IN THE INCOME TAX APPELLATE TRIBUNAL
PUNE BENCH "C", PUNE

BEFORE SHRI R.S. SYAL, VICE PRESIDENT AND
SHRI S.S. VISWANETHRA RAVI, JUDICIAL MEMBER

ITA No.259/PUN/2017
निर्धारण वर्ष / Assessment Year : 2012-13

M/s. Walter Tools India Private Limited, Mumbai-Pune Road, Dapodi, Pune 411 012 PAN : AAACW4857C	Vs.	ACIT, Circle-10, Pune
Appellant		Respondent

Assessee by	Shri Nikhil Pathak
Revenue by	Shri T. Vijaya Bhaskar Reddy
Date of hearing	26-02-2020
Date of pronouncement	28-02-2020

आदेश / ORDER

PER R.S.SYAL, VP :

This appeal by the assessee arises out of the final assessment order dated 28-11-2016 passed by the Assessing Officer (AO) u/s. 143(3) r.w.s. 144C(13) of the Income-tax Act, 1961 (hereinafter also called 'the Act') in relation to the assessment year 2012-13.

2. The only issue raised in this appeal is against the transfer pricing addition of Rs.1,59,45,450/- made by the AO by treating Arms' Length Price (ALP) of the international transaction of `Payment of Management Services Fees' at Nil.

3. Factual matrix of the case is that the assessee is a domestic company engaged in the business of distribution of cutting and drilling tools. It imported finished goods from overseas Walter group entities for the purpose of resale in India under the brand name of Prototyp and Walter. The assessee filed a return declaring total income of Rs.49,25,610/-. The return was accompanied by Form No. 3CEB containing details of international transactions ranging from Import of finished goods to Commission income and Payment of management services fees etc. The issue involved before us though directly relates to the international transaction of `Payment of management services fees' but also has link with the sole business segment of the assessee enveloping the international transaction of finished goods, which is a separate international transaction. The assessee benchmarked the international transactions of Import of finished goods and Payment of management services fees separately under the Transactional Net Margin Method (TNMM). In the solitary Business (Trading) segment, the assessee computed operating margin of the tested party at 1.03% for benchmarking the transactions of Import of finished goods. Certain comparables were chosen whose mean

margin, without working capital adjustment, was computed at 5.19% and with working capital adjustment at 6.99%. The assessee in its T.P. study report *suo motu* offered a transfer pricing adjustment of Rs.6,07,50,000/- by treating the arm's length margin at 7.00% as against its own margin at 1.03%. In the computation of income, the assessee offered such amount of Rs.6.07 crore and odd as its additional income. In calculating its own margin at 1.03%, the assessee took into consideration all the items of operating revenue and operating expenses from its Profit and loss account including a sum of Rs.1.59 crore, being, Payment of management services fees paid to its Associated Enterprise (AE). The Transfer Pricing Officer (TPO) accepted the international transactions of Import of finished goods, under the Business segment, declared by the assessee (after taking into account the voluntarily offered transfer pricing addition of Rs.6.07 crore) at ALP. He, however, disputed the correctness of the ALP of the international transaction of `Payment of management services fees'. The TPO opined that the assessee did not lead any evidence of availing the management services. He also found certain other inconsistencies in the same and came to the conclusion that ALP of the international transaction of `Payment of management services fees' was Nil. This led to recommending the transfer pricing adjustment of Rs.1.59 crore, which got incorporated in the draft order. The assessee remained unsuccessful before the Dispute Resolution Panel (DRP), which has brought the assessee to the Tribunal against the addition of equivalent amount made by the AO in the final assessment order.

4. We have heard both the sides and gone through the relevant material on record. The business of the assessee mainly consists of Trading of cutting tools. Out of the total revenue from the assessee's Profit and loss account at Rs.101.31 crore, revenue from sale of products stands at Rs.99.30 crore. In addition, the assessee earned commission income of Rs.4.14 lakh @ 10% of the value of sales. The Expense side of the assessee's Profit and loss account records certain operating and non-operating costs. The assessee aggregated Trading of goods and Commission income in the overall Business/Trading segment. Its PLI under the TNMM was calculated at 1.03% at pages 67 and 68 of the Transfer Pricing study report. The assessee having only one business segment, calculated its operating profit at Rs.1.04,63,364/- by considering

all the items of operating revenue and operating expenses from its P&L account including Payment of management services fee at Rs.1.59 crore. This is substantiated from the assessee's Profit and loss account, whose copy is available at page 81 of the paper book. It can be seen there from that the Net profit has been computed at Rs.44.12 lakh. On adding up the amount of non-operating expenses of Rs.60.50 lakh, the figure of operating profit at Rs.1.04 crore is obtained, which matches with the figure as shown in the T.P. Study report for demonstrating the PLI of the assessee at 1.03%. The assessee selected certain comparables with their mean margin at 6.99% (before working capital adjustment) and 5.19% (after working capital adjustment). With the increased unadjusted margin of the comparables at 6.99%, the assessee rounded it to 7.00% and took it as the arm's length margin. The assessee itself offered Rs.6.07 crore for taxation towards the transfer pricing addition. Thus, it is clear that the assessee's own margin (after considering the Payment of management services fees at Rs.1.59 crore) stands at 1.03%, which was taken as a starting point for computing the *suo motu* transfer pricing adjustment with the average margin of comparables at 7.00%.

