

आयकर अपीलिय अधिकरण, राजकोट न्यायपीठ, राजकोट  
**IN THE INCOME TAX APPELLATE TRIBUNAL  
RAJKOT BENCH, RAJKOT**

*(Conducted Through Virtual Court)*

**BEFORE SMT.ANNAPURNA GUPTA, ACCOUNTANT MEMBER  
AND  
SHRI SIDDHARTHA NAUTIYAL, JUDICIAL MEMBER**

**IT(TP)A No.85& 287/RJT/2017  
Assessment Year :2012-13 and 2013-14**

Ahlstrom Fiber Composites India Pvt. Ltd. Mundra SEZ Integrated Textile & Apparel Park (MITA), Plot No.7 Survey No141, Mundra Kutch-370 421.Gujarat PAN : AAGCA 90137 M	Vs.	ACIT, "Aayakar Bhavan" Gandhidham Circle Gandhidham.
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**IT(TP)A No.97/RJT/2016  
Assessment Year :2011-12**

Ahlstrom Fiber Composites India Pvt. Ltd. Mundra SEZ Integrated Textile & Apparel Park (MITA), Gujarat PAN : AAGCA 90137 M	Vs.	ACIT, "Aayakar Bhavan" Gandhidham Circle Gandhidham.
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<b>अपीलार्थी/ (Appellant)</b>		<b>प्रत्यर्थी/(Respondent)</b>
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Assessee by :	Shri S.N. Soparkar, Id.AR
Revenue by :	Shri Shramdeep Sinha, Id.CIT-DR

सुनवाई की तारीख/**Date of Hearing** : **05/07/2023**  
घोषणा की तारीख /**Date of Pronouncement**: **03/08/2023**

**आदेश/O R D E R**

**PER ANNAPURNA GUPTA, ACCOUNTANT MEMBER**

These three appeals have been filed by the assessee against separate orders passed by the Assessing Officer under section 143(3)

read with section 144C(13) of the Income Tax Act, 1961 ("the Act" for short) pertaining to Asst.Year 2011-12, 2012-13 and 2013-14. Since identical issues are involved in these appeals, they are disposed of by this common order for the sake of convenience.

2. It was common ground that the issues involved in all the appeals was identical. All the appeals were therefore taken up for hearing together and are being disposed off by this common consolidated order.

3. We shall be dealing with the issues in the context of facts relating to the Asst.Year 2011-12 in ITA No.97/RJT/2016 and our decision rendered will apply *pari passu* to the rest of the appeals.

#### **ITA No.97/RJT/2016 Asst.Year 2011-12**

4. Ground no.1 raised by the assessee reads as under:

*“Ground No. i: Transfer Pricing adjustment in relation to international transaction of sales to Associated Enterprises*

*1.1. On the facts and in the circumstances of the case and in law, the Learned Income-tax Officer, Deputy Commissioner of Income Tax-Gandhidham Circle, Gandhidham (Ld. AO) under the directions of Honourable Dispute Resolution Panel (Hon'ble DRP), erred in making an upward adjustment of Rs.15,83,20,738/- in relation to the international transaction of sales to Associated Enterprises (AEs).*

*1.2. On the facts and in the circumstances of the case and in law, the Ld. AO and the Learned Additional Commissioner of Income-tax, Transfer Pricing Officer - i (Ld. TPO) erred in rejecting the audited segmental financials of the Appellant, thereby ignoring the internal AE and Non AE segment comparison.*

*1.3. On the facts and in the circumstances of the case and in law, the Ld. AO/TPO erred in rejecting cost plus method (CPM) adopted by the Appellant and selecting Transactional Net Margin Method (TNMM) as the most appropriate method to determine the Arm's Length Price of the transaction of sale of goods to AEs.*

*1.4. Without prejudice, the Ld. TPO erred in selecting certain functionally dissimilar companies as comparable to benchmark the international transaction of sales of goods to AEs under TNMM approach.*

*The Appellant prays that the addition made by the Ld. AO / TPO in relation to the international transaction of sales to AE be deleted.*

5. As is evident from the above, the issue in the above grounds relates to transfer pricing adjustment made in relation to the international transaction of sales made by the assessee with its Associate Enterprise (AEs).

6. Brief background of the case is that the assessee, M/s Ahlstrom Fiber Composites India Pvt. Ltd. (AFCIPL), was incorporated in 2008 and is a subsidiary of Ahlstrom Corporation, Finland. The assessee is engaged in the production of variety of non-woven fabrics. It started commercial production from April 5, 2010 and the Asst. Year 2011-12, the impugned year before us, was the first year of production of the assessee. During the impugned year, due to certain technical issues, it could not manufacture the desired products, being anti-static/alcohol repellent treated advanced non-woven, and therefore in order to utilize its large production capacity, the assessee produced certain untreated intermediate products i.e. SS/SSM untreated non-woven fabrics, some of which were sold to its Associate Enterprise (AE). Besides sale of the goods, several other international transactions were entered into with its AEs as listed at para-3 of the TPO's order as under:

S. No.	Description of the transactions	Amount (Rs.)
1	Sale of finished goods	531,137,045
2	Reimbursement of Bank guarantee commission	11,229,897
3	Payment of Business area service fee	9,741,600
4	Reimbursement of Freight expenses	7,614,536
5	Payment of royalty	4,867,500
6	Payment of Management fee	4,025,611
7	Payment of Network service fee	2,276,772
8	Receipt of Software Support	1,382,629
9	Reimbursement of Software license cost	621,846
10	Payment of Comfort letter fee	107,379
11	Reimbursement of Travelling expenses	53,704
12	Payment of Guarantee fee	35,747
13	Reimbursement of Travelling expenses	29,538

7. During assessment proceedings, reference was made by the AO under section 92CA(3) to the Transfer Pricing Officer (TPO) to determine the Arms Length Price (ALP) of the international transactions. The TPO, in his order passed dated 22.1.2015, made no adverse inference with respect to ALP of all other international transactions except that relating to the sale of finished goods to AE.

8. The assessee had benchmarked the said international transaction using Cost Plus Method (CPM) and taking its own segmental data of exports to AE and non-AE segments, treating the non-AE segment as an internal comparable, the assessee had demonstrated that its markup to cost in the AE segment, at 9.84%, exceeded that of its internal comparable non-AE segment, at (-) 9.37%, thus demonstrating that its international transaction of sales to its AE was at ALP. The TPO rejected the segmental accounts of the assessee and also the CPM method selected as the Most Appropriate Method (MAM) for benchmarking the transactions and treating Transactional Net Margin Method (TNMM) as the MAM, he selected comparables and determined their average margin of operating profit to operating cost, OP/OC, at 5.41%. Applying this to the proportionate operating cost of the AE segment of the assessee, he determined ALP of the sales made to the AE at Rs.68,94,57,783/- as opposed to Rs.53,11,37,045/- shown by the assessee; resulting in proposed adjustment of Rs.15,893,20,738/ on account of determination of ALP of the international transactions of sales. The assessee objected to the aforesaid proposed adjustment before the DRP who dismissed all the objections of the assessee, and accordingly, the adjustment of Rs.15.83 crores was made to the international transaction of sales, in the order passed under section 143(3) of the Act.

9. During the course of arguments before us, the ld.counsel of the assessee began by challenging rejection of the segmental accounts of the assessee by the TPO. His contentions before us were to the effect that by virtue of segmental accounts the assessee had taken an internal comparable for the CPM selected by it for benchmarking international transaction and that the ld.TPO had rejected the segmental accounts on frivolous basis, without pointing out any specific defect in the same. That further the DRP had failed to adjudicate the objections of the assessee before it in this regard. He drew our attention to the show cause notice issued by the TPO during TP proceedings, reproduced at page no.3 of the order of the TPO, pointing out therefrom the basis with the TPO for rejecting the segmental accounts of the assessee as being;

- i) That as per the Notes to Accounts to the audited accounts of the assessee, there were no primary reportable segments;
- ii) That despite the same, the assessee had submitted segmental accounts in relation to its export and domestic segments, with the exports segment being further bifurcated into AE and non-AE segment. That these segmental accounts were verified by Chartered Accountants, who had not prepared the audited accounts of the assessee.

