aricent US to benefit FSS India have been allocated on pro rata basis to three parties by the assessee. Thus it is difficult to actually quantity the amount spent for India entity. The report is also a preliminary draft for discussion purpose only (pages 234 of paper book). It is obvious that quantification is not conclusive nor is it possible to be conclusive from the recipient's perspective. As we said earlier that some costs may be attributable to the assessee but are difficult to quantify. So an adhoc allowance of 1% of total costs can be allowed to the assessee and the remaining to be considered for determination of ALP for transactions tested under TNMM. The TPO is directed to recomputed the ALP accordingly. Objection is partly accepted by the DRP."

**8.** The assessee is in appeal before us vide ground No. 2 to 2.7. Assessee has objected to the TP adjustment of Rs. 24022522/-.

**9.** Before us the counsel for the assessee vehemently stated that the TPO grossly erred in not following the directions of the DRP. It is the say of the counsel that the DRP has directed the TPO to allow 1% of total cost to the assessee as against 1% of corporate charges allowed by the TPO. The counsel further stated that if 1% of the total cost of the assessee is taken than it will come to Rs. 8883840653/- which is higher than the amount of Rs. 24022522/- paid by the assessee towards corporate charges. The counsel concluded by saying that if the directions of the DRP are given effect to no adjustment on account of corporate charges would survive.

**10.** The DR strongly supported the findings of the AO/TPO.

**11.** We have carefully considered the orders of the authorities below. Since the revenue is not in appeal before us, the direction of the DRP has attained finality. This means that the TPO should give effect to the directions of the DRP in letter and spirit. The direction of the DRP has been mentioned elsewhere and since the DRP has directed the TPO to compute the ALP at 1% of total cost the same should be followed. We accordingly direct the TPO/AO to follow the directions of the DRP and if found that after giving effect to the directions total cost of the assessee works out to be higher than what has been paid by the assessee towards corporate charges no adjustment on account of corporate charges need to made. Accordingly grounds No. 2 to 2.7 are allowed.

**12.** Ground No. 3 relates to the transfer pricing adjustment of Rs. 23,56,249/- on account of interest on foreign currency loan extended to AE.

**13.** Facts on record show that during the year under consideration the assessee earned interest income of Rs. 23,56,249/- in respect of loan of US dollar Nine Hundred thousand extended to its AE Aricent Japan Limited and Aricent Beijing Limited. The assessee has charged interest at LIBOR + 1.5%. The assessee claimed that the rate of interest charged was comparable to the prevailing rate of interest in the international market. Thus international transaction was considered as being at arms length price applying CUP as the most appropriate method as the same was adequately bench marked with respect to

comparable uncontrolled transaction of expenses of payment of interest on similar loans.

**14.** However, the TPO was of the opinion that the manner in which the CUP method has been applied by the assessee is erroneous. The TPO applied rate of interest at 17.26% which was computed as under:—

CUP Rate is thus arrived at as under.

Basic interest rate for the credit rating of the AE 9.88%

| | |
|---|---|
| Add : Transaction cost | 395 basis points |
| CUP Rate | |
| Add : Adjustment for security | Not computed |
| Final CUP rate > | 13.83 + Adjustment for security + Risk adjustment for single customer |

**15.** Assessee raised objections before the DRP. The DRP upheld the adjustment made by the TPO, however imputed rate of interest @ 13.25% being PLR of SBI. Aggrieved by this the assessee before us.

**16.** The counsel for the assessee stated that the present transaction of lending loan to the associate is in foreign currencies given to foreign associate enterprises. Hence, the comparable transaction for the purpose of application of external CUP should be considered to be foreign currency lending by unrelated parties. The counsel further pointed out that even the RBI has issued directions subsequently mentioning that LIBOR rate has to be applied for charging interest on export credit.

**17.** The counsel drew our attention to the decision of the Hon'ble Delhi High Court in the case of *CIT* v. *Cotton Naturals India (P.) Ltd* . [2015] 55 taxmann.com 523/231 Taxman 401. The counsel further pointed out that in subsequent assessment year 2012-13 the DRP has followed the judgment of the Hon'ble Delhi High Court in Cotton Naturals and revenue is not in appeal. It is the say of the counsel that in view of the direct decision of Hon'ble High Court of Delhi (*supra*) the LIBOR rate + 1.5% should be accepted and no TP adjustment should be made.

**18.** The DR strongly relied upon the findings of the AO/TPO. It is the say of the DR that the Hon'ble Delhi High Court in the case of Cotton Naturals has considered the facts where the loan transactions have been done in the foreign currencies. The DR further pointed that while charging the rate of interest many factors have to be considered namely transaction cost, security volatility in the market and risks, therefore, rate adopted by the TPO should be accepted.

**19.** We have carefully considered the orders of the authorities below. We have also gone through the relevant loan agreement which is placed at pages 131-134 and 135-138 of the paper book. We find that the loan agreement with FSS, Japan clearly mentions that the borrower shall pay interest rate of 1.5% over prevailing LIBOR and the transaction is in US dollar. Similarly the agreement with FSS Beijing show interest at 150 basis points over prevailing LIBOR and the transaction is in US dollar. Considering the facts of the case in the light of the agreements and in the light of the decision of DRP in A.Y. 2012-13 wherein all the apprehensions raised by the DR has been duly considered by the DRP which is also under appeal before us in ITA No. 1944/Del/2017, we are of the considered view that rate of interest at LIBOR + 1.5% should be taken as the rate and since the assessee has already charged the interest on loan at LIBOR + 150 basis points, the TP adjustment in interest on loan amounting to Rs. 2356249/- deserves to be deleted. We direct accordingly.

**20.** Ground No. 4 relates to the disallowance of project expenses amounting to Rs. 171617599/- treating the same to be capital expenditure incurred on project which were yet to take off.

**21.** Facts on record show that the assessee has incurred expenses of Rs. 17.16 crores in respect of the various software projects. Such expense were claimed to be routine business expenses such as training and travelling expenses incurred in the course of carrying on software business.

**22.** During the assessment proceedings the Assessing Officer asked the assessee to submit detail of the project expense and such details were furnished by the assessee. After considering the submissions and the details, the Assessing Officer was of the belief that these expenses are of capital nature giving enduring benefits to the business of the assessee and are in respect of projects which were yet to take off. Accordingly the expenditure was disallowed. The objections raised by the assessee before the DRP were of no avail.

**23.** Before us the Ld. Counsel for the assessee drew out attention to the past assessment/appellate history of the assessee in respect of such expenses and pointed out that in the earlier assessment year such expenses were allowed as revenue expenditure and the appeals of the revenue have been dismissed. The DR could not bring any decision in favour of the revenue.

**24.** We have carefully considered the orders of the authorities below. We have also gone through the past assessments/appellate history in respect of the impugned addition. In A.Y. 2003-04 the Tribunal deleted the additions in *Flextronics Software System Ltd*. v. *CIT* [2009] 28 SOT 371 which order was affirmed by the Hon'ble Delhi High Court in ITA No. 778/2011. In A.Y. 2004-05 the Tribunal has deleted the additions in ITA No. 1897/Del/2009 and in A.Y. 2006-07 the Tribunal once again deleted the addition *Arcient Technologies (Holding) Ltd*. v. *Dy. CIT* [2011] 9 taxmann.com 287 which order affirmed by the Hon'ble Delhi High court in ITA No.1071/2011. Considering the past assessments/appellate history of the assessee we direct the Assessing Officer to delete the disallowance of Rs. 1716599/-.

**25.** Ground No. 5 relates to the disallowance of Rs. 24022522/-being expenses incurred on corporate charges u/s. 40a of the Act.

**26.** Facts show that the assessee has claimed of Rs. 24022522/-as deduction in the profit and loss account as corporate charges being expenses allocated by Aricent Inc USA company for various services including accounting and finance executive management, tax, treasury, legal, corporate, marketing and insurance provided by Aricent Inc USA.

**27.** While examining the expenses the Assessing Officer was of the opinion that the corporate charges are in the nature of consultation charges/technical fees having been remitted out of India on which no TDS was deducted by the assessee and was of the firm belief that provisions of section 40a squarely apply and accordingly disallowed 2.40 crores. Such disallowance was confirmed by the DRP.

