Cisco Systems Capital (India) Pvt.Ltd.

Cisco Systems Capital (India) Pvt.Ltd ("assessee") is engaged in the business of leasing and finance. Karnataka HC dismissed revenue's appeal against Bangalore ITAT order for AY 2008-09. Revenue in appeal raised three substantial questions of law - first 2 questions pertained to validity of the assessment order passed by the AO without following Sec 144C procedure during the course of remand proceedings and 3rd question challenging the dismissal of Sec 263 order by the Tribunal in the first round of proceedings.

The original assessment order under Sec.143(3) r.w.Sec.144C was passed against which Pr. CIT initiated revision proceedings under Sec 263 which was quashed by the ITAT and remanded the matter for re-adjudication. Subsequently, the TPO passed an order under Sec. 92CA read with Sec 254 relating to AY 2008-09 and AY 2009-10 and the AO passed final order under Sec 143(3) against which assessee filed an appeal on the ground that a draft assessment order was not passed. While CIT(A) dismissed the appeal, ITAT allowed assessee's appeal to which the Revenue objected by way of an appeal before the Hon'ble HC. The HC noted that in the second round of appellate proceedings, the Revenue has failed to appreciate the mandate of Sec. 144C which postulates that AO shall in the first instance forward a draft of the proposed order of assessment to the eligible assessee for acceptance or filing of objections. HC rejected Revenue's justification for not passing draft assessment order basis non-applicability of the CBDT Circular No.9/2013 dated 19.11.2013 which mandated applicability of Sec.144C to any variation income or loss returned by an eligible assessee and since no such variation was involved in the second round of appellate proceedings, there was no requirement to pass a draft order. The HC admonished incorrect interpretation by Revenue of the phrase 'at the first instance' and observed that passing of draft assessment order is quintessential before issuing the final order. It relied on rulings of Delhi HC in JCB India and Gujarat HC in C-Sam (India), wherein, against similar arguments advanced by the Revenue, it was categorically observed that even in remand proceedings, it was mandatory for the AO to pass draft assessment order under Sec. 144C and issuance of final assessment order sans the draft order was bad in law. It held *"Having regard to the language employed by the legislature under Sec. 144C of the Act, it is mandatory to the Assessing Officer to pass draft assessment order before issuing the final order, breach of the same would result in violation of the principles of natural justice making the order itself void ab-initio."*

Case Law Update

(a) Holds recovery of expenses as provision of intra-group services; and (b) Restores issue on location savings - Parexel International (India) Private Limited [TS-506-ITAT-2021(Bang)-TP]

Facts:

- The Assessee company is registered as clinical research agency and is engaged in providing clinical research services in India. The Assessee is remunerated at a cost plus mark-up.
- Paraxel Group entities are also engaged in conducting the clinical trial depending on the requirements of Sponsors. In case a trial is required to be undertaken in India, the Assessee in some cases is given the assignment of coordinating and facilitating the clinical trial in India by the AE. The actual clinical trials are undertaken by the investigators such as hospitals, physicians etc. The entire risk of conducting the clinical trial and its success/ failure lies with the Sponsor/ AEs and the Assessee is insulated.
- The Assessee enters into an agreement with the Investigator on behalf of and as an agent of the Sponsor and makes payment to the Investigator. During the year under consideration, the amount so paid to the Investigator was recovered from the AE on cost to cost basis.
- The TPO held that the Assessee invest considerable time and resources on identifying and coordinating with the Investigators and accordingly, the expenses paid ought to be considered as operating cost of the Assessee. The TPO accordingly imputed a mark-up on the recovery of expenses and proposed a TP adjustment.

- Separately, the TPO held that conducting clinical trials in India has resulted in location savings for the AEs as the costs are significantly lower in India as compared to developed countries where AEs were located. Based on an arbitrary article available on internet, the TPO computed total cost savings of INR 43.38 crores. The said purported savings were split in the ratio of 50:50 between the AE and the Assessee by the TPO and accordingly a TP adjustment on account of alleged location savings was proposed.
- DRP upheld the approach of the TPO.

