

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

आयकर अपील सं. / ITA No.1218/PUN/2017
निर्धारण वर्ष / Assessment Year : 2009-10

ACIT, Circle-2, Pune	Vs.	M/s.Nalco Water India Limited, S.No.238/239, 3 rd Floor, Quadra-1, Panchshil, Magarpatta Road, Sade Satra Nali, Pune 411 028 PAN : AAACO4994N
Appellant		Respondent

Assessee by Shri Ketan Ved
Revenue by Shri Jagdish P. Chandraker
Date of hearing 29-09-2021
Date of pronouncement 30-09-2021

आदेश / ORDER

PER R.S.SYAL, VP :

This appeal by the Revenue is directed against the order passed by the Id. CIT(A)-22, Kolkata on 08-02-2017 in relation to the assessment year 2009-10.

2. Ground No.1 raised by the Revenue reads as under :

“ On the facts and circumstances of the case, the CIT(A) has erred on holding that intra group activities performed by NALCO USA under ‘SA’ and by Nalco Pacific under the ‘TAMA’ constitute intra group services and the said activities are not in the nature of stewardship activity”.

3. Briefly stated, the factual matrix of the case is that the assessee is a part of the Nalco group headquartered in the USA. Nalco USA is a leading global provider of water treatment and process

improvement services, chemicals and equipment programs for industrial and institutional applications throughout the world. The assessee is an Indian subsidiary of Nalco, USA. It is primarily into the business of manufacturing and selling speciality chemicals, such as, water treatment chemicals, industrial additives, oilfield chemicals and de-mineralized water. The assessee filed its return declaring total income of Rs.3,42,70,000/-. Two international transactions were reported in Form No. 3CEB. The Assessing Officer (AO) made a reference to the Transfer Pricing Officer (TPO) for determining the Arm's Length Price (ALP) of the international transactions. The international transactions are receipt of Headquarter services from Nalco, USA amounting to Rs.10,21,74,000/- and receipt of Technical Consultancy services from Nalco Pacific Pte Ltd., Singapore amounting to Rs.3,37,87,000/-. In order to demonstrate that the international transactions were at ALP, the assessee applied the Transactional Net Margin Method (TNMM). The TPO observed that the services availed by the assessee were pursuant to two separate agreements viz., one with Nalco Company, USA (Services Agreement or SA) and another with Nalco Pacific Pte Ltd., Singapore (Technical and Management Assistance Agreement or TAMA). The TPO took note of the relevant clauses of the two

Agreements for ascertaining the true nature of services. He show caused the assessee as to why the services, claimed as intra group services, be not treated as stewardship activity carried out by the AEs. The assessee filed exhaustive reply to the TPO's show cause notice, giving details of benefits derived from such services. The TPO countered such reply and held that the services performed by the AEs were in the nature of stewardship activity. In reaching this conclusion, he relied on *DIT(IT) Vs. Morgan Stanley and Company Inc. (2007) 292 ITR 416 (SC)*. The TPO, thereafter, determined Nil ALP of the transactions, which led to proposing transfer pricing adjustment of Rs.13,59,61,000/-. The assessment order was finalized, *inter alia*, with the above transfer pricing addition. The Id. CIT(A) got convinced with the assessee's submissions and held that the services received were not in the nature of stewardship activity. Since the TPO did not apply any particular method for determining the ALP, the Id. CIT(A) held that the ALP determined by the assessee did not warrant any interference. Aggrieved thereby, the Revenue has come up in appeal before the Tribunal.

4. We have heard the rival submissions and gone through the relevant material on record. It is seen that the assessee availed Headquarter services from Nalco, USA under the Service Agreement

and Technical and Management Assistance services from Nalco Pacific Pte Ltd., Singapore under the Technical and Management Assistance Agreement. The assessee aggregated these services and showed them at ALP in its Transfer pricing study report. The TPO came to hold that the nature of services availed by the assessee were stewardship activity and hence, no compensation was required to be paid. The point in controversy is determination of the nature of services availed by the assessee. The Service Agreement entered into with Nalco, USA provides for rendition of Headquarter services. The list of services has been given under Exhibit-A, as reproduced on pages 4 and 5 of the TPO's order. The assessee submitted copious details of the services availed by it from Nalco, USA that have been reproduced on page 29 onwards of the TPO's order, who dealt with the assessee's reply on page 115 onwards of his order.