**28.** Before us the Ld. Counsel for the assessee drew our attention to the provisions of section 195 (1) of the Act and pointed out that the liability to deduct tax at source under this section arises only if the amount paid/payable to the no resident is liable to tax in India. It is the say of the counsel that since the payee is a tax resident of US and eligible to be governed by the provisions of Act or the India US treaty, no disallowance can be made.

**29.** The DR relied upon the findings of the lower authorities but could not controvert the submissions of the counsel.

**30.** We have given a thoughtful consideration of the orders of the authorities below qua the issue. There is no dispute that the payee Aricent Inc USA is a tax resident of US and is, therefore, governed by the provisions of the Act or the India US tax treaty, whichever is more beneficial.

**31.** Article 12 of the DTAA between the India and USA provides for the taxability of transactions in the nature of royality and fees for included services. Article 12 (2) provides that royalities/fee for included services arising in India and paid to a resident in USA may be taxed in India if the recipient is a beneficial owner of the royalities or FTS. As per Article 12 royalities and fees for included services if paid for "make available technical knowledge, experience, skill, know how or processes or consist of the

development and transfer of technical plan or technical design will only be considered for taxability."

**32.** We have given a thoughtful consideration to the nature of services provided by AE. In our considered view no such services 'make available' technical knowledge etc to the assessee. No technical knowledge experience or skill as required by article 12 is acquired as a result of provision of the services by Aricent USA. In terms of the provisions of article 12 of the Indo-US DTAA fees paid by the assessee to its AE Aricent USA would not be taxable in India and therefore, the assessee was not required to deduct tax at source. We accordingly direct the Assessing Officer to delete the disallowance.

**33.** Ground No. 6 needs no separate adjudication. Ground No. 7 relates to the charging of interest u/s. 234 B and 234 C of the Act. The levy of interest is mandatory though consequential. We direct the Assessing Officer to charge interest as per the provisions of the law. Interest u/s. 234 C of the Act has to be charged on the returned income of the assessee.

*Additional Grounds of appeal on deduction of depreciation on goodwill*

**34.** Vide application dated 26.08.2014 the assessee has prayed to raise the following by way of additional ground of appeal.

> "That on the facts and circumstances of the case and in law, the depreciation should be directed to be allowed in terms of section 32 (1) (i) of the Act in respect of intangible asset in the nature of 'Goodwill amounting to Rs. 26,75,57,10,570 arising on amalgamation of Flextronics Software Systems Limited ('Flextronics') and Future Software Limited ('FSL') with Kappa Investment Limited (later renamed as Aricent Technologies Holdings Limited i.e. the Applicant ) pursuant to scheme of amalgamation approved by the Hon'ble Delhi High Court vide order dated 16.05.2007."

**35.** At the outset the DR objected to the admission of the aforestated additional ground. It is the say of the DR that the assessee failed to claim depreciation on goodwill in its return which was filed by the assessee when the goodwill in question was accounted for in the books of the assessee. The return was duly verified by the assessee itself, and the assessee had access to legal advice being such a big, reputed company of a global group. The DR further pointed out that the assessee had further opportunity by filing a revised return but again failed to claim it by filing revised return. The DR continued by stating that the assessee further failed to claim depreciation before the Assessing Officer during the entire assessment proceedings and further failed to claim depreciation before the DRP. The DR concluded by saying that at this stage the additional ground raised by the assessee should not be admitted.

**36.** Per contra the counsel for the assessee stated that being a legal claim the assessee can raise the issue for the first time before the Tribunal. Strong reliance was placed on the decision of Hon'ble Supreme Court in the case of *NTPC Ltd.* v. *CIT* [1998] 229 ITR 383.

**37.** We have given a thoughtful consideration to the rival submissions. Depreciation on goodwill is no more res-integra as this issue has been settled down by the Hon'ble Supreme Court in favour of the assessee and against the revenue in the case of *CIT* v. *Smifs Securities Ltd* . [2012] 24 taxmann.com 222/210 Taxman 428/348 ITR 302 where in the Hon'ble Supreme Court was concerned with claim of depreciation on goodwill made by the amalgamated company.

**38.** However, the issue which has to be decided first is whether such claim of depreciation can be made for the first time at this stage in the light of the ratio laid down by the Hon'ble Supreme Court in the case of *NTPC Ltd.* (*supra*).

**39.** The Hon'ble Supreme Court in the case of *NTPC Ltd.* (*supra*) reframed the question for consideration as follows :—

> "Ques : Where on the facts found by the authorities below a question of law arises (though not

raised before the authorities) which bears on the tax liability of the assessee, whether the Tribunal has jurisdiction to examine the same ?"

**40.** The Hon'ble Supreme Court answered as under:—

> Ans : "Under section 254 of the Income Tax Act, the Appellate Tribunal may after giving both the parties to the appeal an opportunity of being heard, pass such orders thereon as it thinks fit. The power of the Tribunal in dealing with appeal is thus expressed in the widest possible terms. The purpose of the assessment proceedings before the taxing authorities is to assessee correctly the tax liability of an assessee in accordance with law. If, for example, as a result of a judicial decision given while the appeal is pending before the Tribunal, it is found that a non-taxable items is taxed or a permissible deduction is denied, we do not see any reason why the assessee should be prevented from raising that question before the Tribunal for the first time, so long as the relevant facts are on record in respect of that item. We do not see any reason to restrict the power of the Tribunal under section 254 only to decide the grounds which arise from the order of the Commissioner of Income - tax (Appeals). Both the assessee as well as the Department have a right to file an appeal/cross-objections before the Tribunal. We fail to see why the Tribunal should be prevented from considering questions of law arising in assessment proceedings although not raised earlier.
>
> In the case of *Jute Corporation of India Ltd. CIT* [1991] 187 ITR 688, this court, while dealing with the power of the Appellate Assistant Commissioner observed that an appellate authority has all the powers which the original authority may have in deciding the question before it subject to the restrictions or limitations, if any, prescribed by the statutory provisions. In the absence of any statutory provision, the appellate authority is vested with all the plenary powers which the subordinate authority may have in the matter. There is no good reason to justify curtailment of the power of the Appellate Assistant Commissioner in entertaining an additional ground raised by the assessee in seeking modification of the order of assessment passed by the Income-tax Officer. This court further observed that there may be several factors justifying the raising of a new plea in an appeal and each case has to be considered on its own facts. The Appellate Assistant Commissioner must-be-satisfied that the ground raised was bona fide and that the same could not have been raised earlier for good reasons. The Appellate Assistant Commissioner should exercise his discretion in permitting or not permitting the assessee to raise an additional ground in accordance with law and reaon. The same observations would apply to appeals before the Tribunal also.
>
> The view that the Tribunal is confined only to issues arising out of the appeal before the Commissioner of Income-tax (Appeals) takes too narrow a view of the powers of the Appellate Tribunal (vide, e.g., *CIT* v. *Anand Prasad* [1981] 128 ITR 388 (Delhi), *CIT* v. *Karamchand Premchand P. Ltd.* [1969] 74 ITR 254 (Guj.) and *CIT* v. *Cellulose Products of India Ltd* . [1985] 151 ITR 499 (Guj) [FB]). Undoubtedly, the Tribunal will have the discretion to allow or not allow a new ground to be raised. But where the Tribunal is only required to consider a question of law arising from the facts which are on record in the assessment proceedings we fail to see why such a question should not be allowed to be raised when it is necessary to consider that question in order to correctly assess the tax liability of an assessee.
>
> The reframed question, therefore, is answered in the affirmative, i.e. the Tribunal has jurisdiction to examine a question of law which arises from the facts as found as found by the authorities below and having a bearing on the tax liability of the assessee. we remand the proceedings to the Tribunal for consideration of the new grounds raised by the assessee on the merits."

**41.** In our understanding of the decision of Hon'ble Supreme Court (*supra*), the emphasis is "on facts as found by the authorities below and having bearing on the tax liability of the assessee" on such emphasis

the Hon'ble Supreme court held that the Tribunal has jurisdiction to examine the question of law.

