

IN THE INCOME TAX APPELLATE TRIBUNAL
“A” BENCH : BANGALORE

BEFORE SHRI SUNIL KUMAR YADAV, JUDICIAL MEMBER
AND SHRI S. JAYARAMAN, ACCOUNTANT MEMBER

IT(TP)A No.1192/Bang/2011
Assessment year : 2007-08

DMG Mori Seiki India Machines and Services Pvt. Ltd., [Erstwhile DMG Deckel Maho Gildemeister (India) Pvt. Ltd.], No.3/1, 3 rd Main Road, KIADB, Peenya 1 st Stage, Bangalore – 560 058. PAN: AABCD 0003E	Vs.	The Deputy Commissioner of Income Tax, Circle 11(1), Bangalore.
APPELLANT		RESPONDENT

Appellant by	:	Shri Vikram Vijayaraghavan, Advocate
Respondent by	:	Shri Kamaladhar, Standing Counsel

Date of hearing	:	19.10.2016
Date of Pronouncement	:	26.10.2016

ORDER

Per Sunil Kumar Yadav, Judicial Member

This appeal is preferred by the assessee against the order of
DRP/AO *inter alia* on various grounds, which are as under:-

“The grounds stated hereunder are independent of, and without prejudice to one another. The Appellant submits as under:

- 1 Assessment and reference to Transfer Pricing Officer are bad in law**

- a) The order issued by the Deputy Commissioner of Income-tax - Circle 11(1) ['AO'], is bad on facts and in law and is in violation of the principles of natural justice.

Without prejudice to the to the generality of the above, the order issued by the AO is bad in law insofar as the fact that the AO did not issue to DMG Mori Seiki India Machines and Services Private Ltd ('the Appellant or 'the Company'), a show cause notice as per proviso to section 92C(3) of the Income-tax Act, 1961 ['the Act'].

- b) The AO has erred in law in making a reference to the Assistant Commissioner of Income-tax (Transfer Pricing) - I ['TPO'], *inter alia*, since he has not recorded an opinion that any of the conditions in section 92C(3) of the Act, were satisfied in the instant case. The AO also erred in not following the provision contained in section 92CA(I) of the Act.

2 The TPO has erred in justifying the motive of shifting of profits

- a) On the facts and in the circumstances of the case and in law, the learned TPO erred in not demonstrating that the motive of the Appellant was to shift profits outside India by manipulating the prices charged in the international transaction, which is a pre-requisite condition to make any adjustment under the provision of Chapter X of the Act.

3 Determination of arm's length price of 'management fee'

- a) The AO/TPO erred on facts in determining the arm's length price of management fees as 'Nil'. in substitution to the arm's length price determined by the Appellant.
- b) The AO/TPO erred on facts in concluding that the Appellant did not derive any commercial benefit from such services.
- c) The AO/TPO erred on facts in not appreciating that the net margin of the Appellant after considering the payment of management fee is more than the arithmetical mean of the net

margins of the comparable companies.

- d) The AO/TPO erred on facts in not giving cognisance to the back-up documents and supporting papers in relation to the management fees, before arriving at an arm's length price of the management fees.

4 Rejection of the most appropriate method applied by the Appellant

- a) On the facts and in the circumstances of the case and in law, the learned AO/TPO erred in disregarding the benchmarking analysis and comparable transactions selected by the Appellant in the transfer pricing study report maintained as per section 92D of the Act read with Rule 10D of the Income-tax Rules, 1962 ['the Rules'].
- b) The AO/TPO erred on facts and in law in rejecting one method ['TNMM'] and selecting another method ['CUP'] as the most appropriate method without providing reasons to the Appellant for rejecting the method adopted by the Appellant.
- c) On the facts and in the circumstances of the case, the learned AO/TPO erred in law in concluding that payment of management fee is a separate segment.

5 Variation of 5% from the arithmetic mean

The AO/TPO erred in law in not granting the benefits of proviso to section 92C(2) of the Act available to the Appellant.

6 Interest under section 234B of the Act

- a) The learned AO has erred in levying interest under section 234B of the Act amounting to Rs 7,689,648.
- b) The learned AO has erred in levying excess interest under section 234B of the Act amounting to Rs 428,855.

7 Interest under section 234D of the Act

The learned AO has erred in levying interest under section 234D of the Act amounting to Rs 14,240.

