

What's New

News Flash



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Tribunal recognises difficulty in providing 'concrete' evidence in respect of services provided against management fee

Facts

TNS India Pvt. Ltd.¹ (the taxpayer) was engaged in conducting quantitative and qualitative market research. It had entered into several international transactions with its associated enterprises (AEs), of which the disputed transaction was that of payment of management fees. The other international transactions were accepted as having arm's length pricing, after being aggregated and benchmarked using Transaction Net Margin Method (TNMM). The Transfer Pricing Officer (TPO) challenged the management fee transaction and determined its arm's length price (ALP) to be NIL.

Before setting forth the Tribunal's ruling, the following facts in respect of the management fee transaction are worth noting:

- As a part of its business strategy, the Group had centralized key management functions in AEs which were set up exclusively for this purpose. These AEs provided management services, and were non-profit entities.
- The services/ process/ know-how/ systems/ knowledge were available to the taxpayer on a real-time and continuous basis through the Group intranet.
- The taxpayer received the advantage of specialization, skills and expertise, know-how and technology, which was developed in-house by the Group in all core areas of its business of market research. Other benefits were in the form of global consistency in business practices, economies of scale, and improvements in efficiency.
- As documentary evidence to counter the TPO's challenge, the taxpayer submitted the following:
 1. documentation including a detailed description of services received from AEs;
 2. inter-company service agreement;
 3. financial statements and tax return of AEs;
 4. confirmation that such payments had been made by other group companies too (average management fee as a percentage of sales paid by other group companies was 6.07%, which was higher than 4.5% paid by the taxpayer);

5. basis of allocation of costs by the global headquarters and regional headquarters; and
6. details of withholding tax on management fee payments.

Tribunal ruling:

The Tribunal held as follows:

- Providing concrete evidence with reference to services provided in the nature of specific activities in day-to-day business was difficult as they were not tangible in nature. However, by the way business is conducted, one could perceive the same. Unless the TPO observed the role of AEs in the taxpayer's business, it would be difficult to place on record the sort of advice given in day-to-day operations. Accordingly, the TPO's contention that services were not rendered, was not acceptable.
- Taxpayer had placed a lot of evidence in support of its claim. The detailed write-up of services provided and benefit received, as provided by the taxpayer, had neither been contradicted by the Revenue authorities, nor had they specified any other evidence that would satisfy them.
- The role of a TPO was to determine the ALP of a transaction. By rejecting outright the entire payment of management fee, the TPO went beyond his jurisdiction. In the guise of determination of ALP, the TPO could not question the business decision of payment and determine that no services were rendered. [*Reliance placed on Delhi High Court ruling in case of EKL Appliances Ltd (ITA No. 1608 & 1070/2011)*].
- While determining the profit level indicator (PLI) for the taxpayer under TNMM, the management fee transaction had been considered. After paying management fee, the taxpayer's PLI under TNMM was higher than that of comparables. Considering this, adjustment on account of management fee was not proper.
- Inter-company service agreement was entered into in an earlier year and the taxpayer had been paying and claiming management fee in earlier and later years.
- The management fee amount was within the norms prescribed for payment of fees to various group companies of similar nature.

In view of the above, the Tribunal, in principle, allowed the claim of management fees. However, it observed that since the TPO had not examined whether or not the payment of management fee was in accordance with the pricing methodology laid out in the inter-company service agreement, the matter relating to quantification of the claim was restored back to the TPO.

PwC observations

- The Tribunal's recognition of the fact that it could be difficult to put forth 'concrete' evidence to prove rendering of services and benefits received, as they may not be tangible in nature, is indeed the most reassuring and welcome outcome of this verdict. Interestingly, to drive home this point the Tribunal has made a very apt comparison of the role of management services in a business, with the role of an anaesthetist in an operation conducted by a surgeon. To explain, the Tribunal has stated that there may be evidence of an operation in the form of scars etc. However, the role of an anaesthetist before the operation and after gaining consciousness was difficult to prove.
- It is worth noting that documentary evidence filed by the taxpayer in the instant case was not only acknowledged by the Tribunal, but was also considered by it to be in plenty. Needless to say, taxpayers in general, would need to maintain documentation specific to their own set of facts. However, just as it happened in the instant case, if documentary evidence is robust, it would become difficult for the Revenue authorities to either contradict the evidence or suggest any additional evidence to be filed. This could significantly fortify a taxpayer's position in an appeal, and is thus a key takeaway from this decision.
- From the ruling, it appears that the TNMM, using the aggregation approach, has been accepted by the

Tribunal as a corroborative methodology to justify the management fee. The message, therefore, is that when building up a defense for management fee transactions, it may be worthwhile to also undertake a TNMM analysis of the post-management fee net profit.

1. TNS India Pvt. Ltd. v. ACIT [TS-21-ITAT-2014(HYD)-TP]

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