**42.** The fact that the scheme of amalgamation approved by the Hon'ble High Court is available on record. Goodwill was shown as an intangible asset in the balance sheet and was available before the Assessing Officer at the time of the assessment proceedings. Explanation-5 to section 32 (1) of the Act reads as under:—

> "For the removal of doubts, it is hereby declared that the provisions of this sub-section shall apply whether or not the assessee has claimed the deduction in respect of depreciation in computing his total income"

**43.** This was very much available before the Assessing Officer. Even if the assessee had not claimed depreciation on goodwill, the Assessing Officer was duty bound to compute the depreciation as per the provisions of the law.

**44.** The contention of the DR that the assessee had several opportunities to claim depreciation is not acceptable because when the assessee filed its return of income the claim of depreciation on goodwill was highly debatable issue. It is only after the decision of the Hon'ble Supreme Court in the case of *Smifs Securities* (*supra*) the issue attained finality as the Hon'ble Supreme Court has held that goodwill is an intangible asset.

**45.** Since all the facts relating to the creation of goodwill are available on the record, we have no hesitation in admitting the additional ground for the adjudication.

**46.** Having admitted the additional ground relating to the claim of depreciation let us now examine the facts relating to the creation of goodwill.

**47.** Future Software Limited ('FSL') was incorporated on May 22, 1985 as Future Software Systems Limited and its name was changed to FSL on August 24, 2000.

FSSL was incorporated in India on December 30, 1991 as Hughes Software Systems Limited. Thereafter, its name was changed to FSSL on February 18, 2005. As on October 27, 2006, the assessee held 82.01 per cent stake in FSL.

The assessee [earlier known as Kappa Investment Limited ('KIL')], an unlisted Indian company, was incorporated on June 14, 2006 for the purpose of promoting, establishing, forming, acquiring or investing in entities engaged in the business of designing, developing, marketing and distributing IT software and hardware. The assessee (earlier known as KIL) commenced business on August 11, 2006 and acquired controlling equity stake in FSSL and FSL.

In order to fund the amalgamation of FSSL and FSL with the assessee, the parent company of the assessee invested additional funds of about Rs. 2,462 crores in the assessee for acquiring shares in FSSL and FSL.

Thereafter, FSSL and FSL amalgamated into the assessee with effect from April 1, 2007 under a scheme of arrangement & amalgamation ('Scheme of Merger') under the provisions of section 391 to 394 of the Companies Act, 1956. The said scheme of Merger was also in accordance with the provisions of Section 2(1 B) of the Income-tax Act, 1961 ('Act') and the shareholders of FSSL and FSL were issued shares in the assessee (earlier known as KIL), pursuant to the said merger.

**48.** The scheme of arrangement approved by Hon'ble High Court which was between Flextronics Software Systems Limited (FSSL) and Future software Limited (FSL) and Kappa Investments Limited Clause 15.8 read:—

> "15.8 The amount representing the different between

(*a*) the aggregate value of:

(*a*) book value of investment in the equity shares of Flextronics Software in the books of Kappa cancelled pursuant to Clause 14.1

(*b*) book value of investment in the equity shares of Future Soft in the books of Flextronics Software cancelled pursuant to Clause 14.2 and

(*b*) the aggregate value of :

(*a*) face value of share capital of Flextronics Software held by Kappa

(*b*) face value of share capital of Future Soft by Flextronics Software

shall be debited to goodwill in the balance sheet of Kappa.

**49.** The issue of shares/accounting treatment has been dealt in the scheme of arrangement at Clause 13 and the Hon'ble High Court held:—

> "This court doth hereby sanction the scheme of arrangement set forth in Schedule-I annexed hereto and doth hereby declare the same to be binding on all the shareholders and creditors of the Transferor and Transferee companies and all concerned and doth approve the said scheme of arrangement with effect from the appointed date i.e. 01.04.2007."

**50.** The salient features of the scheme of amalgamation are as follows:

(*a*) The scheme was sanctioned by the High Court of Delhi on May 16, 2007 with retrospective effect from April 1, 2007, being the appointed date of the merger and August 10, 2007, being the effective date of amalgamation for accounting purpose;

(*b*) Assessee adopted pooling-of-interest accounting method as approved by High Court for the purpose of transferring the assets and liabilities of the amalgamating companies at their respective book value, which was subject to the adjustments made for the difference in the accounting policies between the two companies as specified in the scheme of amalgamation;

(*c*) As per clause 1(e) and 1(g) of the amalgamation scheme, the details of assets and liabilities of FSSL and FSL which were to vest on the Assessee, after the amalgamation were as follows:

All secured and unsecured debts, present and future liabilities, contingent liabilities, duties and obligations and all assets and properties, wherever situated whether movable or immovable, real or personal, in possession or reversion, corporeal or incorporeal, tangible or Intangible, present or contingent, all Land and buildings, all plant and machineries, computers and accessories, software, leasehold improvements, vehicles, fixed assets, work-in-progress, appliances, accessories, sundry debtors, inventories current assets, deferred tax assets, investments including investments in overseas subsidiaries, overseas offices, reserves, provisions, funds, as on the appointed date.

Offices, import entitlements, import licenses, other licenses, registrations, copyrights, patents, trade names, trademarks, applications of copyrights, patents, trade names, and trademarks, any other intellectual property rights whether registered or not, labels, label designs, quality certificates, leases, licenses, tenancy rights, premises, hire purchase and lease agreements,

office equipment, electrical fittings, furniture and fittings, capital work-in-progress, telephones, telexes, email and facsimile connections, communication facilities, equipment and installations and utilities, electricity, water and other service connections, benefits of agreements, contracts and arrangements including customer contracts etc and all the rights, title, interest, goodwill benefit and advantage etc.

(*d*) As per the scheme of amalgamation agreement, equity shares of Assessee were allotted to the shareholders of FSSL and FSL in the following agreed ratio:

To the shareholders of FSSL: 810 equity shares of Rs. 10 each of Assessee issued for every 100 equity shares of Rs. 5 each held by the shareholder of FSSL;

To the shareholders of FSL: 50 equity shares of Rs. 10 each of Assessee issued for every 100 equity shares of Rs. 5 each held by the shareholder of FSL

*Re : Goodwill recognition/computation*

For the purpose of amalgamation, the intrinsic value of equity share of each of KIL, FSSL and FSL, based on net-worth of these companies for the purpose of amalgamation, was determined on the basis of valuation report dated 10.11.2006 obtained from Ernst & Young ('EY') as under:

| *No.* | *Name of the company* | *No. of equity shares* | *Instrinsic Value of equity share* | *Fair Value (in Rs. Crs.)* | *Remarks/ Valuation methodology* |
|---|---|---|---|---|---|
| 1 | Assessee company | 9.51 crs | Rs. 110.7 | Rs. 1,053 | Based on NAV method |
| 2 | Flextronics Software Systems Limited | 3.31 crs | Rs. 897.2 | Rs. 2,967 | Based on weighted average Method |
| 3 | Future Software Limited | 4.41 crs | Rs. 55.9 | Rs. 246 | Based on weighted average method |

Thereafter, on the basis of the intrinsic value (refer *supra*), equity shares of Assessee were allotted to the shareholders of FSSl and FSL, as under :

To the shareholders of FSSL: 810 equity shares of Rs. 10 each of Assessee issued for every 100 equity shares of Rs. 5 each held by the shareholder of FSSL;

To the shareholders of FSL: 50 equity shares of Rs. 10 each of Assessee issued for every 100 equity shares of Rs. 5 each held by the shareholder of FSL.

The aforesaid exchange ratio was duly approved in the meeting of the shareholders of FSSL and by the Hon'ble High Court, as part of the scheme of amalgamation.

