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*** IN THE HIGH COURT OF DELHI AT NEW DELHI**

% ***Judgment delivered on: 11 July 2024***

\+ ITA 159/2023

THE COMMISSIONER OF INCOME TAX - INTERNATIONAL TAXATION -1 .....Appellant

Through: Mr. Ruchir Bhatia, SSC with Mr. Anant Mann, Mr. Pratyaksh Gupta, Mr. Abhishek Anand, Advs.

versus

A.T. KEARNEY LTD. .....Respondent

Through: Mr. Ajay Vohra, Sr. Adv. with Mr. Samarth Chaudhary, Adv.

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CORAM:
HON'BLE MR. JUSTICE YASHWANT VARMA
HON'BLE MR. JUSTICE RAVINDER DUDEJA

J U D G M E N T

YASHWANT VARMA, J. (Oral)

1. The **Commissioner of Income Tax (Appeals)**[1] impugns the order of the **Income Tax Appellate Tribunal**[2] dated 25 February

[1] CIT(A)
[2] Tribunal

2020 and poses the following common questions in these appeals:

> "2.1 Whether in the facts and circumstances of the case, the ld. ITAT was justified in law in deleting the addition made by the TPO by holding that the payment made for Intra Group Services was for commercial expediency?
> 2.2 Whether in the facts and circumstances of the case, ld. ITAT was right in not appreciating that TPO has not disallowed the Intra Group Services merely on the issue of non-substantiation of commercial expediency by the Assessee but after considering several other factors?
> 2.3 Whether in the facts and circumstances of the case the ld. IT AT was justified in law to deleted entire interest on receivable without considering the fact that the ld. CIT(A) has given details reasons to apply interest rate equivalent to 14.77% being SBI PLR+200 basis point in the FY 2008-09?"

2. For the purposes of evaluating the challenge which stands raised, we deem it apposite to take note of the following essential facts. A.T. Kearney Ltd., the respondent-assessee, is stated to be a management consulting subsidiary engaged in providing consultancy services to industry and its activities extend to consultancy and advisory services being provided to diverse multinational enterprises. It established a branch office in India in 1997 which for the purposes of brevity shall hereinafter be referred to as 'ATK BO'. ATK BO has two offices in India in New Delhi and Mumbai and has a client base which spreads across a wide spectrum of sectors including automotive, engineering, energy, real estate and others. It is stated to also extend its services to public sector entities, government companies and other industry organisations.

3. For **Assessment Years**[3] 2009-10 and 2010-11, and which are

[3] AYs

the years with which we are concerned in these appeals, the **Transfer Pricing Officer**[4] had made adjustments principally in three segments, namely (a) **Intra Group Services**[5], (b) Receivables, and (c) Provision of Management Consultancy Services.

4. Although aggrieved by the additions which were originally proposed by the TPO, ATKBO chose not to file any objections before the **Dispute Resolution Panel**[6], it however preferred an appeal before the CIT(A) which came to be partially allowed. This led to appeals being instituted before the Tribunal.

5. When these appeals were initially called before us on 21 March 2024 we had taken note of a contention addressed on behalf of the appellants and who had sought to argue that the respondent-assessee had not undertaken any benchmarking exercise in respect of IGS. In order to cut short that controversy and notwithstanding our attention being drawn to the grounds in that respect having been specifically taken before the CIT(A) we had by way of our order dated 21 March 2024 requested the appellant to place on the record a copy of the **Transfer Pricing Report**[7].

6. Insofar as the issue of benchmarking is concerned, we find that the TP Report specifically alludes to this aspect as would be evident from paragraph 4.3 which is extracted hereinbelow:

[4] TPO
[5] IGS
[6] DRP
[7] TP Report

"**4.3. Payment of management fees**

As the global operational headquarters of ATK, AT Kearny Inc. US ("ATK US") provides management services that benefit ATK Affiliates. The management services provided by ATK US includes the following: finance management services, services rendered by the office of CEO, Professional Development services.