Tribunal's Ruling

(A) Mark-up on recovery of expenses

- Hon'ble Tribunal noted that selection of the investigator for clinical trial is an important task in the whole work undertaken by the Assessee. The Assessee acted as coordinator and facilitator in selecting the investigator and invested considerable time and resources on this.
- Regarding the contention of the Assessee that remuneration for these services has already been included in the provision of clinical trial services and no separate fee is charged for coordinating and facilitating with the investigators, Hon'ble Tribunal opined that coordinating and facilitating is a separate intra-group services provided by the Assessee and the Assessee must charge some fee as it would have, had the services been provided to a third party. Reliance was placed of OECD TP Guidelines.
- Regarding the Assessee reliance on the Addendum to Services Agreement which stated that 'pass-through costs' are to be recovered on cost to cost basis, Hon'ble Tribunal observed that the addendum was only a self-serving document solely made with an intention to evade payment of taxes. Further, Hon'ble Tribunal also noted that in the earlier years, investigator payments were reimbursed to the Assessee with a mark-up.
- Upholding the approach of the TPO, Hon'ble Tribunal remarked: "we are of the opinion that this intra-group services rendered by the assessee to the parent company cannot be considered as reimbursement of expenses or pass through costs. It is separate services in itself for which the assessee needs to determine the ALP which the assessee failed to do so. The assessee has provided services for which the TPO is justified in marking up the services so as to make TP adjustment. The various case laws relied on by the ld. AR are different on its own facts, which cannot be applied to the facts of the present case. Hence the TPO/AO correctly ascertained the ALP of this transaction and made adjustment on this count. The same is sustained."

(B) Location Saving

Relying on the Assessee's own order for prior years, Hon'ble Tribunal remanded the issue with following observations:

- The location savings and conditions are available to all parties irrespective the transaction is between the related party or unrelated party.
- The key factor which is required to looked into while considering the location cost advantage to an entity working in low cost jurisdiction is that, whether there are suitable local comparable data to determine the conditions in which third party would be carrying out such an activity which would be the measure of Arm's Length and if on such comparability analysis the price received or charged is comparable then no attribution on account of locational savings can be made.
- If comparable data are available where transaction is being tested or where the tested party is located, then the benefits of location savings can be said to have been captured in the arm's length price which has been determined.
- Location saving or condition can be a relevant factor for conducting a proper enquiry for determination of arm's length price of the international transactions but cannot be itself the basis for determination of arm's length price adjustment.
- Computation of the location saving by the TPO is purely based on some articles and not on the basis of actual cost in the US in comparison to India and therefore suffer from serious defect.
- Hon'ble Tribunal concluded that " Since the functional comparability of the companies selected by the assessee has not been examined by the TPO as well as no steps were taken to find out the other comparables of the assessee for determination of ALP therefore, the issue of determination of ALP and consequential adjustment, if any, is required to be examined and adjudication afresh at the level of TPO/A.O. Needless to say that, the Assessee is receiving its price in foreign currency therefore the comparable uncontrolled price shall also have at least 75 percent of their revenue in foreign currency otherwise the price received from domestic market may not be acceptable when the assessee is receiving its 100 percent revenue in foreign exchange."

Upholds "NIL" determination of ALP for management fees for lack of relevant documentary evidence - Lite-on Mobile India Pvt.Ltd [TS-566-ITAT-2021(CHNY)-TP]

Facts:

- The Assessee is in the business of contract manufacturing of moulded components for mobile phones had entered into managerial services agreement with its AE for availing various services.
- The Assessee had also entered into various other international transactions with its AEs. The Assessee has aggregated all transactions with its AEs and has adopted TNMM to benchmark all international transactions except interest paid on External Commercial Borrowing.
- During TP assessment proceedings, the TPO has accepted TP study conducted by the Assessee by adopting TNMM in respect of all international transactions except payment for management fees. In respect of payment of management fees, the TPO determined arm's length price as 'NIL' by holding that the Assessee failed to satisfy need and receipt test.

Tribunal's Ruling

Upholding the approach of the TPO of determination of arm's length price as "NIL", Hon'ble Tribunal made the following observations:

- A careful examination of services agreement shows that agreement is general one, which specifies various need based services to be provided by its AEs to its group company without any specific services that required by the Assessee;
- The agreement does not have any clause to protect beneficiary from deficiency in services provided by service provider;
- Allocation of Charges is fixed in relation to most of the services on the basis of sales without any reference to what services that are availed by the Assessee and their technical specification;
- The agreement specifically states that relevant documents evidencing rendition of services would be available, however, the Assessee has failed to produce any documents except few general e-mails;
- Even if agreement is considered to be genuine, the Assessee has never tried to verify correctness of cost allocation done by service provider.