The aggregate fair value of acquired businesses, i.e., FSSL and FSL was determined at Rs. 3,213 crores, as follows:

Rs. in crores

| | | |
|---|---|---|
| 3.31 crore equity shares of FSSL @ 897.20 | = | 2,967.14 |
| 4.41 crore equity shares of FSL @ 55.90- | = | 246.26 |
| | | 3,213.40 |

The details of fair value and actual discharge of purchase consideration by the assesse are provided below for reference:

| *Date* | *Transaction* | *Mode of payment* | *Actual cash invested/ Shares issued (in Rs. Crs)* | *FMV as per EY (in Rs. Crs)* |
|---|---|---|---|---|
| 29.05.2006 | For purchase of shares of FSL by FSSL | Cash | 249 | 246 |

| | | | | |
|---|---|---|---|---|
| 01.09.2006 | For purchase of shares of FSSL by | Cash | 2,349 | 2,471 |

The aforesaid facts were duly stated vide Note no 1 and 5 of the Notes to Accounts, forming part of the audited accounts for the financial year 2007-08. The same is reproduced here under :

> "The excess of book value of investments in equity shares and the face value of investments in equity shares of Flextronics Software Systems Limited recorded in the books of account of Aricent 'Technologies (Holdings) Limited and that of Future Software Limited recorded in the books of account of Flextronics Software Systems Limited has been debited to Goodwill in Schedule D. In terms of the scheme of amalgamation, the goodwill will not be amortised but will he tested for Impairment at each balance sheet date in accordance with generally accepted accounting principles in India and the prescribed accounting standards issued by the Institute of Chartered Accountants of India. "

As per the methodology approved as part of the scheme of amalgamation, the computation of goodwill arising on amalgamation of FSSL and FSL with the assessee company, is demonstrated hereunder :

| *Particulars* | *Amounts (in Rs. Crs)* |
|---|---|
| Investment (in cash) by FSSL in FSL | 249 |
| Investment (in cash; by the assessee company in FSSL | 2,463 |
| Total Investment in shares of FSSL and FSL (A) | 2,712 |
| Face value of share capital of FSSL held by the assessee company | (14) |
| Face value of share capital of FSL held by FSSL | (22) |
| Total Face value of shares (B) | (36) |
| Goodwill arising on amalgamation (A-B) | 2,676 |

including price of shares issued by KIL

Alternatively, the above amount of goodwill can be corroborated by following as well:

| *Particulars* | *Amount (in Rs.)* |
|---|---|
| Discharge of consideration (cash investment plus shares issued on amalgamation) | 3074 |
| Less: Face value of shares of FSSL and FSL cancelled upon amalgamation | (36) |
| Less: Net assets acquired | (362) |
| Goodwill | 2,676 |

In this regard, it would be pertinent to mention that the aforesaid amount of goodwill comprises of the various intangible assets, as mentioned hereunder :

(*i*) Reputation

(*ii*) Customer relationship/contracts

(*iii*) Technology for business verticals, e.g. technology, DataCom, SS7, VoIP, Wireless and mobile handsets

(*iv*) Records, files, engineering process information, manuals, data

(*v*) Catalogue, quotations, sales and advertisement materials, etc.

(*vi*) Patents for processes - It may be noted that a list of such patents were appended as Schedule C of Hon'ble High Court approved scheme of arrangement for the merger.

*Re: Net asset acquired from FSSL and FSS*

Break-up of net assets of FSSL and FSS as of 31st March 2007 i.e. prior to the amalgamation is as follows:

| *Assets* | *FSL (in Rs.)* | *FSSL (in Rs.)* | *Book value as on 31.03.2007 (in Rs.)* |
|---|---|---|---|
| Land 1 (Jwala mills) | | 35,90,82,054 | 35,90,82,054 |
| Land 2 (Plot 31) and Building | | 11,23,59,026 | 11,23,59,026 |

| | | | |
|---|---|---|---|
| Other Fixed assets | 10,51,33,667 | 82,91,94,005 | 93,43,27,672 |
| Capital Advances | | 82,89,358 | 82,89,358 |
| Deferred Tax Assets | 97,46,618 | 13,33,71,643 | 14,31,18,261 |
| Current assets, (net of liabilities) | 37,55,69,385 | 1,69,01,34,587 | 2,085,703,972 |
| Net assets (as per books) | 49,04,49,670 | 3,13,24,30,673 | 3,622,880,343 |

Note: Inter-company investments have been excluded and capital reduction by FSSL has been considered in above

The above amount of goodwill can be corroborated by following as well

| *Particulars* | *Amount (in Rs. crs)* |
|---|---|
| Discharge of consideration (cash investment + shares issued on amalgamation) | 3074 |
| Less: Face value of shares of FSSL and FSL cancelled upon amalgamation | (36) |
| Less: Net assets (refer *supra*) | (362) |
| Goodwill | 2,676 |

In this regard, it would also be pertinent to mention that the aforesaid mechanism has been duly certified by the tax auditor of the assessee company inasmuch as the same was duly reflected under the head 'intangible assets' in the depreciation chart as per clause 14 of the Tax audit report in Form 3CD, which was filed before the assessing officer, during the course of the assessment proceedings.

**51.** This is how the goodwill was acquired and found place in the books of the assessee duly reflected in the fixed assets schedule.

**52.** The DR vehemently stated that goodwill acquired pursuant to amalgamation, is nothing but a book entry to account for the difference between the consideration and the net assets acquired. Elaborate factual exercise, in accordance with relevant accounting standards (present 1nd As 103 As 38, 37 and others, or the relevant standards applicable to the relevant year) has to be carried out to ascertain whether such difference is to be recognized as goodwill of amalgamation or not.

**53.** This contention of the DR is not acceptable as the Hon'ble High Court in its order giving effect to the scheme of amalgamation mentioned elsewhere has clearly stated that the difference in the net asset value of FSSL and FSL and the consideration paid by the assessee shall be towards goodwill.

**54.** The DR further contended that the goodwill generated in the process of amalgamation was used for the purpose of business of the assessee for the entire previous year or only after the date of amalgamation is not known. As can be seen from the scheme sanctioned by the Hon'ble High Court vide order dated 16.05.2007 the scheme has been given a retrospective from 01.04.2007 being the appointed date of the merger and 10.08.2007 being the effective date of amalgamation for accounting purpose. Thus it can be seen that the date of amalgamation for accounting purpose is 10.08.2007.

**55.** The another contention of the Ld. DR is that there is no cost of acquisition of goodwill, therefore, the actual cost of goodwill of amalgamation is zero. To butterress his claim the DR stated that such claim of depreciation is without sanction of the law. Referring to the relevant portion of section 32 of the Act the DR stated that the term used u/s. 32(1)(ii) must be understood in light of terms placed before it and therefore the question is that under examination is not whether depreciation is allowable on goodwill acquired/created during amalgamation. The DR further stated that as per section 32(1) of the Act 'depreciation', in the case of any block of assets, is to be computed on the written down value. According to explanation 2 of section 32(1) "written down value of the block of assets" shall have the same meaning as in section 43(6)(c). This section lays down the meaning of the term "written down value", as under:

43(6) "written down value" means—

(*a*) in the case of assets acquired in the previous year, the actual cost to the

assessee;

(*b*) in the case of assets acquired before the previous year, the actual cost to the assessee less all depreciation actually allowed to him under this Act, or under the Indian Income-tax Act, 1922 (11 of 1922), or any Act repealed by that Act, or under any executive orders issued when the Indian Income-tax Act, 1886 (2 of 1886), was in force:

Provided that in determining the written down value in respect of buildings, machinery or plant for the purposes of clause (ii) of sub-section (1) of section 32, "depreciation actually allowed" shall not include depreciation allowed under sub-clauses (a), (b) and (c) of clause (vi) of sub-section (2) of section 10 of the Indian Income-tax Act, 1922 (11 of 1922), where such depreciation was not deductible in determining the written down value for the purposes of the said clause (vi);

(*c*) in the case of any block of assets,—

(*i*) in respect of any previous year relevant to the assessment year commencing on the 1st day of April, 1988, the aggregate of the written down values of all the assets falling within that block of assets at the beginning of the previous year and adjusted,—

(A) by the increase by the actual cost of any asset falling within that block, acquired during the previous year;

(B) by the reduction of the moneys payable in respect of any asset falling within that block, which is sold or discarded or demolished or destroyed during that previous year together with the amount of the scrap value, if any, so, however, that the amount of such reduction does not exceed the written down value as so increased; and

(C) in the case of a slump sale, decrease by the actual cost of the asset falling within that block as reduced—

(*a*) by the amount of depreciation actually allowed to him under this Act or under the corresponding provisions of the Indian Income-tax Act, 1922 (11 of 1922) in respect of any previous year relevant to the assessment year commencing before the 1st day of April, 1988; and

(*b*) by the amount of depreciation that would have been allowable to the assessee for any assessment year commencing on or after the 1st day of April, 1988 as if the asset was the only asset in the relevant block of assets,

so, however, that the amount of such decrease does not exceed the written down value;

(*ii*) in respect of any previous year relevant to the assessment year commencing on or after the 1st day of April, 1989, the written down value of that block of assets in the immediately preceding previous year as reduced by the depreciation actually allowed in respect of that block of assets in relation to the said preceding previous year and as further adjusted by the increase or the reduction referred to in item (i).