- Finance management services comprises of WIP Systems CPSS; Interface with HRIS; Global Planning; global activities in the area of General accounting and Tax, Treasury and Compliance.
- Services rendered by the office of the CEO comprises of vision, strategy and policy making for the firm. The CEO, in some circumstances, also attend the public events and assists in sales efforts if it helps ATK in securing an assignment or a client relationship.
- Professional Development Services comprises of the training services such as coordination of web based training and senior management training for partners and principals as well as elite program for high performing, high-potential managers and principals. Further, these services also comprise of the management of technical platform for Web based training and other trainings related to IT solutions

The key terms of the management fee agreement entered into between ATK US and its affiliates is enumerated below.

Associated Enterprise	**Value of transaction for year ended 31 March, 2009**	**Nature & Terms of the Inter-company agreement**
ATKUS	Rs. 53,224,798	➢ The agreement has been entered into by and between ATK US and its Affiliates for availing of management support services which is effective from January 1, 2008. ➢ Services provided by ATK US shall include services as mentioned in Para 4.3 above. ➢ Charges for the provision of services to ATK BO shall include cost and a profit mark- up equal to ten

		percent. ➢ Costs shall mean all direct and indirect costs related to provision of services by ATK US. This includes salary and compensation of employees, expenses related to fixed and related assets (including depreciation), expenses related to workspace, telecommunication, and any other expenses directly related to provision of services (including taxes and overheads). ➢ Payment shall be due and payable upon receipt of invoice of ATK US. ➢ Payments for management fees shall be made in US dollar unless otherwise agreed by ATK US and ATK BO.

7. Proceeding then to deal with the payment of management fee, it becomes evident from a reading of pages 253 to 255 of the TP Report as it exists on our digital record that the respondent assessee ultimately adopted the **Transactional Net Margin Method**[8] for the purposes of Arm's Length Analysis. The TP Report thereafter and more particularly from paragraph 5.3.4 onwards proceeded to analyse and deal with the aspect of comparability with uncontrolled transactions. On due consideration of all facts, the report carried the following findings and conclusions:

> **"5.3.6 Findings and conclusions**
> Based on our analysis, the comparable companies operating

[8] TNMM

> margins' (computed as defined above)lie between (-) 8.66 percent and 52.15 percent. The arithmetic mean of the mentioned range is13.14 percent. A summary of the operating margins for the 18 accepted companies is provided in **Annexure 12.**
>
> Based on the information provided by ATK BO, the operating margin of the AE of ATK BO from provision of management services is **10 percent on operating cost.** Since AE of ATK BO's margin of 10 percent on operating cost is lower than the mean operating margin of the comparables, the transaction between ATK BO and its AE in respect of payment of management fees can be considered to be at arm's length read with sub-section (3) of Section 92 of the Act, from an Indian transfer pricing perspective"

8. We note that the controversy itself arises in the context of the original order framed by the TPO and to which we would briefly refer bearing in mind the facts as they obtained for A.Y. 2009-10. The order of the TPO dated 28 January 2013 indicates that it identified the following issues which merited consideration:

> "**6.** On the basis of the above it can be seen that in order to examine the arm's length price of intra group services received by one of the associated enterprises following essential information should be available
>
> 1. Whether the AE has received intra group services?
> 2. What are the economic and commercial benefits derived by the recipient of intra group services?
> 3. In order to identify the charges relating to services, there should be mechanism in place which can identify (i) the cost incurred by the AE in providing the intra group services and (ii) the basis of allocation of cost to various AEs.
> 4. Whether a comparable independent enterprise would have paid for the services in comparable circumstances?"