Our attention was drawn to the show cause notice, bringing out the above at para 4-1 of the order as under:

3. (i) As per Note-15 to the accounts, the company has determined its business segment as non woven fabrics. Since 100% of the company business is from non woven fabrics there are no other primary reportable segments.

(ii) However for the purpose of benchmarking International transactions the taxpayer has submitted following segmentals.

<i>Export</i>		<i>Domestic</i>
<i>AE</i>	<i>NonAE</i>	

*The taxpayer was requested to submit basis of segmental account along with supporting documentary evidence vide order sheet entry dated 21.11.2014. The taxpayer merely submitted copy of segmentals verified by M/s Mukund and Rohit Chartered Accountants who incidentally did not prepare the audited accounts of the taxpayer. The audited accounts which were prepared by M/s. A. Aneja and Company. The taxpayer did not file any documentary evidence to corroborate the segmentals furnished by it. The segmental filed by the taxpayer are therefore rejected.”*

10. He thereafter drew our attention to the reply of the assessee, pointing out that the segmental analysis was done based on actual/ allocation keys and was further reviewed by the independent auditors. The submission of the assessee to this are reproduced at para 4.2 of the order. He thereafter drew our attention to the finding of the TPO while rejecting the assessee's contentions contained in para 8, wherein he pointed out that TPO had reiterated the basis mentioned in his show cause notice for rejecting the segmental accounts, as audited accounts mentioning no segment and segmental data having been audited by CAs who had not audited the final accounts. The ld.counsel for the assessee pointed out that without going into the basis of preparation of the segmental accounts, which the assessee had reiterated had been prepared based on actual allocation keys, the TPO had summarily rejected the same merely on frivolous basis. He contended that for the purpose of reporting in the audited annual accounts the segments identified are totally different; that Accounting standard prescribed by the Institute of Chartered accountants of India for reporting on segments, Accounting Standard -17(AS-17), requires reporting of financial information or result about different types of products and services that the concerned business segment produces which includes the different geographical areas of business operation. This being the criteria since the assessee produced only one product, there was no requirement of furnishing any segmental data as per the AS-17 in the audited accounts; but for the purpose of benchmarking of international transaction on sales, the assessee

had got the segmental accounts prepared with the respect to the AE and non-AE segments of export sales undertaken by it, thus creating data relating to an internal comparable. He therefore stated that the mere fact that the segmental accounts were not reported in its audited balance sheet and /or were audited by some other Cas who were not auditors of the assessee company, made no difference nor had any effect on the veracity of segmental accounts. He therefore stated that TPO had given no cogent reason for rejecting the assessee's segmental accounts.

11. To this, the Id.DR countered by stating that segmental accounts prepared by the assessee were not reliable since they reflected huge difference between the profits of the AE export segments and the non-AE export segments which was as high as 19.21%; that segmental analysis by the assessee was cryptic and there was no notes or explanation to justify allocation of expenditure between two segments nor any material was produced before the TPO; that even *prima facie*, it was evident from a very simple test applied to these segmental analysis that it was not based on any logical reasoning. Submissions in writing, dated 5.1.2023, to this effect were submitted by the Id.DR before us. In the written submission, the Id.DR had produced a chart to justify his contention that the allocation key adopted by the assessee for preparing segmental data was not uniform.

12. At this juncture, agreeing with the Ld.Counsel for the assessee that the basis of rejecting the segmental accounts by the TPO was totally frivolous and agreeing with him that what mattered for accepting these accounts was whether they had been prepared on a just and reasonable basis and noting the fact that the assessee had not been given an opportunity to submit its justification for the basis of preparation of its segmental accounts, nor was it examined

by the TPO on this basis, it was considered fit to restore the issue to the AO/TPO to examine the basis of preparing segmental accounts by the assessee. Both the parties fairly agreed with the same.

13. Since the entire basis of the TPO for rejecting benchmarking analysis done by the assessee and proposing the adjustment to the international transactions of sale by adopting TNMM method, began with the rejection of the segmental accounts of the assessee, we deem it fit to restore this issue to the file of the TPO. The entire issue relating to the determination of ALP of international transaction of the sale is restored back to the TPO, to be determined afresh after first dealing with the aspect of justifiability of segmental data submitted by the assessee along with the MAM adopted by it for determining the ALP of the transaction. Needless to add the assessee be provided due opportunity of hearing in this regard.

In view of the above, ground no.1 raised by the assessee is allowed for statistical purposes.

14. Ground no.2 raised by the assessee reads as under:

*“2.1 On the facts and in the circumstances of the case and in law, the Ld. AO under the directions of Hon'ble DRP, erred in disallowing payment of Management fees, SAP and Opti-mill fees and Business Area Service fees amounting to Rs.1,60,83,722/- by concluding that the expenses are not incurred wholly and exclusively for the purpose of business. While making the addition, the Ld. AO erred in law and on facts on the following:*

- i. in stating that services are not rendered for all the months;*
- ii. in correlating the payment of management charges with the sales/production;*
- iii. in stating that the agreement is one sided and is only taking care of Ahlstrom Non-woven LLC;*
- iv. in questioning the business requirement of the services;*
- v. in stating that the payment mechanism is nothing but a mere revenue sharing agreement with the group entities and*
- vi. in stating that services paid for do not provide any benefit or provide benefit that are duplicative in nature.*

2.2 On the facts and in the circumstances of the case and in law, the Ld. AO under the directions of Hon'ble DRP, erred in not appreciating the observation of the Ld. TPO that no adverse inference have been drawn for the international transactions of Management fees and Business Area Service Fees.

*The Appellant prays that the additions made by the Ld. AO in relation to the disallowance of Management fees, SAP and Opti-mill fees and Business Area Service fees be deleted."*

15. The facts relating to the issue are that expenditure amounting in all to Rs.1,60,83,722/- incurred on account of the following were disallowed under section 37(1) of the Act:

i)	Management fees	:	Rs.40,25,611/-
ii)	SAP & Opti-mill service fee	:	Rs.13,82,629/-
iii)	Business Area Service	:	<u>Rs.97,41,600-</u>
	Total	:	Rs.1,60,83,722/-

16. All the above were paid to the assessee's group concern, M/s Ahlstrom Corporation and were paid as management fees. Disallowance was proposed by the AO in his draft order holding that it was not incurred wholly and exclusively for the purpose of business of the assessee on finding that the assessee failed to establish business necessity for incurring the expenses. The assessee's objection before the DRP to this proposed addition was dismissed by the DRP, and accordingly, the disallowances of the aforesaid expenses were made by the AO in his order passed u/s 143(3) of the Act.

17. During the course of hearing before us, the ld.counsel for the assessee drew our attention to the order of the DRP dismissing the assessee's objections to the proposed disallowance of the impugned expenses from page no.16 to 19 of the order as under:

**5.10 Ground of objection 10**

" on the facts and circumstances of the case and in law, the Ld. erred in proposing to disallow management charges of Rs.1,60,83,722 comprising of corporate management fees of Rs.40,25,611, SAP & Opti-mill service fee of Rs.13,82,629 and Business Area Service ('BAS') fee of Rs.87,41,600 by considering it as."