**56.** Thus, if an asset is acquired during the previous year and it falls in a block of asset (like intangible in this case), then the written down value of that block of asset (to which such acquired asset belongs) would be increased by the actual cost of the asset acquired. Now definition of 'actual cost" is given in section 43(1). According to this "actual cost" means the actual cost of the assets to the assessee, reduced by that portion of the cost thereof, if any, as has been met directly or indirectly by any other person or

authority. Explanation 7 of section 43(1) reads as below:

> *Explanation* 7. —Where, in a scheme of amalgamation, any capital asset is transferred by the amalgamating company to the amalgamated company and the amalgamated company is an Indian company, the actual cost of the transferred capital asset to the amalgamated company shall be taken to be the same as it would have been if the amalgamating company had continued to hold the capital asset for the purposes of its own business.

**57.** In the case before us, goodwill was transferred by the amalgamating company (FSL and FSSL) to amalgamated company (assessee). According to this explanation, the 'actual cost' of goodwill to the amalgamated company (i.e the assessee) shall be same as it would have been if the amalgamating companies (FSL and FSSL) had continued to hold the capital asset (i.e. goodwill) for the purpose of its own business. Since the actual cost of goodwill in the case of amalgamating companies is zero, the actual cost in the case of amalgamated company (i.e. assessee) shall also be zero (and not the amount it paid to acquire the goodwill).

**58.** To clarify further, Explanation 2 to clause 43(6)(c) reads as under

> Explanation 2. —Where in any previous year, any block of assets is transferred,—
>
> (*a*) by a holding company to its subsidiary company or by a subsidiary company to its holding company and the conditions of clause (iv) or, as the case may be, of clause (v) of section 47 are satisfied; or
>
> (*b*) by the amalgamating company to the amalgamated company in a scheme of amalgamation, and the amalgamated company is an Indian company,

then, notwithstanding anything contained in clause (1), the actual cost of the block of assets in the case of the transferee-company or the amalgamated company; as the case may be, shall be the written down value of the block of assets as in the case of the transferor-company or the amalgamating company for the immediately preceding previous year as reduced by the amount of depreciation actually allowed in relation to the said preceding previous year.

Thus the Act clearly lay down that the actual cost of the block of asset (intangible block in this case) in the hand of the amalgamated company (assessee) would be written down value in the immediate preceding year in the case of amalgamating companies. Since, the written down value of the intangible block of asset was zero in the books of the amalgamating companies, the actual cost would remain zero in the hand of amalgamated company (the assessee). The written down value of block of assets "intangibles/goodwill" in the immediately preceding previous year (i.e. FY 2006-07 for AY 2008-09) was zero. Further, there is no actual cost incurred for acquisition of goodwill during the previous year. Hence, WDV of this block of assets for the previous year will also be zero. Accordingly the depreciation will be NIL.

**59.** The aforestated interpretation of the relevant provisions, in our understanding of the law is not correct for the simple reason that by virtue of the scheme of the amalgamation the appellant paid consideration over and above the net asset value of the amalgamating companies and therefore, the difference has been rightly taken as the cost of acquisition of goodwill.

**60.** The DR further emphasized that if the 6th proviso to section 32 (i) is considered the depreciation under this provision is to be restricted to the amount considering that amalgamation has not taken place and since in the hands of the amalgamating companies the depreciation on goodwill would have been zero there cannot be deprecation in the hand of the amalgamated company. In support reliance was placed on the decision of the coordinate bench of the Tribunal Bangalore in *United Breweries Ltd.* v. *Addl. CIT* [2016] 76 taxmann.com 103. Once again the DR is not appreciating the facts of the case in

hand in their true perspective. It has to be understood that there was no goodwill in the books of amalgamating companies and only after the scheme of amalgamation, when the amalgamating companies amalgamated, goodwill came into existence being the difference between the consideration paid by amalgamated company over and above the net asset value of the amalgamating companies. The reliance placed on the judgment of coordinate bench is misplaced in as much as in that case the value of the goodwill in the books of amalgamating company was only Rs.7.45 crores which has been shown by the assessee at Rs.62.30 croes and on this it was held by the appellate authority that the assessee has failed to justify the valuation of goodwill at Rs.62.30 crores. The facts of the case in hand clearly show the valuation of goodwill as per the valuation report and there is no quarrel in so far as the net asset value of the amalgamating companies is concerned. The same has the sanction of the Hon'ble High Court.

**61.** Another argument of the DR is that the assessee has not paid anything for the goodwill acquired in business reconstruction. No consideration can be ascribed to acquisition of goodwill. There was no goodwill before amalgamation. Hence, it is not a case that goodwill has been bought or purchased and therefore, the cost of acquisition of such goodwill in the hands of the assessee should be taken as nil. Once again the DR has erred in not understanding the scheme of amalgamation. In the order of the Hon'ble High Court itself it is clearly mentioned that anything paid over and above the net asset value of the amalgamating companies shall be towards goodwill.

**62.** The DR further referred to the decision relied upon by the counsel in the case of *Smifs Securities* (*supra*) and stated that the Hon'ble Supreme Court has only laid down the ratio that goodwill is an intangible asset and eligible for deprecation but has nowhere the Hon'ble Supreme Court has given any finding in respect of deprecation on goodwill in the case of amalgamation. We do not find any merit in this contention of the DR. A conspectus reading of the Judgment of the Hon'ble Supreme Court clearly show that the Hon'ble Supreme Court was seized with the facts of amalgamation of one company with the assessee company and has held that the excess consideration paid by it over value of net asset acquired of the amalgamating company amounted to goodwill for which the depreciation was to be allowed. The Hon'ble High Court of Delhi in the case of *Hindustan Coca Cola Beverages (P.) Ltd.* [2011] 9 taxmann.com 104/198 Taxman 104/331 ITR 192 has upheld the findings of the Tribunal that payments made towards business acquired on slum price and a part of the price so paid was allocated to the intangible asset covered under the head goodwill.

**63.** Considering the settled position of law and in the light of the factual matrix of the assessee discussed elsewhere we direct the Assessing Officer to allow deprecation on goodwill as per rates applicable for the year under consideration.

**64.** In the result, the additional ground raised by the assessee is allowed and appeal of the assessee is allowed.

ITA No.2671/Del/2014 (A. Y. 2009-10)

**65.** Ground No.1 is of general in nature and needs no separate adjudication.

**66.** Ground No.2 is in relation to the non giving of the correct credit of prepared taxes, tax deducted at sources and MAT credit.

**67.** We are of the considered view that the Assessing Officer should compute the correct tax liability and give all the credits of the prepaid taxes including credit of TDS. The Assessing Officer should also compute the MAT credit as per the provisions of the law. We direct accordingly.

**68.** Ground No. 3 and 4 relates to the claim of depreciation in respect of goodwill pursuant to the scheme of amalgamation.

**69.** This issue has been raised for the first time before the Tribunal in ITA No.90/Del/2013 (supra). We have adjudicated upon the admission of the additional ground and the claim of depreciation. For a detailed discussion there in we direct the Assessing Officer to compute the depreciation of goodwill as per the rates applicable for the year under consideration.