The relevant extract from Hon'ble Tribunal's order is quoted as under:

"In this case, the assessee, except furnishing agreement between parties, invoices raised by AE and few e-mail correspondence, no other documents have been filed to prove any services in fact, was rendered by its AE. Therefore, in our considered view, even if agreement is considered to be genuine, the assessee has never tried to verify correctness of cost allocation done by service provider. Further, the assessee has failed to substantiate payment of such huge managerial fees month on month without any supporting evidences like technical specification of services rendered by its AE, personnel deployed for said purposes and other evidences including correspondence between parties. Although, the assessee refers to number of e-mail correspondence between few employees of the assessee and its AE, but on perusal of e-mail samples filed by the assessee, what we could notice is these e-mails are general in nature and further with reference to daily production of products manufactured by the assessee in respect of sales to different regions. Further, none of e-mail correspondence filed by the assessee depicts any evidence of rendering any kind of managerial or technical services to justify claim of the assessee that it has received managerial services from its AE. Therefore, we are of the considered view, that the assessee has made periodical payment to its AE in the guise of managerial fee without any justification for such payment and further without any evidence on record to suggest that services were actually rendered."

[emphasis added]

- Disallowances made by the TPO is on cumulative ground, including necessity of services and want of evidence to justify payment of management fees and therefore the case law (CIT vs EKL Appliances Ltd., 345 ITR 241) relied upon by the Assessee are not relevant.
- Payment of management fees has to be examined, qua, evidence without going into aspect of operating margin of Assessee and TP study conducted for that purpose. Hon'ble Tribunal also distinguished case law relied upon by the Assessee to support adoption of aggregated benchmarking under TNMM.
- Hon'ble remarked: "On perusal of facts available on record and on the basis of facts brought out by authorities below, we are of the considered view that the assessee has failed to bring on record any evidences to justify payment of management fees. Therefore, we are of the considered view that case laws relied upon by the assessee on the issue of necessity of availing services and question of cost benefit analysis of said expenditure has no application to present issue on hand.

12. In this view of the matter and considering facts and circumstances of the case, we are of the considered view that there is no error in reasons given by ld.TPO/DRP in making TP adjustments for payment of managerial services fee to its AE. Therefore, we are inclined to uphold findings of the learned DRP and reject grounds taken by the assessee."

[emphasis added]

- Assessment Order passed beyond one month from receiving DRP directions pursuant to Tribunal's remand to DRP, null and void - Fresenius Kabi Oncology Ltd (earlier known as M/s Dabur Pharma Ltd.) [TS-1131-ITAT-2016(DEL)-TP]

Hon'ble Tribunal in the Original proceedings has restored the case to the file of the DRP for passing speaking order under Section 144C of the Act.

On the direction of the ITAT, the DRP passed the order dated 17 January 2013 and directed the AO to complete the assessment in accordance with the directions given in the said order. Thereafter, the AO passed the final assessment order on 24 July 2013.

Ruling on the validity of Assessment Order passed beyond one month from receiving the DRP directions pursuant to Tribunal's remand to DRP, Hon'ble Tribunal held as under:

- As per Section 144C(13) of the Act, it is mandatory for the AO to pass the assessment order inconformity with the direction given by the DRP within one month from the end of the month in which such direction has been received;
- The provisions contained in sub-Section (13) of Section 144C of the Act overrides the provisions contained in Section 153 or Section 153B of the Act.
- Regarding Department's reliance on 4th proviso to Section 153(2A) of the Act, Hon'ble ITAT noted that it deals with a situation when a reference has been made by the AO under Section 92CA(1) of the Act, the time limit for completion of the assessment is two years from the receipt of the order under Section 254 of the Act. In the present case, as there was no such direction given by the ITAT to the AO to make the reference again rather the directions were given to the DRP.
- Considering the totality of the facts and the legal provision, Hon'ble Tribunal held that the assessment Order beyond one month from receiving DRP directions was barred by limitation.