5. We espouse some of the services on representative basis for ascertaining their true character. The first item is 'Communication Services'. The assessee submitted relevant documents putting forth that the services were in the nature of Translation and Media centre. Benefit derived from such services was also given to be the translation services meant for ethical speaking policy in Chinese language for Asia Pacific region and the back-ups including Policy

procedure; Information on Nalco Group and Nalco, US; and Energy Audits and Technical consumption etc. The TPO gave his remarks that the translation costs cannot be allocated on the basis of region or global sales and further that the contents were general in nature. The next services availed by the assessee from Nalco, USA is 'Energy Services'. The assessee indicated benefit from it to be in the nature of developing growth modifier program which was done in collaboration with Nalco, Russia and helped it in creating overall technical and operational benefit for the manufacturing process. The TPO rejected the assessee's contention by observing that no direct benefit was received. The next service is 'Facilities Management' in respect of which the assessee submitted that it obtained logo files which included specifications of sign types, illumination standards, materials, typography style, viewing angles all of which were vital and formed an integral part of the identification of the Nalco group entities. The assessee further submitted that the said signage was essential and applied by it in its factories and corporate offices which helped in maintaining global image of the company *vis-à-vis* its customers and employees. The TPO again rejected this by observing that it was already covered by separate agreement between the assessee and Nalco, USA. Under the 'Finance Controller Services',

the assessee submitted the benefit of complete document on processes for implementation of Sarbanes Oxley providing for the process scope, process background and the narrative process. It was also emphasized that such services were availed from a perspective of implementation of globally accepted Sarbanes Oxley within the Accounting and Financial system of Nalco India as it gave an edge over its competitors. The TPO rejected this contention by holding that it pertained to creation of accounts and ledger heads. The next service is of 'Human Resources'. The assessee indicated the benefit in the form of document talks explicitly on key facts about the global human resources practice and key benefits derived by various Nalco entities. The policy documents laid down guidelines and rules in relation to prevention of substance abuse by the workers engaged in manufacturing process during the work hours. The policy talked about the referral scheme for employees located anywhere at the global level, wherein monetary reward was given for any referral being a successful hire. The TPO rejected the same by holding that no direct benefit was received by the assessee. The next item is 'Information Technology Services' in respect of which the assessee stated that presentation on the new initiatives taken for implementation of various IT programs was essential for

manufacturing process focused on water, energy and its business units. It also included estimates for supply chain, ERP compliance, finance, automation, HR etc. Such services were for provision of support services in case of troubleshooting. A detailed list of the benefits derived from such services was also given. The TPO again knocked down the assessee's contention by giving identical reasons. Similar is the position about other services for which the assessee gave a detailed account of the benefits derived, all of which were repelled by the TPO with similar reasons.

6. Now we turn to the Second Agreement entered into by the assessee with Nalco Pacific Pte Ltd., Singapore. This Agreement provides that Nalco Pacific Pte Ltd., Singapore would furnish to Nalco India the technical assistance services in the following forms, which are summarized herein for brevity :

- A. Commercial advice and technical assistance on an Asia/Pacific market segment approach to the resolution of industrial problems in such sectors.
- B. Advice and technical assistance in adapting to Nalco India needs the highest technology applied by other Nalco Asia/Pacific group companies.
- C. Providing centralized financial planning services and advice on banking; investments and exchange positions etc.
- D. Advice and assistance regarding budget control systems and procedure, production cost controls, reporting mechanism etc.

E. Advice on the establishment and enhancement of computer systems.

F. Advice and assistance with respect to the production planning of Nalco India.

G. Advice on procurement of raw materials from suppliers in Asia/Pacific in the most efficient and economical manner.

H. Advice on Asia/Pacific risk analysis, Asia/Pacific Insurance protection and Asia/Pacific product liability consideration.

I. Advice and assistance regarding compliance with Asia/Pacific norms for transportation, handling and labeling of products.

J. Advice and assistance on local research goals and planning.

K. Advice regarding handling of hazardous materials and making available expertise in preventing of handling catastrophe situations.