**70.** Ground No.5.1 to 5.6 - Transfer pricing adjustment of Rs.4,83,97,589/- on account of payment of corporate charges.

**71.** Facts on record show that during the year the assessee in the course of carrying on of its software development business has entered, interalia, into international transaction of payment of corporate charges of Rs.48397589/-. We find that the associated enterprises allocated these corporate charges among the group companies on the basis of cost + 5% markup which are based on the report prepared by an independent consultant.

**72.** This international transaction of payment of corporate charges was bench marked and TNMM was considered as the most appropriate method with OP/OC as the profit level indicator. Before the TPO the assessee contended that since the operating profit margin of the assessee @ 27.36% is higher than that of the comparable companies @ 14.24%, the international transaction of payment of corporate charges was considered to be arms length.

**73.** This contention of the assessee was dismissed by the TPO who was of the opinion that CUP is the most appropriate method. The TPO further observed that since the assessee has not received any economic and commercial benefits from such payment and the evidence of incurring such expenditure by AE has not been placed on record. The TPO adopted the arms length price of such international transaction at Nil. The TPO further observed that the assessee has not been able to prove that it has actually received services of some value that call for cost allocation. The TPO was of the firm belief that the question of benefit test is a highly relevant factor in determination of ALP as no independent person would pay for services unless he receives direct or tangible benefit of it. The TPO considered the following issues for determination of ALP in respect of this international transaction.

*a.* The taxpayer's agreement with the associated enterprises related to intra group services is to be examined to see as to what kind of services were to be provided by the AE to the taxpayer. As normally such agreements refer to a large number of services which could be rendered by the AE, the taxpayer has to specify the service(s) which is actually received by it for which the payment is made.

*b.* Whether the taxpayer really needed such services or not. If so, what direct or tangible benefit it has derived.

*c.* Contemporaneous information on the basis of which rate or payment for the service is determined. This includes the cost benefit analysis done by the taxpayer at the time of entering into agreement. Whether any benchmarking analysis was done by the taxpayer so as to compare the amount which he would have paid to an independent person under similar circumstances.

*d.* Whether an independent person would have paid such amount in comparable circumstances

*e.* Whether the expected benefit commensurate with the payment

*f.* Whether the taxpayer has separately incurred any expenditure on similar service's and if so the necessity of making further payment to the AE for the same activity or it is a duplicate payment.

*g.* Whether the payment is in the nature of shareholder's activity or largely for the benefit of the AE.

*h.* Whether the AE is rendering such services to other AEs or independent parties and if so the rate/amount charged from such persons.

*i.* The cost incurred by the AE for providing such services and the basis of allocation key has charged any markup on such payments the arm's length margin is also examined.

**74.** After jotting down the above mentioned points the TPO opined that the assessee has not been able to show as to when and how the various services were requisitioned from the AE's, whether the services were actually needed by it and whether the same were actually received by it, what cost benefit analyzed was done particularly when a huge payment has been made by it to the AE's. The TPO concluded by holding that the assessee failed to demonstrate the benefits passed to the assessee by the AE on availing such services. Applying CUP, the ALP of service fee was determined at Nil and the additions were made.

**75.** The objections were raised before the DRP. The DRP confirmed the ALP determination and the adjustment made by TPO and further directed the TPO to treat the arms length price of following international transaction aggregating to Rs.54858133/- at Nil.

1. Legal and professional expenses
2. Facility rental
3. Insurance
4. Repairs and maintenance
5. Training

**76.** Aggrieved by this the assessee before us.

**77.** Before us the counsel for the assessee stated that the corporate charges relates to the entire turnover/provision of services of the assessee and constitutes an essential part of the cost of the sales. The counsel once again reiterated that the OPM of the assessee @ 27.36% is higher than that of all the comparable companies @ 14.24%. The adjustment made by the TPO and enhanced by the DRP is unwarranted and should be deleted. It is the say of the counsel that the assessee is free to conduct business in the manner that assessee deems fit and the commercial or business expediency of incurring any expenditure is to be seen from the point of view of the assessee. The counsel further stated that as long as the item of expenditure has been incurred wholly and exclusively for the purpose of business of the assessee, whether or not such expenditure actually benefits assessee is irrelevant for the purpose of determination of ALP.

**78.** The counsel further stated that the TPO/DRP grossly erred in holding that the transaction is having a bearing on income of the assessee and hence to be analyzed separately.

**79.** Referring to the enhancement in the TP adjustment by the DRP the counsel stated that without giving any opportunity to the assessee the TPO has made an adjustment of Rs.54858133/-. In support the counsel moved an application for admission of additional evidence and prayed for the deletion of adjustment made by the TPO on account of reimbursement of expenses.

**80.** Per contra the DR strongly supported the findings of the TPO/DRP. It is the say of the DR that the evidences furnished by the assessee do not show that they are from the third party. It is the say of the DR that such evidences need further verification from TPO for fresh adjudication.

**81.** We have given a thoughtful consideration to the orders of the authorities below. In so far as the

quarrel relating to the TP adjustment made by the TPO Rs.4,83,97,589/- is concerned, the facts have to be understood in their true perspective. The fact is that Aricent USA was formed only to provide centralized corporate management services to all entities in the group and it does not have any other business activity or sources of revenue. This means that Aricent USA was formed as a special purpose vehicle (SPV). This has to be further considered with the agreement between the assessee and the AE. The evidences placed before us are copies of Emails exchanged between the appellant and the associated enterprises to substantiate that significant services were rendered by the AE. In our considered view it is the prerogative of the assessee to decide as to whether or not the services are required. Our view find support from the decision of the Hon'ble High Court in the case of *Sony Ericsson Mobile Communications India (P.) Ltd./Reebok India Company* v. *CIT* [2015] 55 taxmann.com 240/231 Taxman 113/374 ITR 118 wherein Hon'ble High Court has held that once the expenditure is incurred for business purposes, the Assessing Officer cannot question requirement and quantum of expenditure the relevant finding read as under

> "54…………………….So long as the expenditure is for business consideration, the Assessing Officer cannot question the quantum or the wisdom of the assessee in incurring the expense. Issue of arm's length price, per se does not arise, when deduction under Section 37(1) is claimed. Expenditure and decision of the assessee, whether or not to incur the said expenditure; the quantum thereof, cannot be a subject matter of challenge or disallowance by the Assessing Officer, once it is accepted that the expenditure was wholly i.e. the quantum of expenditure incurred was fully, and exclusively for business purpose."

**82.** In another decision in the case of *CIT* v. *EKL Appliances Ltd.* [2012] 24 taxmann.com 199/209 Taxman 200/345 TIR 241, the Hon'ble Delhi High Court has laid down the law in this regard, as under :—

> "21. The position emerging from the above decisions is that it is not necessary for the assessee to show that any legitimate expenditure incurred by him was also incurred out of necessity. It is also not necessary for the 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. It is this principle that inter alia finds expression in the OECD guidelines, in the paragraphs which we have quoted above.
>
> ** ** **
>
> 22……..„ ……..So longastheexpenditureorpayment 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. As provided in the OECD guidelines, he is expected to examine the international transaction as he actually finds the same and then make suitable adjustment but a wholesale disallowance of the expenditure, particularly on the grounds which have been given by the TPO is not contemplated or authorised. '
>
> Similarly, the Hon'ble Delhi High Court in the case of *CIT* v. *Lumax Industries Ltd.* [IT Appeal No. 102 of 2014] held that the Transfer Pricing provisions do not authorize disallowance of any expenditure on the basis that it was not necessary for the assessee to incur the expenditure. The Hon'ble Court held as under:
>
> "16. On the question of addition made by the AO on account of ALP for the payment of royalty, learned counsel for the Assessee has rightly referred to the decision in *Commissioner of Income Tax* v. *Sony Ericsson Mobile Communication*(2015) 374 ITR 118 where the determination of the ALP of the royalty paid as Nil was not approved. The Court's attention has also been drawn to the

decision in *Commissioner of Income Tax* v. *EKL Appliances Limited* (2012) 345 ITR *24'1* wherein it was held that Rule I OB (1) (a) did not authorize disallowance of any expenditure on the ground that it was not necessary for the assessee to have incurred such expense. It was observed that though the quantum of expenditure could be examined. the entire expenditure could not be disallowed on the ground that U was not necessary. "

The Delhi High Court in the case of *CIT* v. *Cushman & Wakefield (India) (P.) Ltd.* [2015] 60 taxmann.com 168/233 Taxman 250 has held that the authority of the TPO is to conduct a TP analysis to determine the ALP and not to determine whether the tax payer derives any benefit from the service. The Hon'ble Delhi High Court has opined that the determination of benefit to the tax payer is in the domain of the AO. The Hon'ble High Court held as follows:

"34. The Court first notes that 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 A O. This distinction was made clear by the IT AT in *Dresser-Rand India Pvt. Ltd.* v. *Additional Commissioner of Income Tax* , 2012 (13) ITR (Trib) 422 ………….