5. The TPO determined the ALP of the international transaction of Payment of management services fees at Nil. The effect of such determination on the overall profit is that the assessee ought to have shown its income higher to this extent. In other words, in the absence of Payment of management services fee of Rs.1.59 crore, the assessee's profit margin would have increased from 1.03% to 2.66%. As against the variation in the profit margin of the assessee, the margin of comparables is stationary at 7%. If another expenditure of the assessee is held to be not at ALP, it would further increase the amount of income and the consequential profit margin of the assessee beyond 2.66%. With every increase in the margin of the assessee, there will be a southwards sojourn of the difference between the arm's length margin of the comparables at 7% and that of the assessee. To cite an example, if difference between the assessee's margin and that of comparables is, say, X%, and the transfer pricing adjustment comes to Rs. A, then with the reduction in the assessee's deductible expenditure equivalent to Y% (because of ALP adjustment of another transaction) and the corresponding increase in the assessee's margin, the difference in the margins will reduce from X% to X(-)Y% and the amount of

transfer pricing addition will correspondingly reduce from Rs.A to Rs.A (-) equivalent of Y%. With the assessee's margin at 1.03%, in the scenario of no *suo motu* transfer pricing adjustment offered by the assessee coupled with the ALP of management services fees accepted at Rs.1.59 crore and the mean margin of comparables at 7.00%, the transfer pricing adjustment would be equivalent of 5.97% (7.00% – 1.03%). In another scenario of other factors remaining the same but with the ALP of management services fees at Rs.1.59 crore taken at Nil, the profit rate of the assessee will increase from 1.03% to 2.66% requiring the transfer pricing adjustment at equivalent of 4.34% (7.00% - 2.66%). To put it simply, the *suo motu* transfer pricing adjustment of Rs.6.07 crore representing additional profit equivalent of 5.97% (7.00% of comparables minus 1.03% of the assessee with the claim of payment of management services fees), in a sense, consists of two parts, namely, 4.34% towards profit in the international transaction of import of finished goods and 1.63% towards management services fees paid, if the ALP of the latter is to be taken as Nil.

6. One needs to appreciate qualitative difference between two situations viz., the first, in which the assessee itself imports the goods from its AE at such a price coinciding with arm's length margin of 7.00% and the second, in which it imports the goods at a price coinciding with profit at 1.03%, as is the case before us. In normal circumstances, the contention of the assessee for adjusting the surplus amount of profit in the Business/Trading transactions with the transfer pricing adjustment in the international transaction of Payment of management services fees would not have merited acceptance, if it had made transactions of import of finished goods at such a price giving profit at 7.00%. The contention, in that set-up, if accepted, would have amounted to aggregation of two distinct international transactions resulting into cross subsidization, which is a proposition unacceptable in the transfer pricing regime. However, the position which is instantly obtaining before us is that the assessee actually imported goods at such a price which gave it a profit margin of 1.03% after taking the transaction of Payment of management services fees of Rs.1.59 crore at ALP. To make good the deficiency in the actual profit so computed *vis-à-vis* the arm's length profit rate, the assessee offered transfer pricing adjustment

at 5.97%. In case, the assessee had itself taken the ALP of Payment of management services fees at Nil or in other words, not claimed any deduction for it, then the assessee's margin would have swelled from 1.03% to 2.66%. With the ALP margin static at 7.00%, the transfer pricing adjustment would have come down to 4.34% rather than 5.97%. Under these circumstances, when the assessee offered *suo motu* transfer pricing adjustment of Rs.6.07 crore at 5.97%, considering arm's length margin at 7.00%, the same also encompassed the effect of international transaction of Payment of management services fees at ALP. The AO/TPO, in our considered opinion, were not justified in accepting on one hand the transfer pricing adjustment of Rs.6.07 crore in the international transaction of import of goods with the assessee's margin at 1.03% (after the claim of management services fees at 1.59 core at ALP) and simultaneously on the other hand making separate transfer pricing adjustment of Rs.1.59 crore in the international transaction of Payment of management support fees. Such an action has resulted into double disallowance of Rs.1.59 crore, which cannot legally stand.