L. Promoting the effective interchange of information and interplay of managers and technicians between Nalco India and the various companies of the Nalco Asia/Pacific group.

7. The assessee elaborated the benefits derived by it from the services rendered by the Nalco Pacific Pte Ltd., Singapore. The TPO has tabulated the benefits claimed to have been derived by the assessee and his Remarks on page 126 onwards of his order. For example, the first category is 'Finance and Accounting'. The assessee gave description of the benefits derived by it from such services in a structured manner catering to Expense claim

Reimbursement system; Cash Collection & Credit Control Training; Expense Reimbursement System; Budgeting process and Timetable; India Business Contract and Tax Training; Training for Asia Pacific Sales Improvement so on and so forth. The assessee substantiated the receipt of such services with the help of corresponding e-mails and other documents. The TPO negated the assessee's contention by simply holding that no direct benefit was received or these were duplicate services. Similar is the position *qua* other services, namely, 'WPS and water services' for which the assessee stated the benefit in the nature of Integrated Water Management Training Workshop; Integrated Water Management Presentation; Cost aspects of various units, Technical Water Treatment Proposal after site visit; Technical Audit report etc. The TPO rejected the assessee's claim again by holding that no direct benefit was received. Similar position prevailed for other services availed by the assessee from Nalco Pacific Pte Ltd., Singapore for which complete details, backed by the corresponding e-mails and other documents, were submitted that have been set out by the TPO in his order in the tabular form. All such contentions did not convince the TPO, who rejected the same by simply holding that no direct benefit was received.

8. On a careful perusal of the services received by the assessee from Nalco, USA and Nalco Pacific Pte Ltd., Singapore, it becomes abundantly clear that the services facilitated the carrying on the business operations by the assessee in a more efficient and effective manner by adhering to the international standards in a globally uniform manner.

9. The moot question is whether the services under consideration are in the nature of stewardship activity as has been held by the TPO or core business intra-group services as claimed by the assessee? In order to appreciate the controversy, it is *sine qua non* to first comprehend the term 'stewardship', which has not been defined either in the Income-tax Act, 1961 or in the Income-tax Rules, 1962. In commercial parlance, stewardship activities are those which are undertaken by an enterprise to protect one's own interest. When Y engages X for rendition of some service, any activity of Y to ensure that the work assigned to X is performed as per its specifications, constitutes a stewardship activity. On the other hand, if an activity/service of the renderer company produces some effect on the recipient company, whether or not resulting into a tangible benefit to the recipient, the same, in our considered opinion, ceases to be a stewardship activity. One of the forms of stewardship activities is a

shareholder activity, which takes place when some act or service is done by a shareholder to the company in order to ensure that his investment in the shares is safe and further such an act or service does not produce any effect to the company receiving it. For example, if company X is a shareholder in company Y and it does some activity to protect its investment therein, and the effect of such an activity is confined to it alone, the same would be construed as shareholder activity. A stewardship activity in general or a shareholder activity in particular in the case of two related companies, is quite different from a normal intra-group service, which is rendered for the purpose of the recipient company. Effect of a non-shareholder activity is rendered to the company receiving it, which is in sharp contrast to the effect being rendered to a company rendering such service in the case of a stewardship or shareholder activity. If we expand the scope of shareholder activity to producing some direct or indirect effect to the recipient company with the consequence of higher profits to it and the resultant higher dividends to the renderer or the shareholder company, then probably most of the activities, including even operational activities, would fall within the sweep of shareholder activity, which is an absurd proposition. In our opinion, stewardship activity or shareholder activity excludes

such activities which produce any effect to the recipient company.