- a) not incurred wholly & exclusively for the purpose of business;
- b) a mere revenue sharing agreement with the group concern in proposing this addition, the Ld.AO has erred in law and on facts on the following:
  - in stating that services are not rendered for all the months;
  - in correlating the payment of management charges with the sales/production;
  - in stating that the agreement is one sided and is only taking care of Ahlstrom Non-woven LLC;
  - in questioning the business requirement of the services;
  - in stating that the payment mechanism is nothing but a mere revenue sharing agreement with the group entities;

**DRP adjudication Ground No.10**

Management fees has been paid as per Agreement dated 01 January 2010 based on intra group Services arrangement where under Ahlstrom Corporation allocated actual cost along with a 10% mark-up to subsidiaries for management and advisory services in the field of human resource, legal risk management, finance, purchase, sustainability, etc.

SAP and Optimill service charges have been paid vide agreement dated 01 January 2010 to Ahlstrom Corporation for receiving software support w.r.t. SAP and Optimill business IT system (Inventory Management Software) which to is allocated to all group companies based on as mark-up of 10% of the actual expenditure incurred by it and allocated to all the group companies of the basis of their net sales.

Business area service fee for sharing costs and benefits of the joint management and advisory function of this business area vide agreement dated 01 January 2010 required that the actual direct and indirect cost are allocated to the companies based on the business areas external net sales.

The assessing officer has given detailed arguments at para 5.3 to 5.7. The AO has pointed out that the services have not been consistently rendered from month to month, and that the nature of benefits derived from the services received is not clear since the taxpayer is in a position to perform most of these services for itself. In these circumstances the AO has held the necessity of the services and connection with business and benefit thereto is not proved.

Delhi High Court in *Cushman and Wakefield (India) Pvt Ltd 367 ITR 730*, has explained in similar circumstances that expenses are disallowable u/s 37(1) is not having been incurred wholly and exclusively for the purpose of business, in similar circumstances benchmarking of Intra Group Services at NIL has also been upheld by Courts and Tribunals and the following extract from OECD guidelines is elucidatory.

Extract from OECD Transfer pricing guidelines for Multinational Enterprises and Tax Administrations 2010

**B.1 Determining whether Intra-group services have been rendered**

7.6 "..... economic or commercial value to enhance its commercial position. This can be determined by considering whether on independent enterprise in comparable circumstances would have been willing to pay for the activity if performed for it by an independent enterprise or would have performed the activity in-house for itself. If the activity is not one for which the independent enterprise would have been willing to pay or perform for itself, the activity ordinarily should not be considered as an intra-group service the arm's length principle."

The OECD Transfer Pricing guidelines further elaborate the benefit test to provide that the arm's length price of services in nature of (i) shareholder services, (ii) duplicative service, (iii) services providing incidental benefits and (iv) passive benefits would be nil. Thus documentation of intra-Group Services is vitally import to allow the tax authorities to satisfy themselves about the nature and genuineness of intra-group services.

The benefit test is now well recognized and well accepted. It is accepted that benefits from intra-group services must be sufficiently direct and substantial, so that an independent entity in similar circumstances, would be prepared to pay for it. If no benefit have been provided then the services cannot be charged for. in respect of furnishing documentation, similarly Generic explanations have been provided. Mere explanations in generic terms about the benefits are inadequate for allowability as held in several rulings of Tribunals. DRP has made an attempt to examine the jurisprudence on the subject, and a collation of decisions on the subject, albeit in the context of transfer pricing but wherein the applicability of the basic reasoning and rationale for admissibility is relevant to the present case are provided for ready reference.

Name of case	Ratio of decision
Gemplus India Pvt. Ltd. 2010-TII-55-ITAT-BANG-TP	<p><b>Sufficient Evidence of costs involved and services actually rendered should be provided.</b></p> <p>Taxpayer was unable to establish before TPO that payments were made commensurate to volume and quality of services provided and since no details were available on record i.r.o payments to Singapore affiliate TPO was justified in holding that taxpayer had not prove commensurate benefits against payments of service charges and making an ALP adjustment.</p>
Knorr Bremse India Pvt. Ltd. 2012-TII-138-ITAT-DEL-TP	<p><b>Incidental benefit to taxpayer does not require any payment to AE</b></p> <p>Emails and other contemporaneous record revealed that incidental and passive association benefit had been provided by the AE and thus ITAT held that TPO had rightly adopted nil value for benchmarking ALP.</p>
CIT Vs. Cushman and Wake filed India P Ltd. 2014-TII-07-HC-DEL-TP	<p><b>Reimbursement for services on cost basis also require benchmarking</b></p> <p>This being a transaction between related parties, since taxpayer did not benchmark these costs in its TP study, benchmarking is required under comprehensive transfer pricing analysis.</p>
Cranes Software International Ltd. TS-353-ITAT- 2014 (BANG)-TP	<p><b>Sufficient Evidence of costs involved and services as actually rendered should be provided.</b></p> <p>Taxpayer failed to maintain documentation, or benchmark services received from AE-ITAT held that the Court had to go into substance and not be satisfied with form. The taxpayer had failed to show that any services had been received from sister concerns and when no services were received then lower authority were justified in considering ALP to be zero.</p>
Festo Controls Pvt. Ltd. Vs. DCIT (2013) 30 taxman.com 16 (BANG-TRIB)	<p><b>Sufficient Evidence of costs involved and services actually rendered should be provided</b></p> <p>The assessee is also required to prove that the benefit derived from the services received is of a more than just remote or indirect benefit.</p>
Deloitte Consulting India (P) Ltd Vs. DY.CIT/ITO(2012)22 taxman.com 107/137 ITD 21/19 ITR (TRIB)378/150 TTJ 824 (MUM).	<p><b>Sufficient Evidence of costs involved and services actually rendered should be provided</b></p> <p>ITAT held ALP rightly determined at nil since assessee had not furnish evidence to prove that three personnel had rendered marketing services to company having derived tangible benefit from the expenditure was not substantiated with evidence; unlikely</p>
Invensys Systems Inc, in re[2009] 183 Taxman 81(AAR New Delhi)	<p><b>Does not preclude enquiry that Cost allocation/contribution should be at ALP,</b></p> <p>Rulings indirectly support the proposition that stewardship or shareholder activities do not involve an element of service so as to commercially and economically benefit the recipient i.e. the Indian company.</p>
ABB Ltd. In re [2010] 189 Taxman 422 (AAR New Delhi)	

*The TPO has marshaled considerable material after studying the agreements and examining the invoices. The taxpayer has been allowed adequate opportunity to place of record tangible evidence to prove that benefit was received from services rendered, and that these were necessary, not in the not duplicative. But Taxpayer failed to discharge the onus of providing this. On similar facts, and again in the case of a transfer pricing case, in the recent case of **Bombardier Transport India P. Ltd Vs. DCIT**, dt 4 November 2015, Tribunal has held confirming DRP and TPOs orders that,*

**Extract from *Bombardier Transport India P. Ltd Vs. DCIT***

*" From the review of the services and benefit report and the supporting documents submitted by the Assessee company, it can be seen that the assessee company benefited from the supervision and guidance of the group's functional experts which help the Assessee company in efficiently carrying its business operation by leveraging on group synergies. In this regard, the Assessee company has attached as Annexure-2 to the synopsis submitted at the time of hearing, brief overview on the various intra-group services received by it during the year from the various Hub divisions and from the Group entities which were substantiated and validated by the intercompany service agreements entered into by the assessee company with its Associated Enterprises' (AEs) along with various documentary evidences submitted before the Ld. TPO and the Ld. DRP, The said Annexure provides the resultant benefits derived by the Assessee company by availing the intra-group service, Though, the said Annexure-it show that the Assessee company was benefitted significantly from the intra-group services received from its AEs, it failed to give the supporting evidence such as invoice, confirmation from parties to prove the same. The assessee company has also undertaken a detailed cost benefit analysis in order to demonstrate the cost savings achieved by the Assessee company by availing the said services from the AEs. Therefore, when AEs transact with each other, for the purpose of transfer pricing they must replicate the dynamics of market forces, as there is no concept of free lunch in business dealings. Thus, Ld. DRP rightly held that the benefit test which is well recognized by OECD and other developed countries Tax regime have to be seen for allowing the payment in case of intra Group Services. The expected benefit must be sufficiently direct and substantial so that an independent entity in similar circumstance, would be prepared to pay for it. If no benefits have been provided (or was expected to be provided), then the services cannot be charged for. Since the assessee just explained in generic nature about the benefits vis-à-vis the intra-group services payment to its AEs, therefore, we uphold the orders of Ld.DRP and Ld.TPO".*