9. Upon consideration of the submissions which were addressed before it, the TPO came to record the following conclusions:

> "**6.2.3** After carefully consideration of submission's filed by assessee in response to the show cause and in support of its contentions, it is seen that the contentions raised by the assessee in this regard cannot be accepted on following grounds:

- There is no evidence that the services have actually been provided. The assessee has failed miserably to demonstrate the need for these services as also the receipt of the same.
- Even if it is considered that some sort of services have been provided by the designated persons, there is no evidence that those persons have not provided any service to the AE. Those persons are in the payroll of AE and therefore, major portion of work must have been carried out by them for the AE and only ancillary services would have been provided to the assessee company and therefore, any charge in this regard is not justified in view of OECD TP guidelines paragraph 7.13 under chapter VII.
- So far as claim of revenue generation, the auditor of assessee company has not mentioned anything about such arrangement in audited financials either in the Notes to accounts or anywhere else. Therefore, the claim of assessee has no credible basis and cannot be accepted.
- Moreover, cost allocation is also not certified by any independent auditor and the basis of cost allocation is also not understandable.
- There is no basis/evidence for revenue claimed to have been generated from the alleged services.
- Cost allocation for the intra group services has no basis nor any such basis has been given for each segmental intra group services received. The assessee has further contended that analysis undertaken by the assessee cannot be rejected without an appropriate basis. In this regard it is to be pointed out that the assessee could not substantiate its claim that services claimed to be availed have actually been availed by it and an independent enterprise would be willing to pay such amount under such circumstances. Moreover, analysis is without any basis and is not credible. Therefore, such analysis is liable to be rejected. The assessee has also contended that for proposal analysis on CUP for determination of ALP for these transactions as NIL, no reason/data has been given to assessee. In this regard it is pointed out that the assessee has failed to substantiate itself buy documentary evidence that such services have actually been rendered to the assessee and so it is natural corollary that ALP of such transaction will be nil where payment is made for no services. It can be said on the basis of discussion made above that this arrangement is nothing but a profit shifting device.
- The assessee has failed to establish any direct nexus, whatsoever, of any kind, which may help its case of having

received the business from its AE as a result of services provided by the AE.

- The assessee has failed to established that its associated enterprises have specifically dedicated service centers for the assessee. The AE was not prohibited from rendering services to third parties as well. It is apparent, as has been mentioned above, that services of such nature are being performed by the assessee itself during its normal course of business. Under arm's length circumstances no independent enterprise would be willing to pay for services which are a part of its routine business performed by it and would not engage it to receive such incidental services for a payment, even at cost.
- Moreover, it is not disputed that the activities for which it is paying are also performed by itself. Under the OECD guidelines, no intra-group service should be found for activities undertaken by one group member that merely duplicate a service that another group member is performing for itself, or that is being performed for such other group member by a third party. Moreover, even if it is presumed without conceding that business exigencies do permit third party involvement inspite of its own endeavor, in no case is there is scope for duplicity of services. Moreover, the cost of such services, if any, would need to be identified to prove that it has not overpaid its AE than what would have been paid under arm's length circumstances."

10. It is the aforesaid view which came to be assailed before the Tribunal. While dealing with the issue of IGS, the Tribunal principally followed its decision rendered for A.Y. 2008-09. This becomes evident from a reading of paragraph 7 of the order impugned before us and which is extracted hereinbelow:

> "**7.** We have considered the rival arguments made by both the sides, perused the orders of the AO and the CIT(A) and the paper book filed on behalf of the assessee. We find identical issue had come up before the tribunal in assessee own case vide ITA No. 6249/Del/2012 for A.Y. 2008-09. The Tribunal vide order dated 21st May, 2018 at para 16 to 18 of the order has observed as under:
>
> "11. After considering the written submission of the ld. DR and the orders of the authorities below, in our considered opinion, in order to examine the ALP of intra group services received by one of the associated enterprises, following

essential information should be available:

1. Whether the AE has received intra group services?
2. What are the economic and commercial benefits derived by the recipient of intra group services
3. In order to indentify the charges relating to services, there should be a mechanism in place which can identity (i) the cost incurred by the AE in providing the intra group services and (ii) the basis of allocation of cost to various AEs.
4. Whether a comparable independent enterprise would have paid for the services in comparable circumstances?