10. It was in 1968 that section 482 regulations of the USA Treasury Regulations on intra-group services provided the first U.S. transfer pricing rules on services. New service regulations were proposed in 2003, which took the form of Temporary regulations in 2006, and eventually Final Regulations for Treatment of Services under Section 482 (USA Regulation 2009) were issued. The final regulations are effective for taxation years beginning after 31.7.2009. It has been mentioned in the 2009 Regulation that: 'Section 1.482-9T(1)(3)(iv) of the 2006 temporary regulations provides that an activity is a shareholder activity if the *sole effect* of that activity is either to protect the renderer's capital investment in the recipient or in other members of the controlled group or to facilitate compliance by the renderer with reporting, legal or regulatory requirements applicable specifically to the renderer, or both.' There was some debate as to whether the '*sole effect*' language should be employed to brand any activity as a shareholder activity or it should be substituted with the '*primary effect*'. In other words, if the primary effect of the activity or service is produced to the renderer company but some incidental effect also flows to the recipient company, then also it should be categorized as shareholder activity. After considering all the

opinions, the Treasury Department and the IRS believed that : *`the “sole effect” language is appropriate.*’ It was noticed that : *`The “primary effect” language in the 2003 proposed regulations could inappropriately include activities that are not true shareholder activities and may even consist of substantial activities that are non-shareholder activities.*’ Thus, it explained: “Shareholder activities. - An activity is not considered to provide a benefit if the *sole effect* of that activity is either to protect the renderer’s capital investment in the recipient or in other members of the controlled group, or to facilitate compliance by the renderer with reporting, legal, or regulatory requirements applicable specifically to the renderer, or both. *Activities in the nature of day to day management generally do not relate to protection of the renderer’s capital investment.*”

Certain examples have been given for ascertaining whether or not an activity is a shareholder activity. Example 13, which is relevant in our context, is - *`Company X establishes detailed personnel policies for its subsidiaries, including Company Y. Company X also reviews and approves the performance appraisals of Company Y’s executives, monitors levels of compensation paid to all Company Y personnel, and is involved in hiring and firing decisions regarding the senior executives of Company Y. Because this personnel-related*

activity by Company X involves day-to-day management of Company Y, this activity does not relate solely to Company X's role as an investor of capital or a shareholder of Company Y, and therefore does not constitute a shareholder activity.' Thus it emerges even from the USA Treasury Regulations that an activity will be considered as a shareholder activity if its '*sole effect*' is either to protect the renderer's capital investment in the recipient etc. or to facilitate compliance by the renderer with its own reporting, legal, or regulatory requirements. It is further manifested that activities in the nature of day to day management cannot be considered as protection of the renderer's capital investment and hence they cease to be stewardship or shareholder activity.

11. We have noticed the description of services performed by Nalco, USA under the broader heads of Insurance & Risk Management; Treasury; Marketing; Credit and Collections; Operations Planning; Supply chain; Procurement; Safety, Health & Environmental; Information Technology; Customer service; Human resources etc. We have also noticed *supra* the portrayal of services performed by Nalco, Singapore under the broader heads of Commercial advice; Advice and technical assistance; Centralized financial planning services; Advice and assistance regarding budget

control systems; Advice on the establishment and enhancement of computer systems; Advice and assistance with respect to the production planning; Advice on procurement of raw materials ; and Advice on Asia/Pacific risk analysis etc. It gets vivid on such a perusal that the services are in the nature of regular business services performed by the group entities with a view to enable the assessee to carry on its business operations, thereby causing effect on it. As such, these do not qualify as `stewardship activities`.

12. It is further relevant to accentuate the definition of `Costs` in the Service Agreement with Nalco, USA, given as per Clause 1(a) to mean “The actual costs incurred by Parent to provide the Services defined herein and the overhead allocated to the Services incurred by Parent, in each case for the relevant calendar years. Actual costs and overhead for this purpose shall not include costs for Stewardship”. On going through the above definition, it becomes obvious that the actual costs incurred by Nalco, USA along with the overhead allocated in the provision of Services have been included in the cost base by expressly providing that “Actual costs and overhead for this purpose shall not include costs for Stewardship”. In other words, the costs incurred by the Parent company in performing stewardship

activities do not form part of the cost base for inclusion in the overall costs in rendition of the services under the Agreement.