*Perusal of the above will show that the Tribunal has affirmed that the benefit test is well recognized and that the expected benefits from intra group services must be sufficiently direct and substantial, so that an independent entity in similar circumstances, would be prepared to pay for it. if no benefits have been provided or these are duplicative then the services cannot be charges for, and mere explanations in generic terms about the benefits are inadequate for allow ability. Taxpayer has failed to discharge the onus of proving both issues. In light of the fact and support from judicial decisions supra, the objections of the taxpayer are rejected and the AOs order is approved. The disallowance toward Intra-group Services is thus justified and is upheld. It is reiterated that the Hon'ble Delhi High Court in *Cushman and Wakefiled (India) Pvt. Ltd.* 367 ITR 730, has explained that the expenses are disallowance u/s 37(1) as not having been incurred wholly and exclusively for the purpose of business. The AO has correctly disallowed the expenditure u/s 37(1) in respect of management charges of Rs.1,60,83,722 comprising of corporate management fees of Rs.40,25,611, SAP & Opti-mill service fee of Rs.13,82,629 and Business Area Service ('BAS') fee of Rs.97,41,600. The AOs order is approved.*

18. Referring to the same, he pointed out that the DRP in substance had agreed with the finding of the AO that since the assessee had failed to establish the necessity for availing services in connection with the expenses incurred and benefit thereto was not proved, therefore, the expenses were liable to be disallowed under

section 37(1) of the Act. He pointed out that the DRP had relied on various case laws in support of his finding as above.

19. The ld.counsel for the assessee argued that the finding of the DRP in this regard were not in accordance with law. His contention primarily was to the effect that –

- i) Nature of services received by virtue of incurrance of these expenses was established by the assessee, and factum of receipt of services was not doubted by the AO nor was the fact that the services were rendered for the purpose of business;
- ii) For the purpose of making disallowance under section 37(1) of the Act, the necessity of incurring of expenses is not required to be established, and as long as expenses were incurred for the purpose of business, and as long commercial expediency for incurring expense was established, which was to be determined from the stand point of the assessee, the disallowance could not made under section37(1) of the Act;
- iii) In any case, the TPO had made no adverse inference with regard to the ALP of the transactions, therefore, the AO could not have made any disallowance under section 37(1) of the Act.

20. With regard to his contention on the nature of services received by virtue of these expenses being established to the AO, he drew our attention to the facts noted by the DRP in its order as reproduced above vis-à-vis these expenses, and pointed out that the payment for management fee and SAP & Opti-mill service charges had been made in lieu of agreement entered into by the assessee with M/s Ahlstrom Corporation dated 1.1.2001 for intra-group Service arrangement for management and advisory services in the field of human resource, IT, legal, risk management, finance, etc and for receiving software support with respect to SAP and Opti-mill business IT system (inventory management software) . That the

charges were based on actual cost incurred by Ahlstrom Corporation plus markup of 10%; that these services were rendered to all group companies; that the business area service fee was incurred for sharing costs and benefits of the joint management and advisory function of the business area in which the assessee operated i.e. food and medical business area. The business area team with the Ahlstrom Group from time to time rendered certain functions like management, advisory functions and some other services, which were required by the assessee and the actual direct and relevant indirect costs of the business area were allocated to the companies belonging to the business area based on each company's share of the business area's external net sales. The ld.counsel for the assessee pointed out from the draft order of the AO and that of the DRP also the factum of rendering of services by the group companies was never doubted and the disallowance hinged only on the finding that the assessee was unable to establish the necessity for availing these services or benefit that accrued to it. The ld.counsel for the assessee pointed out that the AO arrived at this finding of no necessity for incurring the expenses noting, from the details of the payment of management charges made during the year furnished by the assessee, that the services were not rendered for all the months of the year, and were rendered only for fourth quarter 2010 and first quarter of 2011. From the same, the AO inferred that there were periods during which all activities of the assessee had been carried out even without services for which a sum of Rs.1.60 crores was paid. He pointed out from the details of sales made in each quarter, which showed an increasing trend, the AO questioned the assessee as to why only the services were required in the last two quarters. The ld.counsel for the assessee contended that the doubts raised by the AO in his draft order were clarified pointing out that the services were actually rendered for the

entire year, but the group company had waived off charges for the first two quarters as a matter of business prudence and in support of this contention an illustrative chart reflecting management services rendered for the first two quarters of the year were also filed. He also pointed out that it was explained to the DRP that no services were availed by the assessee from the group concern in relation to routine business activities to run business operation and the services received had no direct linkage to the sales or the revenue, and therefore, insistence on benefit accrued to the assessee on account of incurrance of expenses was demonstrated to be misplaced.

21. The ld.counsel for the assessee further pointed out the finding of the AO that the expenses incurred under the head “management charges” could not be stated to be wholly and exclusively for the purpose of business, since in addition to these expenses, the assessee had incurred office expenses, misc. expenses was also demonstrated to the DRP to be misplaced. He contended that it was pointed out to the DRP that payment for management services rendered by the Ahlstrom Corporation was completely different from the administrative expenses incurred by the assessee under the head “office expenses” and “Misc. Expenses”, pointing out that office expenses included expenditure incurred on account of purchases of office consumables, cleaning, books & periodicals etc. whereas management charges were for general management, business development, financial advisory services etc. He drew our attention to the submissions explaining anomaly pointed out to the DRP from para 4.8.22 to 4.8.32 and 4.8.43 as under:

*“4.8.22 Ld. AO in the order has mentioned that the services are not rendered for all the months. All the invoices have been raised in the third and fourth quarter of FY 2010-11. This shows that the activities of the Assessee can be carried out even without these services. In arriving at this conclusion, the Ld. AO*

*has correlated the sales of the first two quarters with the sales of the last two quarters.*

- 4.8.23 *In this connection, the Assessee wishes to submit that the contention of the Ld. AO that the services were received only in the third and fourth quarter of FY 2010-11 and not in the first two quarters is incorrect.*
- 4-8.24 *Merely because invoices were raised only in the last two quarters, does not necessarily mean that the services were not required/provided. The Assessee has received the services from the group companies for the entire year. However, as a matter of business jurisprudence, the Group Company waived off the charge for the first two quarters of FY 2010-11 on the Assessee.*
- 4.8.25 *It was only from the third quarter of the financial year 2010-11 that the Group Companies started charging the management expenses to the Assessee.*
- 4.8.26 *In support of this contention, the Assessee wishes to submit the e-mail correspondence reflecting the waiver of management charges for the first two quarters of FY 2010-11.*

*[Please refer to Page No. 369 to 370 of the Paper Book]*

- 4.8.27 *From the above, it is amply clear that the argument of the Ld. AO that the services were received only in some months of the year and hence it shows that they were not necessarily required is incorrect.*
- i. *"Expenditure is not in direct relation to the revenue of the business"*
- 4.8.28 *Management fees relate to expenses pertaining to business operations of the Assessee and relates to various day to day routine business activities to run business operations.*
- 4.8.29 *These are in nature of routine business operations and administrative expenses which do not have direct linkage to the sales revenue of the Assessee.*
- 4.8.30 *All the expenses are for business purposes and are neither capital nor personal in nature.*
- 4.8.31 *No adverse inference for the international transactions of management fees has been made by Ld. TPO in the TP assessment order dated 27 January 2015.*
- 4.8.32 *Use of Software support services (SAP and opti-mill) does not relate to / has nothing to do with the revenue of business. It is incurred as and when required and has no nexus with earning of revenue.*
- iii. *"Requirement of services vis-a-vis business not proved and payment is mere revenue sharing arrangement with the Group Concern"*