12. Examination of controlled transaction ordinarily should be based on the transaction actually undertaken by the AE as it has been structured by them using the method applied by tax payer in so far these are consistent with the methods described under Chapter II and III. Only in exceptional cases tax Admn. should disregard the actual transactions or substitute other transactions for them. Restructuring of legitimate business transactions would be a wholly arbitrary exercise the inequity of which could be compounded by double transaction created where the other tax administration does not share the same views as to how the transaction should be structured. For this proposition, we draw support from the judgment of the Hon'ble jurisdictional High Court of Delhi in the case of EKL appliances 344 ITR 241

13. In the same judgment, the Hon'ble High Court observed that

> "The character of transaction may derive from relationship between the parties rather than be determined by normal commercial conditions as may have been structured by the tax payer to avoid or minimize tax.
>
> The significance of the aforesaid guidelines lies in the fact that they recognise that barring exceptional cases, the tax administration should not disregard the actual transaction or substitute other transactions for them and the examination of a controlled transaction should ordinarily based on the transactions it has been actually undertaken and structured by the associated enterprises. It is of further significance that the guidelines discourage re-structuring of legitimate business transaction."

14. It has been held by various courts that it is not for the revenue authorities to dictate to the assessee as to how he

should conduct his business and it is not for them to tell the assessee as to what expenditure the assessee can incur. The question whether decision was commercially sound or not is not relevant. The Hon'ble High Court in the judgment cited as EKL Appliances [Supra] has held that the assessee was not required 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 the subsequent years.

15. The Hon'ble High Court of Delhi in the case of Cotton Naturals India [P] Ltd 276 CTR 445 at para 17 of its order has held that "Chapter X and Transfer Pricing rules do not permit the Revenue authorities to step into the shoes of the assessee and decide whether or not a transaction should have been entered. It is for the assessee to take commercial decisions and decide how to conduct and carry on its business."

16. It is incorrect to say that the assessee has not provided appropriate/logical allocation of cost to ATK affiliates for management support and cost allocated to ATK India. Following chart summarizes the total group costs:

17. Break up of cost under each head is exhibited separately in the paper book. Each cost is supported by evidences which are placed at pages 701 to 1421 of the paper book.

18. In so far as the allegation relating to the payment for duplicate services is concerned, it appears that lower authorities have confused ATKBO with another group entity ATK India Pvt. Ltd which is a separate entity whose financial/TP study are placed on our record for the year under consideration. Detailed cost allocation sheets showing different personnel involved for each service has been placed on record separately. We find that the revenue authorities have simply rubbished the email evidences brought on record without examining and pointing out defects in the evidences. It is not proper for the lower authorities to disregard such direct evidences.

19. In so far as the payment relating to management services provided by ATK Australia is concerned, we find that the same has been dismissed by the lower authorities on flimsy grounds. We find that the allocation in respect of services provided by Shri John Yoshimura Regional head of offices is on the basis of time spent by him in relation to ATKBO. In our considered opinion his allocation is logical and sound on the fact of the case. There are email evidences wherein it has

> been mentioned that Shri John Yoshimura was responsible for advising on various performances/review of Indian partners. Moreover, specific dates of physical presence of Shri John Yoshimura in India are exhibited at pages 1417, 1419 and 1420 of the paper book.
>
> 20. Considering the cost allocation chart exhibited elsewhere supported by evidences placed as exhibits in the paper book, we do not find any merit in the transfer pricing adjustments made by DRP/TP/ Assessing Officer on this count and the same is directed to be deleted."

11. Insofar as the identification of an appropriate rate of interest is concerned, it took note of the fact that the TPO had rejected the **Arm's Length Price**[9] suggested by the assessee and required interest being charged at the rate of 14.88%. In appeal the rate of interest was brought down by the CIT(A) to 13.88%.