13. The TPO relied on the judgment of Hon'ble Supreme Court in the case of *Morgan Stanley and Company (supra)* for bringing home his point of view. The issue in that case was whether the Permanent Establishment of the assessee was created in India? The Hon'ble Apex Court, after answering the question before it, further observed that a person may insist on quality control and confidentiality from the service provider and the service provider may also be required to act according to the quality control specification imposed by its customer. It went on to discuss the nature of stewardship activities to point out that: `Stewardship activities involve briefing of the MSAS staff to ensure that the output meets the requirements of the MSCo. These activities include monitoring of the outsourcing operations at MSAS. The object is to protect the interest of the MSCo. These stewards are not involved in day to day management or in any specific services to be undertaken by MSAS. The stewardship activity is basically to protect the interest of the customer..... In such a case it cannot be said that MSCo has been rendering the services to MSAS. In our view MSCo is merely protecting its own interests in the competitive world by ensuring the quality and confidentiality of

MSAS services'. On going through the decision in *Morgan Stanley (supra)*, it gets graphically clear that the stewardship activities are confined to protecting one's own interest rather than rendering benefit to the other company.

14. Adverting to the facts of the instant case, we observe that the rendition of services by Nalco, USA and Nalco Pacific Pte Ltd., Singapore has given effect only to the assessee and has, in no manner, resulted in protecting the individual interests of such companies. All the services rendered by them facilitated the carrying on of the assessee's business. In such circumstances, we are satisfied that the reliance of the AO on the decision in *Morgan Stanley (supra)* is misconceived. We, therefore, accord our imprimatur to the conclusion drawn by the Id. CIT(A) that the services rendered by the two companies were in the nature of intra group services and not stewardship activity.

15. Ordinarily, after answering the character of the services, the next point would have been to determine the ALP of the intra group services. We have noticed above that the TPO determined Nil ALP by holding that the services provided by Nalco, USA and Nalco Pacific Pte Ltd., Singapore were in the nature of stewardship activity. The Id. CIT(A) overturned the TPO's view on this score

and further held that the transacted value of the intra group services was at ALP, *albeit* without carrying out any analysis. The ground taken by the Revenue, as reproduced above, is confined only to challenging the decision of the Id. CIT(A) in construing the services as intra group services. There is no challenge to the decision of the Id. CIT(A) on the second aspect of the international transaction being at the ALP. We, therefore, refrain from going into the aspect of the ALP determination, for which no ground has been raised. In the ultimate analysis, the ground raised in the appeal is not allowed.

16. The next issue raised in this appeal through ground nos. 2 and 3 is against restricting the disallowance of Travelling and Conveyance to 5%. The facts apropos this ground are that the assessee claimed Travelling expenses amounting to Rs.8,48,41,601/-, which included a sum of Rs.38,67,746/- as reimbursement of Travelling to employees. On being called upon to explain the nature of such reimbursement, the assessee submitted that the expenses incurred by the employees were reimbursed by the company. Following the view taken by him for the immediately preceding assessment year, the AO disallowed Rs.38,67,746/-. The Id. CIT(A) deleted the disallowance by relying on the order passed by him for the earlier year.

17. Having heard both the sides and gone through the relevant material on record, it is observed that the lower authorities have gone with their respective views taken for the immediately preceding year. The matter came up for consideration before the Tribunal for the A.Y. 2008-09. Vide its order (ITA No.2111/Kol/2013) dated 05-04-2017, the Tribunal dismissed the Revenue's ground by holding that the approach adopted by the ld. CIT(A) did not warrant interference. Relevant discussion has been made in para 16 of the order. As the facts and circumstances of this ground are *mutatis mutandis* similar to those of the immediately preceding year, respectfully following the precedent, we uphold the impugned order on this score.

18. In the result, the appeal is dismissed.

Order pronounced in the Open Court on 30th September, 2021.

Sd/-
(S.S. VISWANETHRA RAVI)
JUDICIAL MEMBER

Sd/-
(R.S.SYAL)
VICE PRESIDENT

पुणे Pune; दिनांक Dated : 30th September, 2021
सतीश

आदेश की प्रतिलिपि □ प्रेषित/Copy of the Order is forwarded to:

1. अपीलार्थी / The Appellant;
2. प्रत्यर्थी / The CIT(A)-22, Kolkata
3. The Pr.CIT-4, Kolkata
4. DR, ITAT, 'C' Bench, Pune
5. गार्ड फाईल / Guard file.

आदेशानुसार/ BY ORDER,**// True Copy //**

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

		Date	
1.	Draft dictated on	29-09-2021	Sr.PS
2.	Draft placed before author	30-09-2021	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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