22. He further contended that in various judgments it has been laid down that for expenses incurred relating to the business of the assessee, the assessee cannot be questioned on the purpose for incurrence of such expenses, that whether any expenses are

required or not is a matter of business prudence. In this regard, he drew our attention to the following decisions:

- i) *Atherton Vs. British Insulated & Helsby Cables Ltd., (1925) 10 TC 155;*
- ii) *Eastern Investments Ltd. Vs. CIT (1951) 20 ITR 1 (SC)*
- iii) *CIT Vs. Microsoft Corporation of India P.Ltd., (2008) 220 CTR 410 (Delhi);*
- iv) *Ravi Marketing P.Ltd. Vs. CIT (2006) 280 ITR 519 (Cal);*
- v) *Sassoon J. David & Co. P.Ltd. Vs. CIT (1979) 1 taxman 485 (SC);*
- vi) *Jamna Auto industries Vs. CIT, (2008) 167 TAXMAN 192 (P&H HC)*

Finally, he contended that the TPO had categorically held that no adverse inference was to be drawn with regard to other international transactions entered into by the assessee which included the present intra-group services arranged including payment for management fees, SAP and Opti-mill expenses and the business area service expenditure.

23. The ld.DR, on the other hand, relied on the order of the AO/DRP.

24. We have carefully heard contentions of both the parties and gone through orders of the AO and the DRP, and we find merit in the contention made by the ld.counsel for the assessee. Before us, the issue relates to disallowance of intra-group service expenses incurred by the assessee amounting in all to Rs.1.60 crores, the details of which find mention in the earlier part of our order. The fact that these expenses qualified as international transactions and were accepted to be at ALP by the TPO is not disputed. The said facts emanate from the order of the TPO who categorically states

that no adverse inference can be drawn with respect to this transaction. The Id.Departmental Representative also does not contradict this fact. These expenses have been disallowed under section 37(1) of the Act and held not to have been incurred wholly and exclusively for the purpose of the business of the assessee. The reason being that the assessee was unable to establish the business necessity for incurring these expenses and also demonstrating benefit derived by the assessee from the same. The factum of incurrance of expenses by the assessee and the fact of service having rendered by the group concern i.e. Ahlstrom Corporation to the assessee have not been disputed.

25. In the light of the above facts, we are in agreement with the Id.counsel for the assessee that the said expenses could not be held as not having been incurred wholly and exclusively for the purpose of business of the assessee. As rightly pointed out by the Id.counsel for the assessee, there are several judgments including that of Apex Court laying down the principle to be applied for determining allowability of expenses under section 37(1) of the Act and this principle have emerged over years by virtue of judicial interpretation of expression “wholly and exclusively” for the purpose of business appearing in section 37(1) of the Act. Broadly, the principle laid down are –

- i. the term “wholly and exclusively” for the purpose of business is of a wider import, wider than the expression “for the purpose of earning profit”;
- ii. expenses are allowable under section 37(1) of the Act if it is commercially expedient; and
- iii. the expenses should be commercially expedient from the perspective of a prudent businessman and not from the point of view of Revenue.

It is enough to show that money is expended, not out of necessity and with a view to a direct and immediate benefit, but voluntarily on account of commercial expediency, and in order indirectly facilitate the carrying on of business.

- iv. Lastly, it is not necessary to show that the expenditure was profitable one and in fact it earned any profit.

26. On the touch-stone of jurisprudence regarding interpretation of the term “wholly and exclusively” for the purpose of business, we find that no case has been made out by the Revenue showing that the assessee does not fulfill the required parameter to qualify for deduction under section 37(1) of the Act. The only basis being that the assessee was unable to establish necessity of incurring the expenses and benefit accrued to it, which has been outrightly ruled out by Courts for establishing commercial expediency of incurrence of the expenditure, the basis with Revenue authorities therefore for disallowing the impugned expenditure of Rs.1.60 crores in the present case is found to be not in accordance with law.

27. Even otherwise, we have noted from the order of the DRP that it has heavily relied on OECD commentary and various case laws for emphasizing the establishment of necessity of incurring expenses for their allowability u/s 37(1) of the Act, which decisions/commentary we find have been rendered in the context of the determination of ALP of transaction by the TPO, wherein on finding, the assessee failing to qualify the benefit test, it was held that the ALP in such circumstances of international transactions could be treated as NIL. All the case laws and even OECD commentary relied upon by the DRP while upholding the order of the AO on the issue are in the context of determination of ALP of international transaction entered into with the associated enterprise. In the present case, the TPO in his order clearly found the impugned transaction to be at ALP. The TPO being an officer specially

designated for the purpose of determining ALP of international transactions officer and finding the transaction to be at ALP there is no question of the AO thereafter stepping into the shoes of the TPO, applying benefit test to the expenditure incurred, and disallow the expenses u/s 37(1) of the Act for failure to fulfil the said test. The scope of powers of the TPO and that of the AO are completely different. The TPO being a specialized officer for determining the ALP of international transactions, his finding on this aspect of the international transactions are to be treated as final. Once the TPO has given his finding on the issue of determination of ALP of international transactions entered into by the assessee, they are to be accepted by the AO and cannot be inquired into by the AO further. In the present case, the AO, by applying benefit test to the impugned international transaction has attempted to step into the shoes of TPO, since the benefit test could have been applied only for the purpose of determining ALP of the transaction as pointed out by the DRP also from the OECD commentary and from the various decision of the ITAT on this issue. Therefore also, disallowance made by the AO on the impugned expenses amounting to Rs.1.60 crores is held to be not sustainable in law, and directed to be deleted.

Ground no.2 raised by the assessee is allowed.

28. Ground no.3 reads as under:

**Ground No. 3: Disallowance on reimbursement of Bank guarantee commission**

3.1 On the facts and in the circumstances of the case and in law, the Ld. AO under the directions of Hon'ble DRP, erred in disallowing amount paid towards reimbursement of Bank guarantee commission amounting to Rs. 1,12,29,8977- u/s. 37(1) by holding it to be a prior period expense.

3.2 On the facts and in the circumstances of the case and in law, the Ld. AO under the directions of Hon'ble DRP, erred in disallowing amount paid towards reimbursement of Bank guarantee commission amounting to Rs. 1,12,29,8977- u/s. 40a(i). While doing so, he erred in the following:

- i. in concluding that Pohjola Bank has an Agency Permanent Establishment ('PE') in India and accordingly tax was deductible at source on reimbursement of bank guarantee commission considering it as taxable under Article 7 ("Business Income"); and*
- ii. in concluding that bank guarantee fees would get covered under Article 21 ("Other Income") of India-Finland DTAA and should be taxable in India and accordingly tax was deductible at source.*

29. The issue raised in the above grounds relates to disallowance of bank guarantee commission paid by the assessee amounting to Rs.1,12,29,897/-. The facts relating to the issue are that the assessee had paid a sum of Rs.1,12,29,897/- towards bank guarantee commission to its related party, Ahlstrom Corporation, Finland. The same was paid by the assessee as reimbursement of bank guarantee commission. The facts leading to the reimbursement of bank guarantee commission to Ahlstrom Corporation, Finland, being that the assessee had entered into an agreement with ICICI Bank Ltd. for a term loan facility of Rs.171.50 crores on 6.5.2009. As a condition to availing the facility, Pohjola Bank Plc, Finland, had issued a bank guarantee to the tune of 25 million EURO as a security for performance of the company obligation under the aforementioned term loan agreement. Pohjola Bank Plc charged Ahlstrom Corporation, Finland for the commission cost and expenses relating to the guarantee which Ahlstrom Corporation, Finland re-invoiced to the assessee, in terms of an agreement for reimbursement of guarantee expense entered into between the assessee and Ahlstrom Corporation, Finland. The bank guarantee commission therefore paid by the assessee to its related entity was claimed as reimbursement of such expenses charged by Pohjola Bank Plc without any mark-up.