12. An identical issue appears to have been urged in A.Y. 2008-09. That aspect came to be disposed of by the Tribunal as would be evident from the following observations appearing in its order for that year:

> "**13.** After hearing both the sides, we find identical issue had come up before the Tribunal in assessee's own case in A.Y. 2008-09. We find, the Tribunal, vide ITA No.6249/Del/2012, order dated 21st May, 2018, has decided the issue in favour of the assessee, by observing as under:-
>
> > "21. The next issue relates to the adjustment made on the interest received from 8.46% to 17.26% which was reduced by the DRP to 13.38%.
> >
> > 22. This relates to the interest received by the assessee from ATK Finance Ltd on which the assessee received the interest @ 8.46%.
> >
> > 23. The assessee has bench marked receipt of interest using internal CUP by pointing out that the loan received by ATK group from unrelated party i.e. the bank. This was dismissed by DRP which was of the opinion that the lender has

[9] ALP

> negotiated rate of interest to be charged not on credit rate of ATK Finance alone but conjointly with the parent company ATK UK. DRP further observed that the credit rating of ATK Finance cannot be sole guiding factor. DRP was of the view that the interest rate equal to prime lending rate of RBI during the year under consideration should be applied and accordingly direct the TPO.
>
> 24. We find that the assessee has earned interest on fixed deposits @ 7.56%. In our considered opinion, since the assessee has received interest from its AE in France, applying prime lending rate of RBI is not proper In any case, since the assessee is receiving interest on FD @ 7.56%, interest received from· AE @ 8.46% can be considered at ALP. Therefore, no TP adjustment is called for. We direct accordingly."

13. Before proceeding to the issue of IGS, it becomes relevant to note that the TPO had also suggested adjustments in the Transfer Pricing Order based on the allegation that payment of invoices raised by AT KBO to its **Associated Enterprises**[10] had not been received on time. In view of the above, it chose to treat those outstanding receivables as being liable to be recharacterized as unsecured loans. Insofar as this aspect is concerned, the same stands conclusively answered against the appellants by a Coordinate Bench of this Court in terms of the judgment rendered in **Principal Commissioner of Income-tax v. Kusum Health Care Pvt. Ltd.**[11] and where the following pertinent observations came to be rendered:-

> **"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 dehors the context every item of "receivables" appearing in the accounts of an entity, which may have dealings with foreign associated enterprises would automatically be characterised as an international transaction. There may be a delay in collection of monies for supplies made,

[10] AEs
[11] 2017 SCC OnLine Del 12956

> 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 assessee will have to be studied. In other words, there has to be a proper inquiry by the Transfer Pricing Officer 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 associated enterprise, the arrangement reflects an international transaction intended to benefit the associated enterprise in some way.
>
> **11.** The court finds that the entire focus of the Assessing Officer was on just one assessment year and the figure of receivables in relation to that assessment year can hardly reflect a pattern that would justify a Transfer Pricing Officer concluding that the figure of receivables beyond 180 days constitutes an international transaction by itself. With the assessee having already factored in the impact of the receivables on the working capital and thereby on its pricing/profitability vis-a-vis that of its comparables, any further adjustment only on the basis of the outstanding receivables would have distorted the picture and re-characterised the transaction. This was clearly impermissible in law as explained by this court in CIT v. EKL Appliances Ltd. (2012) 345 ITR 241 (Delhi)."

14. Insofar as the issue of IGS is concerned, we find that the TPO has essentially doubted those payments on the anvil of commercial expediency. In our considered opinion, this issue has been correctly answered by the Tribunal and which drew sustenance for its conclusions bearing in mind the decision rendered by this Court in **Commissioner of Income-tax v. EKL Appliances Ltd.**[12] and where the following observations came to be rendered:-

> "**22.** Even rule 10B(l)(a) does not authorise disallowance of any expenditure on the ground that it was not necessary or prudent for the assessee to have incurred the same or that in the view of the Revenue the expenditure was unremunerative or that in view of the continued losses suffered by the assessee in his business, he could have fared better had he not incurred such expenditure. These are irrelevant considerations for the purpose of rule 10B. Whether or not to enter into the transaction is for the assessee to decide. The quantum of expenditure can no doubt be examined by the Transfer