35. The TPO's Report is, subsequent to the Finance Act, 2007, binding on the AO. Thus, it becomes all the more important to clarify the extent of the TPO's authority in this case, which is to determining the ALP" for international transactions referred to him or her by the AO, rather than determining whether such services exist or benefits have accrued. That exercise — of factual verification is retained by the AO under Section 37 in this case. Indeed, this is not to say that the TPO cannot - after a consideration of the facts - state that the ALP is 'nil' given that an independent entity in a comparable transaction would not pay any amount However, this is different from the TPO stating that the did not benefit from these services, which amounts to disallowing expenditure. That decision is outside the authority of the TPO…."

**83.** In the light of the aforestated judicial discussion we are of the considered view that the TPO/DRP grossly erred in examining the impugned corporate charges in the light of benefits and necessity.

**84.** We find that in its transfer pricing report the assessee has treated payment of administrative corporate fees payment as part of operating expenses. The TPO has held that this transaction is having bearing on income of the assessee and hence to be analyzed separately.

**85.** The undisputed fact is that the OPM of the assessee is @ 27.36% whereas that of all the comparable companies is @ 14.24%. As mentioned elsewhere the AE was created as a SPV for the purpose of giving services to the group companies for which the AE has charged cost + 5% as a marker and the assessee is making such payment in lieu of receiving vide scope of services from its AE. We are of the considered view that these are all inter linked transactions and therefore, should not be evaluated on a separate basis. This is also supported by para 1.42 and 1.43 of the OECD guidelines which provide for evaluation of combined transactions where such transactions are closely linked or continues and cannot be evaluate separately.

**86.** This further finds support from the decision of the Hon'ble High Court in the case of *Sony Ericsson Mobile Communications India (P.) Ltd./Reebok India (P.) Ltd.* wherein the Hon'ble High Court affirm the benchmarked of closely linked transaction. The Hon'ble High Court held as under :—

"91. In case the tested party is engaged in single line of business, there is no bar or prohibition from applying the TNM Method on entity level basis. The focus of this method is on net profit amount in proportion to the appropriate base or the PLI. In fact, when transactions are interconnected, combined consideration may be the most reliable means of determining the arm's length price.

There are often situations where closely linked and connected transactions cannot be evaluated adequately on separate basis. Segmentation may be mandated when controlled bundled transactions cannot be adequately compared on an aggregate basis. Thus, taxpayer can aggregate the controlled transactions if the transactions meet the specified common portfolio or package parameters. For complex entities or where one of the entities is not 'plain vanilla distributor, it should be applied when necessary and applicable comparables on functional analysis, with or without adjustments are available. Otherwise, the TNM Method should not be adopted or applied on account of being an inappropriate method.

Further the Hon'ble Delhi Court in the case of *Sony Ericsson Mobile* (*supra*) also held that if the Indian entity has satisfied Transactional Net Margin Method (TNMM), i.e., as long as the operating margins of the Indian enterprise are higher than the operating margins of comparable companies, no further/separate compensation for AMP expenses is warranted. The Hon'ble Court held as under:

"101. However, once the Assessing Officer/TPO accepts and adopts TNM Method, but then chooses to treat a particular expenditure like AMP as a separate international transaction without bifurcation/segregation, it would as noticed above, lead to unusual and incongruous results as AMP expenses is the cost or expense and is not diverse. It is factored in the net profit of the inter-linked transaction. This would be also in consonance with Rule 10B(l)(e). which mandates only arriving at the net profit margin by comparing the profits and loss account of the tested party with the comparable. The TNM Method proceeds on the assumption that functions, assets and risk being broadly similar and once suitable adjustments have been made, all things get taken into account and stand reconciled when computing the net profit margin. Once the comparables pass the functional analysis test and adjustments have been made, then the profit margin as declared when matches with the comparables would result in affirmation of the transfer price as the arm's length price. Then to make a comparison of a horizontal item without segregation would be impermissible.

**87.** The coordinate bench in the case of *BG Exploration and Production India Ltd.* v. *Jt. CIT* [2017] 82 taxmann.com 446 (Delhi - Trib.) wherein the Tribunal has deleted the adjustment on account of payment made for intra group services. The Tribunal held as under :—

"72. On the examination of the volume and us details submitted by the assessee. The Ld. dispute resolution panel has come to the conclusion that assessee has received the services and those services are useful services.. With respect to the clubbing of the transaction it was held that when the transactions are closely interrelated it is but natural to club such transaction and benchmarked it together. The Ld. dispute resolution panel at page No. 30 — 31, has considered the suspect and agreed with the contention of the assessee that intra group services received from its associated enterprise are closely linked to the main business activity of the assessee company placing reliance on the US regulations, OECD regulations and OECD draft notes on comparability. In view of this we do not find any infirmity and none was pointed out before us by the Ld. departmental representative in the order of the Ld. dispute resolution panel. Consequently, after verifying that assessee has demonstrated need for those services, benefit derived from those services, evidence of receipt of such services and submitting that those services are neither duplicative in nature and nor are share holder activities, the DRP directed the Ld. transfer pricing officer to delete the adjustment proposed with respect to the intra group services of Rs. 3329766244/-, deserves to be upheld. The judicial precedents cited before us also supports the view that the needed test, the benefit test are also required to be viewed from the perspective of a businessperson and not from the perspective of the revenue. Further, no evidences have been led before us by revenue stating that these services are duplicative in nature and also serves only the interest of the shareholder. According to the information supplied by the assessee and examined by the Ld. dispute resolution panel does not give any such indication. Further regarding non-sharing of the cost by the joint-venture partners we

have given our findings while deciding the appeal of the assessee that such an action of the joint-venture partners cannot be the reason to determine the arm's length price of the services which is been received by the assessee at nil. In view of this we uphold the finding of the Ld. dispute resolution panel holding that transactions of intra group services are interlinked, therefore, they should be benchmarked together by adopting TNMM as the most appropriate method , hence, directing the Ld. transfer pricing officer to delete the adjustment proposed of Rs.3329766244/-. In the result ground No. 1 to 3 of the appeal of the revenue are dismissed."

**88.** It would not be out of place to refer to the decision of the Hon'ble Delhi High Court in the case of *Magneti Mareli Powertrain India (P.) Ltd.* v. *Dy. CIT* [2016] 75 taxmann.com 213/389 ITR 469 wherein the Hon'ble High Court held that technical know how fee paid by the assessee is to be benchmarked applying TNMM at the entity level. The said decision has been affirmed by the Hon'ble Supreme Court in *Dy. CIT* v. *Magneti Mareli Powertrain India (P.) Ltd.* [2018] 89 taxmann.com 8/252 Taxman 385.

**89.** Considering the judicial decisions discussed here in above in the light of the under lying facts in the issue we hold that TNMM is the most appropriate method for this international transaction and since the OPM of the assessee is higher than the OPM of the comparable companies, we are of the considered view that the benefit and the necessity test applied by the TPO/DRP is uncalled for and accordingly direct the TPO/AO to delete the addition of Rs.48397589/- ground No.5.1 to 5.6 are allowed.