30. The AO in his draft order proposed a disallowance of this expense for two alternate reasons viz. that since it related to prior period, it is disallowable under section 37(1) of the Act;

alternatively, the AO held that the commission expenses were liable to withholding tax in India, since as per the AO, Pohjola Bank Plc had business connection/ permanent establishment(PE) in India in terms of section 9(1)(1) read with explanation 1(a), explanation 2 and 2<sup>nd</sup> proviso to the Act, as also, in terms of Article 5 of Double Taxation Avoidance Agreement between the India and Finland. He further stated that it was liable to TDS in terms of section 195 of the Act also and since no tax had been deducted at source, he held the expenses liable to be disallowed in terms of section 40(a)(i) of the Act.

The assessee objected to the disallowance before the DRP who upheld the disallowance proposed by the AO, applying section 37(1) of the Act and also section 40(a)(ia) of the Act for the purpose of holding that the assessee was liable to withhold the tax in terms of Treaty with Finland. The DRP took a different view as opposed to that taken by the AO holding that the impugned amount qualified as Other Income liable to withholding tax in India in terms of Article 21 of the Treaty with Finland in the source country. The relevant finding of the DRP in this regard at page no.22 of the order is as under:

**2.10 Ground of objection 11**

*"On the facts and circumstances of the case and in law, the Ld. AO erred in proposing to disallow reimbursement of bank guarantee commission amounting to Rs. 1,12,29,897 paid to Ahlstrom Corporation. In proposing this disallowance, the Ld. AO has erred in law and on facts on the following:"*

- *in concluding that bank guarantee commission is a prior period expense and not allowable under section 37(1) of the Act;*
- *in concluding that Pohjola Bank has an Agency Permanent Establishment ("PE") in India and accordingly tax was deductible at source on reimbursement of bank guarantee commission.*

**DRP adjudication Ground No 11**

The Ahlstrom Corporation has entered into an Agreement dated 26 November 2009 with ICICI Bank for term loan facility of Rs 171.5 crore on 6 May 2009. Pohjola Bank PLC has issued a Bank guarantee of Rs 25 Million Euro as a security for performance of the companies obligation under the aforementioned term loan facility for which it charges Ahlstrom Corporation and Ahlstrom Corporation reinvoices taxpayer. During the year taxpayer has reimbursed Ahlstrom Corporation Rs 11229897/-under the said Agreement. The assessing officer has taken up several arguments.

The short point here is that no TDS has been effected on bank guarantee charges paid by the taxpayer to Alstrom corporation since the taxpayers submission is that under India Finland treaty definition of Interest/ FTS does not cover the item of income, and thus TDS was not warranted and the disallowance u/s 40a(i) of the Income Tax Act is not warranted.

The DRP has examined the agreement and also the India Finland DTC. While the definition of interest in the India-Finland DTC and the Act in section 2(28A) in our opinion when read with Circular 202 of 1976 of CBDT does not cover corporate guarantee, the sum is covered under Article 21 of India Finland Treaty. A Bank guarantee or the corporate guarantee enables the subsidiary to avail of the higher credit rating of the AE and obtain a lower interest rate and sometimes obtain a loan where otherwise it may not have been able to get one without the benefit of the surety of the AE. While the definition in section 2(28A) does not cover corporate guarantee recharge and Bank guarantee recharge, on the facts of this case, the Circular 202 Of 1976 dated 5.07.1976 having been issued to explain the extension of the definition to cover fees in the nature of commitment charges on un-utilised portion of credit facilities. However It is pertinent to point out that in other similarly worded articles of interest, for example in Treaties, like the USA, as the extract hereunder from US-MTC Technical Explanation will show, guarantee fees paid within an inter-company group would be covered by the "Other Income" Article ie the Article similar to Article 21 of the US treaties ie Article 21 of the India Finland DTC as extract below will show from the US MTC Technical explanation, that typically deals with income not covered in other articles.

#### US - MTC TECHNICAL EXPLANATION 2006

##### ARTICLE 21 OTHER INCOME

*Article 21 generally assigns taxing jurisdiction over income not dealt with in the other articles (Articles 6 through 20) of the Convention to the State of residence of the beneficial owner of the income. In order for an item of income to be "dealt with" in another article it must be the type of income described in the article and, in most cases, it must have its source in a Contracting State. For example, all royalty income that arises in a Contracting State and that is beneficially owned by a resident of the other Contracting State is "dealt with" in Article 12 (Royalties). However, profits derived in the conduct of a business are "dealt with" in Article 7 (Business Profits) whether or not they have their source in one of the Contracting States.*

*Examples of items of income covered by Article 21 include income from gambling, punitive (but not compensatory) damages and covenants not to compete. The article would also apply to income from a variety of financial transactions, where such income does not arise in the course of the conduct of a trade or business. For example, income from notional principal contracts and other derivatives would fall within Article 21 if derived by persons not engaged in the trade or business of dealing in such instruments, unless such instruments were being used to hedge risks arising in a trade or business. It would also apply to securities lending fees derived by an institutional investor. Further, in most cases guarantee fees paid within an inter-company group would be covered by Article 21, unless the guarantor were engaged in the business of providing such guarantees to unrelated parties.*

In view of the foregoing discussion, bank guarantee fees paid by the taxpayer would go to Article 21, of

India Finland Treaty ie "Other Income" being an article of income not dealt with in the foregoing articles of this convention and arising in the other contracting state which may be taxed in that state.

Now as to characterisation and how the aforesaid item of income would be taxed domestically, said income is taxable as "income from other sources" @ 40% plus surcharge and cess. Therefore the assessing officer was correct in holding that the bank guarantee commission should have been subject to withholding u/s 195 as it is a sum chargeable to tax as "income from other sources" on source basis in India. Tax not having been deducted, the taxpayer has committed a default, warranting a disallowance within the purview of section 40a(i) of the Income Tax Act 1961. Thus on a careful consideration of the facts of this case, the DRP approves the AOs draft order.

On similar grounds as the above, since the nature of the fees involved is similar to bank guarantee commission discussed supra, the DRP also examined the payment of Comfort letter fee to Ahlstrom Corporation of Rs 1073794/- and Guarantee fee of Rs 31747 on which TDS had apparently not been effected. On similar lines as discussed supra these should have been subject to withholding u/s 195 and as discussed supra being sums chargeable to tax. Tax not having been deducted, the taxpayer had committed a default warranting disallowance u/s 40a(i) of the Income Tax Act 1961. Vide order sheet noting dated 28<sup>th</sup> December 2015, the default was pointed out to taxpayer. Should the above result in an enhancement of income appropos income proposed in the draft order, this is within the statutory powers of the DRP u/s 144C(8). As explained supra, the taxpayer was allowed opportunity per requirements of natural justice. **The AO is directed to make the disallowance accordingly and examine this for penalty.**

Alternatively the addition is also approved on the arguments advanced by the assessing officer for detailed and comprehensive reasons holding the bank guarantee commission to be prior period expenses not allowable u/s 37(1) of the Act. The objections of taxpayer are rejected and AOs order is approved.