[12] 2012 SCC OnLine Del 1897

> Pricing Officer as per law but in judging the allowability thereof as business expenditure, he has no authority to disallow the entire expenditure or a part thereof on the ground that the assessee has suffered continuous losses. The financial health of the assessee can never be a criterion to judge allowability of an expense; there is certainly no authority for that. What the Transfer Pricing Officer has done in the present case is to hold that the assessee ought not to have entered into the agreement to pay royalty/brand fee, because it has been suffering losses continuously. So long as the expenditure or payment has been demonstrated to have been incurred or laid out for the purposes of business, it is no concern of the Transfer Pricing Officer 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 Transfer Pricing Officer is not contemplated or authorised."

15. As this Court had held in *EKL Appliances*, it is clearly impermissible for the TPO to disregard the actual transaction unless it comes to the conclusion that an unrelated party would not have undertaken the same in usual course of business. More importantly it is wholly impermissible for the TPO to doubt commercial soundness of the expenditure that may be incurred.

16. Furthermore, it would also not be permissible for the TPO to engage in the restructuring of a transaction, unless the economic substance of a transaction differed from its form and if the form and substance of the transaction were the same but the arrangements relating to the transaction when viewed in totality differed from that which would have been adopted by independent enterprises acting in a commercially rational manner. This position has been duly affirmed by the decision rendered by this Court in **Sony Ericsson Mobile**

Communication India P. Ltd. v. Commissioner of Income-tax[13]

where it was observed as follows:-

> "**147.** The tax authorities examine a related and associated parties' transaction as actually undertaken and structured by the parties. Normally, the tax authorities cannot disregard the actual transaction or substitute the same for another transaction as per their perception. Restructuring of legitimate business transaction would be an arbitrary exercise. This legal position stands affirmed in EKL Appliances Ltd. (supra). The decision accepts two exceptions to the said rule. The first being where the economic substance of the transaction differs from its form. In such cases, the tax authorities may disregard the parties' characterisation of the transaction and re-characterise the same in accordance with its substance. The Tribunal has not invoked the said exception but the second exception, i.e., when the form and substance of the transaction are the same but the arrangements made in relation to the transaction, when viewed in their totality, differ from those which would have been adopted by the independent enterprise behaving in a commercially rational manner. The second exception also mandates that the actual structure should practically impede the tax authorities from determining an appropriate transfer price. The majority judgment does not record the second condition and holds that in their considered opinion, the second exception governs the instant situation as per which, the form and substance of the transaction were the same but the arrangements made in relation to a transaction, when viewed in their totality, differ from those which would have been adopted by an independent enterprise behaving in a commercially rational manner. The aforesaid observations were recorded in the light of the fact in the case of L. G. Electronics (supra). Commenting on the factual matrix of L. G. Electronics case (supra) would be beyond our domain; however, we do not find any factual finding to this effect by the Transfer Pricing Officer or the Tribunal in any of the present cases. However, in L.G. Electronics decision (supra), it is observed that if the AMP expenses and when such expenses are beyond the bright line, the transaction viewed in their totality would differ from one which would have been adopted by an independent enterprise behaving in a commercially rational manner. No reason or ground for holding or the ratio is indicated or stated. There is no material or justification to hold that no independent party would incur the AMP expenses beyond the bright line AMP expenses. Free market conditions would indicate and suggest that an independent third

[13] 2015 SCC OnLine Del 8083

> party would be willing to incur heavy and substantial AMP expenses, if he presumes this is beneficial, and he is adequately compensated. The compensation or the rate of return would depend upon whether it is a case of long-term or short-term association and market conditions, turnover and ironically international or worldwide brand value of the intangibles by the third party."

17. On an overall conspectus of the aforesaid, we find no ground to interfere with the view ultimately taken by the Tribunal. The appeals consequently fail and shall stand dismissed.

YASHWANT VARMA, J.

RAVINDER DUDEJA, J.

JULY 11, 2024
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