7. We have noted above that the assessee took arm's length margin at 7.00% on the basis of the unadjusted mean margin of comparables at 6.99%. In fact, it is the working capital adjusted margin, which is normally considered for the purpose. We note that there is a positive difference of 1.80% in the margin of comparables [6.99% (unadjusted margin) of the comparables minus 5.19% (adjusted margin)] between what the assessee has taken as arm's length margin and what ought to have been taken. The amount of transfer pricing adjustment made by the assessee by taking Nil ALP of the international transaction of `Payment of management services fees' at Rs.1.59 crore accounts for only 1.63% [2.66% (margin of the assessee by taking ALP of Management services fee at Rs.1.59 crore) minus 1.03% (margin of the assessee by taking ALP of Management services fee at Nil)]. The amount of transfer pricing adjustment of Rs.1.59 crore, representing 1.63% profit rate, is in any case less than even 1.80%, being, the cushion between the adjusted and unadjusted mean margin of the comparables. On this score alone, there was no reason to go ahead with the transfer pricing addition of Rs.1.59 crore.

8. Without prejudice to the above discussion, we now proceed to examine if the TPO was justified in determining Nil ALP of the international transaction of Payment of management services fees. In this regard, it is observed that the assessee made payment of Rs.1.59 crore towards availing management services pursuant to the Management services Agreement with Sandvik AB. The TPO observed that the expenses were apportioned by Associated Enterprise amongst different country centres on the basis of their Agreement, which did not have any link with the actual services rendered to the individual units. In the absence of availability of any evidence showing availing of the services by the assessee, the TPO determined Nil ALP. The assessee furnished certain details before the DRP proving the availment of the services. Not convinced, the DRP affirmed the order of the lower authorities by primarily recording that there was no evidence of availing the services and further from some evidence filed by the assessee, it was divulged that the services were, in fact, rendered by Walter AB whereas the Agreement for the services was with Sandvik AB.

9. We have heard both the sides and gone through the relevant material on record. It is seen from a copy of Management services Agreement between Sandvik AB (the providing party) and the assessee (the receiving party), which is applicable to the year under consideration as well, that the term `Providing party' has been defined as `all or some of the Sandvik companies which provide management services'. Thus, it is clear that the charges by Sandvik AB were not only for the services provided by it but also some other group companies including Walter AB. The view point of the DRP on this issue is, therefore, not correct.

10. Now we turn to the issue of availing actual services. It is seen from the Agreement that it provides for rendering intra group services consisting of Management services, IT related services, Services primarily aimed at increasing and retaining the value of intangible assets, Sales services and Schedule related service activities. The Agreement provides that there will be no charge for shareholder related activities. We have perused the nature of services received by the assessee, which have been tabulated on pages 521 and 522 of the paper book. There is a detailed description of services in the categories of Pricing and quotation,

Product and proposal, Product related pricing and quotation, Product drawing and pricing, Business promotion and Calculation. Against each of the above categories, there is an elaborate description of the nature of services and the persons/AE providing them. Then there are copies of e-mails from pages 523 to 537 of the paper book which demonstrate that the personnel of the AE rendered services to the assessee, that have been captured in the table given at pages 521 and 522 of the paper book. This shows that not only there was an Agreement between the assessee and its AE for rendering the services but the assessee actually availed the same.

11. Having come to the conclusion that the services were availed by the assessee, the next question is determination of the ALP of the transaction. The ld. AR drew our attention towards the order passed by the Tribunal in the assessee's own case for the immediately preceding assessment year, 2011-12, a copy of which has been placed at page 224 of the paper book. It was shown that in the identical fact situation, the Tribunal has held the transaction of Payment of management services fee at ALP. This factual assertion could not be controverted by the ld. DR. In the absence

of any distinguishing feature in the facts of the immediately preceding year *vis-a-vis* the current year, respectfully following the precedent, we hold the international transaction of Payment of management services fees was at ALP.

12. In the result, the appeal is allowed.

Order pronounced in the Open Court on 28th February, 2020.

Sd/-	Sd/-
(S.S. VISWANETHRA RAVI)	**(R.S.SYAL)**
JUDICIAL MEMBER	**VICE PRESIDENT**

पुणे Pune; दिनांक Dated : 28th February, 2020
सतीश

<u>आदेश की प्रतिलिपि अग्रेषित/Copy of the Order is forwarded to</u>:

1. अपीलार्थी / The Appellant;
2. प्रत्यर्थी / The Respondent;
3. The CIT(A)-13, Pune
4. The Pr. CIT -5, Pune
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, पुणे "**सी**" / DR 'C', ITAT, Pune
6. गार्ड फाईल / Guard file

आदेशानुसार/ BY ORDER,

// True Copy //

Senior Private Secretary
आयकर अपीलीय अधिकरण ,पुणे / ITAT, Pune

		Date	
1.	Draft dictated on	26-02-2020	Sr.PS
2.	Draft placed before author	27-02-2020	Sr.PS
3.	Draft proposed & placed before the second member		JM
4.	Draft discussed/approved by Second Member.		JM
5.	Approved Draft comes to the Sr.PS/PS		Sr.PS
6.	Kept for pronouncement on		Sr.PS
7.	Date of uploading order		Sr.PS
8.	File sent to the Bench Clerk		Sr.PS
9.	Date on which file goes to the Head Clerk		
10.	Date on which file goes to the A.R.		
11.	Date of dispatch of Order.		

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