31. Before us, ld.counsel for the assessee pointed out that the finding of the DRP in this regard were in total disregard to the arguments and contentions made by the ld.counsel for the assessee before it. He contended that it had been demonstrated to the DRP that the impugned expenses could not be categorized as prior period expenses, as pointing out that they related to the commission paid for the impugned year evidenced with bills/invoices issued by the Ahlstrom Corporation, Finland to the assessee, demonstrating the said facts and that in any case, since the invoices were raised on the assessee during the impugned year itself, the liability for the expenses had crystalised during the impugned year, and therefore,

could not be treated as prior period expenses. Our attention was drawn to the submissions made before the DRP in this regard as under:

- 4.9.24 At the outset, the Assessee wishes to submit that the contention of the Ld. AO that the expenditure pertains to earlier year is not correct. In this connection, we wish to bring to your notice, copies of invoices raised by Ahlstrom Corporation on the Assessee pursuant to the agreement between the Assessee and Ahlstrom Corporation. It is clearly evident from the invoices that the expenditure pertains to FY 2010-11 and as per the mercantile system of accounting followed by the Assessee, the same have been booked as expense in FY 2010-11.
- 4.9.25 Further, the Ld. AO has not provided any evidence in support of his contention that the expenditure relates to FY 2009-10 and not FY 2010-11.
- 4.9.26 Ahlstrom Corporation raises separate invoice for each bank guarantee commission to the Assessee on a quarterly basis. The period to which it pertains is clearly mentioned in the invoice/s. Thus, the liability of the Assessee crystallises as soon as it receives the invoice from Ahlstrom Corporation.
- 4.9.27 Further, not only Ahlstrom Corporation has raised the said invoices in the said period i.e, FY 2010-11, but also Pohjola Bank Plc. has raised the same during the FY 2010-11.
- 4.9.28 Further, we would like to bring to the notice of Hon'ble DRP the Guarantee Expenses Re-invoicing Agreement entered on 26 November 2009. **[Please refer Page No. 335 to 337 of Paper Book]**. In the agreement it is clearly mentioned that Ahlstrom Corporation would immediately raise an invoice on the Assessee, when Ahlstrom Corporation has been raised an invoice from Pohjola Bank Plc. for such guarantee commission. The above mentioned condition in the agreement is the trigger clause for raising of such invoice. Accordingly, when Ahlstrom Corporation was invoiced and made liable to pay such guarantee commission, it had raised such invoice on the Assessee and held the Assessee liable for such guarantee commission. The Assessee then on mercantile system had booked such expenses in its books and reimbursed the said expenses during the FY 2010-11. Accordingly, the reimbursement of such expenses pertains to FY 2010-11 and does not amount to prior period expense. In support of its contention, the Assessee wishes to place on record the invoices received from Ahlstrom Corporation along with the invoice(s) raised by Pohjola Bank Plc. on Ahlstrom Corporation **[Please refer Page No. 371 to 378 of Paper Book]**. It is evident

from the said invoices that Ahlstrom Corporation has raised invoice on the Assessee within a very short period of time on receipt of the invoice from Pohjola Bank Plc.

- 4.9.29 For the sake of argument, one can possibly argue that the Assessee would have contemplated the said expenses as of the relevant period i.e, FY 2010-11 by raising invoices from the Associated Enterprise ('AE') during the relevant FY. However, Assessee has no control on the party outside its group i.e, Pohjola Bank Plc. and as evident from the invoices of Pohjola Bank Plc. the said expense pertains to the relevant FY only and accordingly the contention of the Ld. AO that the expenditure is accrued in FY 2009-10 does not hold good/water.
- 4.9.30 Further, the Ld. AO has blindly taken note of some of the extracts of the Tax Audit Report for the FY 2010-11 and has on its own assumed that the Assessee would not have booked the guarantee commission related to FY 2009-10 during FY 2009-10 and would have delayed booking of the said expenses till FY 2010-11 (the year in which commercial production commenced). On the contrary, Assessee has booked the guarantee commission pertaining to FY 2009-10 in FY 2009-10 and has capitalised the same in its books of accounts.
- 4.9.31 Without prejudice, the Assessee was subject to Statutory and Tax audit during the said FY 2010-11. Statutory and tax auditors both are liable to specifically report for prior period expense, if they come across such prior period expense during their audit procedures. However, both of the auditors have not qualified their audit reports in the said manner and accordingly the said guarantee commission expense relate to the said FY 2010-11 only and Ld. AO has erred in contending the same as prior period expense.
- 4.9.32 The Ld. AO while passing draft order has relied on the below mentioned judgements:
- a) Seshasayee Bros (Travancore) (P) Ltd. vs. CIT (*supra*)
  - b) Mysore Spinning & Manufacturing Co. Ltd. vs. CIT (*supra*)
  - c) Tara Agency vs. CIT (*supra*)
- All the above judgements relied by the Ld. AO discusses non-allowability of prior period expense. In the instant case, the Assessee had paid bank guarantee commission to Ahlstrom Corporation pursuant to an agreement. Chargeability of bank guarantee commission would trigger when Ahlstrom Corporation has been raised with an invoice from Pohjola Bank Plc.
- 4.9.33 Since the expenses has been crystallised and booked in the said relevant period in the books of accounts by the Assessee, question of categorising the said expense as prior period expense does not arise. Accordingly, the case laws relied upon by the Ld. AO are distinguishable from the facts of the case at hand and cannot be relied upon in the instant case.
- 4.9.34 Further the Ld. AO has erred by contending that bank guarantee commission is incurred before setting up of a business and hence it is to be treated as a part of the capital expenditure. The Ld. AO has relied on the below mentioned judgement for the said contention:
- a) Hotel Broadway Complex v. CIT (*supra*)
  - b) S.P.B. Bank Ltd. v. CIT (*supra*)
  - c) Perfect pottery Co. Ltd. v. CIT (*supra*)
  - d) Rani J. Sarala Devi v. CIT (*supra*)
- 4.9.35 The assessee has commenced its operation from 5 April 2010, the same has been accepted by the Ld. AO. Further, Ahlstrom Corporation has charged bank guarantee commission for the FY 2010-11, which relates to the period after commencement of business. Accordingly, the

case laws relied upon by the Ld. AO is not applicable to the case of the Assessee and are distinguishable from the facts of the case at hand.

- 4.9.36 Without prejudice, even if the argument of the Ld. AO that the expense pertains to prior year i.e FY 2009-10 is considered, the liability of the same crystallised in the FY 2010-11, on receipt of invoice from Ahlstrom Corporation. This argument of the assessee is supported by **Gujarat High Court** judgment in the case of **Saurashtra Cement & Chemical Industries Ltd. V. CIT [(1995) 80 Taxman 61 (Guj HC)]**, wherein the court has held as under:

*“Merely because an expense relates to a transaction of an earlier year it does not become a liability payable in the earlier year unless it can be said that the liability was determined and crystallized in the year in question on the basis of maintaining accounts on the mercantile basis. In each case where the accounts are maintained on mercantile basis, it has to be found in respect of any claim whether such liability was crystallized and quantified during the previous year as required to be adjusted in the books of account of that previous year. If any liability, though relating to the earlier year, depends upon making a demand and its acceptance by the assessee and such liability has been actually claimed and paid in the later previous years, it cannot be disallowed as deduction merely on the basis that accounts are maintained on mercantile basis and that it relates to a transaction of the previous year. The true profit and gain of a previous year are required to be computed for the purpose of determining tax liability. The basis of taxing income is accrual of income as well as actual receipt. If for want of necessary material crystallizing the expenditure is not in existence in respect of which such income or expenses relates, the mercantile system does not call for an adjustment in the books of account on estimate basis. It is actually known income or expenses, right to receive or liability to pay which has come to be crystallized is to be taken into account under mercantile system of maintaining books of account. An estimated income or liability, which is yet to be crystallized, can only be adjusted as contingency item but not as an accrued income or liability of that year.”*

**[Please refer to Page No. 702 to 706 of the Paper Book]**

- ii. Failure to deduct tax at source on guarantee commission as per the provisions of Section 40(a)(i) read with Section 195 read with Section 9(1)(i) of the Act.**

32. He further drew our attention to the order of the DRP pointing out that the DRP had not even dealt with submissions made by the assessee before it.