**90.** Ground No.5.7 to 5.8 - Transfer pricing adjustment of Rs.5,48,58,133/- on account of reimbursement of expenses.

**91.** Proceeding further and coming to the TP adjustment of Rs.54858133/- which were made pursuant to the directions of the DRP on account of reimbursement of expenses, we are of the considered view that the transaction of reimbursement of expenses is closely linked with the entire business of the assessee. However, a careful perusal of the additional evidences shows that some of the evidences are not from third party. However, since the TPO has made the addition without offering any opportunity to the assessee, we restore this issue to the files of the TPO. The assessee is directed to furnish all the related evidences and the TPO is directed to examine such evidences and decide the issue afresh as per the provisions of the law.

**92.** Ground No.5.7 to 5.8 are allowed for statistical purposes.

**93.** Ground No.6 to 6.2 relates to the transfer pricing adjustments of Rs.38,31,452/- on account of interest on foreign currency loan extended to AE.

**94.** An identical issue has been considered and decided by us in ITA No.90/Del/2013 vide ground No.3. For the detailed discussion therein the adjustment of Rs.3831452/- is directed to be deleted. Ground No.6.1 to 6.2 are allowed.

**95.** Ground No.7 relates to the transfer pricing adjustment of Rs.92668509/- allegedly on account of re-characterizing the inter company receivables as unsecured loan extended by the assessee of its AE.

**96.** Facts on record show that during the course of the transfer pricing adjustment proceedings the TPO noticed that the balancesheet of the assessee reveals receivables. The TPO observed that the payment for the invoices raised by the assessee have not been received within the stipulated time as provided in the service agreement with the AE. The assessee was asked to furnish the time period for payment as per the service agreement with the AE. The TPO further observed that the delayed payments have to be treated as unsecured loans advanced to the AE on which normal rate of interest @ 16% for the period of delay in receipt of payment beyond the time stipulated in the service agreement shall be charged.

**97.** The assessee strongly objected to this proposition of the TPO pointing out that receivable is not an

international transactions which warrant benchmarking. The assessee further objected for imputing @16% for the delay in receipt of payments.

**98.** Dismissing the contention of the assessee the TPO resorted to Explanation (1)(c) to Section 92 B which has been inserted by Finance Act in 2012 with retrospective effect from 01.04.2002. The TPO was of the firm belief that the delay in receivables constitutes an international transaction in the light of the Explanation (1)(c) to section 92 B of the IT Act. The TPO observed that the assessee has provided benefit to its AE by way of advancing of interest free loan in the garb of delay in receipt of receivables. The TPO finally concluded by charging interest @ 15.77% and made adjustment of Rs.97780581/-. The objection before the DRP was of no avail.

**99.** Before us the counsel for the assessee vehemently stated that the delay of remittances cannot be re-characterized as unsecured loans advanced to the AE's and imputing of the notinal interest thereon, is not in accordance with law. The counsel stated that the OPM of the assessee @ 27.36% is higher than the average working capital adjusted margins of the comparable companies finally accepted by the TPO at 12.97%. In support of his contention strong reliance was placed on the decision of the Hon'ble High Court of Delhi in the case of *Pr. CIT* v. *Kusum Health Care (P.) Ltd.* [2018] 99 taxmann.com 431/[2017] 398 ITR 66. Further reliance was placed on the decision of the coordinate Bench in the case of *Pitney Bowes Software India (P.) Ltd.* v. *Addl. CIT* [2019] 101 taxmann.com 350 (Delhi - Trib.) wherein the Tribunal deleted the adjustment on account of outstanding receivables after taking into consideration the working capital adjusted margins of the comparable companies. The counsel further stated that continuing debit balance cannot be regarded as international transaction on the contrary a continuing debit is a result of international transactions. The counsel further stated that the TPO/DRP grossly erred in re-characterising the account receivable as unsecured loans. The counsel further pointed out that even if the benchmarking of delay in receipt has to be done the same should be done with internal comparables. Since the assessee has received remittances from unrelated third party with a time lag exceeding the credit period and since no interest has been charged for delay in receipt of such remittances from unrelated parties the same should be considered. The counsel concluded by praying that the impugned adjustment should deleted.

**100.** Per contra the DR strongly supported the finding of the TPO and placed strong reliance on Explanation (1)(c) to section 92 B of the Act.

**101.** We have given a thoughtful consideration to the orders of the authorities below. We have carefully considered the rival submissions. In our considered view every indebtness cannot be construed to have arisen out of a loan transaction and interest is involved only in relation to a debt created out of loan transaction. For this proposition, we draw support from the decision of Hon'ble Supreme Court in the case of *Bombay Steam Navigation Co. [1953] (P.) Ltd.* v. *CIT* [1965] 56 ITR 52. This view further find support from the decision of Hon'ble High Court of Delhi in the case of *Kusum Healthcare (P.) Ltd.* (*supra*) where in Hon'ble High court in the context of receivable held that not every item of receivable will be considered as an international transaction of receivable and each receivable has to be seen on case to case basis, the relevant finding read as under :—

> 10. "The Court is unable to agree with the above submissions. The inclusion in the Explanation to Section 92B of the Act of the expression "receivables" does not mean that de hors the context every item of "receivables" appearing in the accounts of an entity, which may have dealings with foreign AEs would automatically be characterised as an international transaction. There may be a delay in collection of monies for supplies made, even beyond the agreed limit, due to a variety of factors which will have to be investigated on a case to case basis. Importantly, the impact this would have on the working capital of the Appellant will have to be studied. In other words, there has to be a proper inquiry by the TPO by analysing the statistics over a period of time to discern a pattern

> which would indicate that vis-a-vis the receivables for the supplies made to an AE, the arrangement reflects an international transaction intended to benefit the AE in some way.
>
> 11. The Court finds that the entire focus of the AO was on just one AY and the figure of receivables in relation to that A Y can hardly reflect a pattern that would justify a TPO concluding that the figure of receivables beyond 180 days constitutes an international transaction by itself."

**102.** It is not the case of the revenue that the impugned transaction is sham or bogus transaction, therefore, the re-characterization of the receivables as unsecured loans is uncalled for.

**103.** There is no dispute that remittances from unrelated third parties have also come with a time lag exceeding the agreed period and the undisputed fact is that the assessee has not charged any interest for delay in receipt of such remittances from unrelated parties. In the light of such undisputed fact any delay in remittances from associated enterprises should not be re-characterized as unsecured loans. We draw support from the decision of Hon'ble High Court of Bombay in the case of *CIT* v. *Indo American Jewellery Ltd.* [2014] 44 taxmann.com 310/223 Taxman 8 (Mag.) the relevant finding read as under :—

> "However, in the facts of the present case, the specific finding of the IT AT is that there is complete uniformity in the act of the assessee in not charging interest from both the Associated Enterprises and Non Associated Enterprises debtors and the delay in realization of the export proceeds in both the cases is same. In these circumstances the decision of the Tribunal in deleting the notional interest on outstanding amount of export proceed realized belatedly cannot be faulted."

**104.** There is no dispute that the OPM of the assessee @ 27.36% is higher than the average working capital adjusted margins of the comparable companies @12.97%, this being so no adjustment is called for in the light of the decision of the Hon'ble High Court of Delhi in the case of *Kusum Health Care* (*supra*).

**105.** In our considered view since the receivables have been received by the assessee within ordinary time period it cannot be re-characterized as unsecured loans and accordingly no adjustment on account of delay in receipt of receivables can be made in the income of the assessee considering the fact that the similar delay is there in respect of receivables from unrelated third parties.

**106.** Considering the facts of the case in hand in totality in the light of the factual matrix discussed here in above viz-a-viz judicial decisions on the point of issue we are of the considered view that resorting to Explanation (1)(c) to section 92B of the Act is uncalled for. We accordingly direct the Assessing Officer /TPO to delete the transfer pricing adjustment of Rs.97780581/-. Ground No.7 is allowed.

**107.** Ground No.8 relates the charging of interest u/s. 234 B and 234 C of the Act. Levy of interest is mandatory though consequential. We direct the Assessing Officer/TPO to levy interest as per the provisions of the law. Interest u/s. 234 C of the Act has to be charged on the returned income.

**108.** In the result, the appeal filed by the assessee is partly allowed.

jaspreet

---

*Partly in favour of assessee.