33. On the issue of disallowance of bank guarantee commission expenses made under section 37(1) of the Act, we have heard both the parties and also gone through orders of the DRP/AO, and we find merit in the contentions of the assessee that the DRP has upheld the findings of the AO in the draft order that the impugned expenses were disallowable as prior period expenses without taking note of the submissions of the assessee before it. A bare perusal of the submissions made by the assessee before the DRP coupled with the evidence filed to the DRP which was also placed before us in PB, reveals the assessee had sufficiently demonstrated that the

impugned expenses were not prior period expenses, but pertained to the impugned year itself. The assessee had filed copies of invoices raised by the Ahlstrom Corporation, Finland for the bank guarantee commission which described the alleged prior period commission expenses raised as pertaining to the impugned year. Even otherwise, we find that the invoices were raised by the Ahlstrom Corporation, Finland on the assessee during the impugned year itself. These facts are all evident from the copies of invoices which were placed before us also in the paper book at page no. There is no *iota* of doubt, therefore, that the expenses pertained to the impugned year alone and could not be categorized as prior period expenses. We have noted that basis for the AO for treating it as prior period expenses was that the loan agreement entered into by the assessee with the ICICI Bank, which was guaranteed by Pohjola Bank Plc., and commission expenses reimbursed from the assessee to the Ahlstrom Corporation, Finland, was dated 8.5.2009. From the same, we deduced that the bank guarantee commission pertained to the financial year 2009-10 relating to the Asst. Year 2010-11, the preceding year. The assessee has sufficiently demonstrated before us that the invoices were raised during the year by Ahlstrom Corporation, Finland on the issue and related to the bank guarantee commission for the impugned year alone. In view of the same, we have no hesitation in holding that the bank guarantee expenses paid by the assessee pertained to the impugned year, and could not be disallowed as prior period expenses under section 37(1) of the Act. The order of the DRP/ AO holding so, is accordingly set aside.

34. We take up now the alternate reason for disallowing bank guarantee expenses, as being disallowable in terms of section 40(a)(i) of the Act for non-deduction of tax at source. As is evident

from the order of the DRP reproduced above, the assessee was held liable to withhold the tax on the impugned payment in terms of Article 21 of the DTAA entered into with Finland. The Article 21 is reproduced hereunder:

“ARTICLE 21  
OTHER INCOME

*1. Items of income of a resident of a Contracting State, wherever arising, not dealt with in the foregoing Articles of this Agreement shall be taxable only in that State.*

*2. The provisions of paragraph 1 shall not apply to income, other than income from immovable property as defined in paragraph 2 of Article 6, if the recipient of such income, being a resident of a Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the income is paid is effectively connected with such permanent establishment or fixed base. In such case the provisions of Article 7 or Article 14, as the case may be, shall apply.*

*3. Notwithstanding the provisions of paragraphs 1 and 2 of this Article, items of income of a resident of a Contracting State not dealt with in the foregoing Articles of this Agreement and arising in the other Contracting State may be taxed in that other State.”*

35. The contention of the Ld.Counsel for the assessee was that extensive arguments were made to the DRP against the applicability of Article 21 of the DTAA between India and Finland which were not even considered by the DRP.Ld.Counsel for the assessee drew our attention to the arguments made which were to the following effect and are reproduced in the submissions made to the DRP–

- (i) DRP has relied on the US Model Tax Convention 2006 (US-MTC) in order to conclude that to the transaction of bank guarantee commission Article 21 applied, which is applicable only in cases where one of the contracting States to the DTTA is USA, while in the present case the other contracting state is Finland and the India Finland DTAA applies.

- (ii) that even otherwise as per the US-MTC applied by the DRP, it dealt with the situation where bank guarantee commission is paid within intra-company group. In the present case, the said transaction is between the Ahlstrom Corporation, Finland and Pohjola Bank Plc which are unrelated party, and therefore, even as per the US-MTC, Article 21 is not attracted to the bank guarantee commission paid, and
- (iii) assuming bank guarantee to be covered under Article 21 of the India Finland DTTA, the same be taxed in India as other income under section 56(1) of the Act and in terms of the same expenses incurred for earning income as per the section 57 of the Act are to be allowed, which in the present case would result in NIL income to Ahlstrom Corporation, Finland, since it is a case of pure reimbursement with no mark-up.
- (iv) Even otherwise, in terms of section 195 of the Act, since reimbursement of expenses is without any mark-up, the provisions of section 195 cannot be invoked in the absence of any amount chargeable to tax in terms of provision of the Act.
- (v) On account of non-discriminatory clause of India-Finland DTAA, in the context of the section 40(a)(ia) of the Act, no disallowance can be made of the impugned amount. Article 23(3) of the India-Finland DTAA was invoked by the Id.counsel for the assessee pointing out that as per the Article 23(3) of the said DTAA, interest, royalty and other disbursements paid by an enterprise of a Contracting State (India) to the resident of other

Contracting State (Finland), shall for the purpose of determining the taxable profits of such enterprise, be deductible under the same condition, as if they had been paid to a resident of the first mentioned State and considered from this aspect, if the commission payment by the assessee to the Ahlstrom Corporation, Finland is to be treated as that paid to an Indian entity, then for non-deduction of TDS on the said payment, no disallowance under the applicable section 40(a)(ia) of the Act is attracted, since the term "commission" mentioned in section 40(a)(ia) is to be read in only the context of commission paid on sales and does not include bank guarantee commission. For this purpose, reliance was placed on the decision of Mumbai Tribunal in the case of Kotak Securities Vs. DCIT, ITA No.6657/Mum/2011. In view of the same, since if the impugned payment of bank guarantee were to be treated as having paid to resident, no disallowance under the provision of the Act were attracted. Applying non-discriminatory clause of the India-Finland DTAA no disallowance could be made for non-deduction of tax at source to the resident-recipient.

36. Ld.Counsel for the assessee pointed out that despite exhaustive contentions raised by the assessee against the applicability of Article 21 of the DTAA between India and Finland to the transaction of reimbursement of Bank guarantee commission, the DRP held Article 21 applicable without dealing with the contentions of the assessee.

37. Ld.DR fairly agreed with the same. He agreed that the issue needed reconsideration by the AO.

In view of the same, the issue of disallowance of bank guarantee commission is restored back to the AO to be dealt with after considering the arguments raised by the assessee. The AO is directed to pass a speaking order after granting due opportunity of hearing to the assessee.

Ground No.3 is allowed for statistical purposes.

38. In effect appeal of the assessee is allowed for statistical purposes.

37. As far as other appeals of the assessee for the Asst.Year 2012-13 and 2013-14 are concerned, as stated in the aforementioned para-2, the grounds and issues raised in these appeals are identically worded except variation in the quantum, and for the reasons, observations and findings given by us in the ITA No.97/RJT/2016 for Asst.Year 2011-12, appeals for the Asst.Year 2012-13 and 2013-14 are allowed for statistical purposes.

38. In the result, the appeals of the assessee are allowed for statistical purposes.

**Order pronounced in the Court on 3<sup>rd</sup> August, 2023 at Ahmedabad.**

*Sd/-*  
**(SIDDHARTHA NAUTIYAL)**  
**JUDICIAL MEMBER**

*Sd/-*  
**(ANNAPURNA GUPTA)**  
**ACCOUNTANT MEMBER**

Ahmedabad, dated 03/08/2023

*vk\**