8 Penalty under section 271(I)(c)

The learned AO has erred in initiating penalty proceedings under section 271 (I)(c) of the Act.

9 Relief

- a) The Appellant prays that Directions be given to grant all such relief arising from the above grounds and also all relief consequential thereto.
- b) The Appellant craves leave to add to or alter, by deletion, substitution, modification or otherwise, the above grounds of appeal, either before or during the hearing of the appeal.
- c) Further, the Appellant prays that the adjustment in relation to Transfer Pricing matters made by the Learned AOITPO and upheld by Honourable DRP is bad in law and is liable to be deleted.”

2. Though various grounds are raised by the assessee, but the main controversy revolves with regard to payment of management fee at arm's length price (“ALP”) by the assessee to its AE on account of management services rendered by the AE.

3. The facts in brief borne out from the record are that assessee was incorporated in India on 31.3.1999. It is a wholly owned subsidiary of DMG Vertriebs und Service GmbH, Germany [hereinafter referred to as “DMG Germany”]. During the relevant previous year, the assessee has entered into following international transactions with DMG Germany (the Associated Enterprise or AE).

Particulars	Amount
Import of spares and tools	1,55,86,880/-
Purchase of alignment carbon, tools, digital spirit level and accessories	2,06,829/-
Commission for providing marketing services – machines	8,54,62,930/-
Income from warranty services	3,64,87,879/-
Management fees	3,64,87,879
Reimbursement of expenses (Receivables)	10,06,662/-
Retention money payable on behalf of Indian customer to AE	2,99,446/-
Reimbursement of expense (Payable)	5,97,276/-
Unearned commission & accrued commission for installation, training any other services	2,65,37,548/-

4. The AO referred these international transactions reported by the assessee in the audit report u/s. 92E filed along with the return of income for the impugned assessment year to the TPO for determination of ALP u/s. 92CA. While examining justification in payment of management fees at arm's length price, the TPO has observed that the assessee started operations in India way back in 1999 and since then the assessee did not pay any management fees till FY 2005-06. This is the first year the assessee paid an amount of Rs.3,64,87,879 as management fees to its AE. In the FYs 2004-05 & 2005-06, no management fees was paid by the assessee to its AE. The TPO did not find payment of management fees at arm's length price and therefore the TPO in his order proposed an adjustment of Rs.3,64,87,879. The AO accordingly incorporated this adjustment in the draft assessment order against which the assessee preferred an application before the Dispute Resolution Panel (DRP).

5. Before the DRP, the assessee has made detailed submissions which was summarized by the DRP at page Nos.13 to 15 of its order and for the sake of reference, we extract the same as under:-

“International Transactions

During the previous year relevant to AY 2007-08, [i.e. FY 2006-07], the Assessee had *inter alia*, paid an amount of Rs.36,487,879 to its AEs for availing the management support services.

Comparability Analysis

For the purpose of determining the arm's length price of the aforesaid international transaction, the Assessee had used the *Prowess* database to conduct a search for comparable companies. The Assessee used the TNMM as the most appropriate method with a PLI of OPM.

Based on the comparability analysis, the arithmetical mean of the OPM margins of the comparable companies was 9.58% vis-a-vis 10.05% earned by DMG India. Since the net profit margin of DMG India (**after considering the payment of management fees**), was higher than that of comparable companies, it was concluded that the international transaction relating to the market-support services are at arm's length.

Facts submitted for Management Fees

For the payment of management fees" DMG India entered into a cost allocation agreement with regard to the provision of management support services availed from DMG GmbH. As per the agreement, DMG GmbH shall provide "*General services and Specific services*".

The Assessee in the paper book filed before the DRP along with form 35A has given the description of the nature of management services availed from the AE. The assessee has submitted that it has availed services in various fields such as Information technology, finance, marketing and distribution, personal support inventory management. The assessee has submitted that it would be relevant to note that assessee company does not have any IT support department. Thus, it depends on DMG GmbH for any support relating to IT products and related infrastructure. Regarding financial services the assessee has submitted that The Assessee submits that the services mentioned above help DMG India with day-to-day financial management and ensure that

financial decisions are taken in an appropriate and timely manner for the Company. Further, if the finance services were not made available from DMG GmbH, the Assessee had to either employ finance personnel to undertake such work or engage third-party consultants to perform the required tasks and ensure efficient management of its services. Assessee also writes that in addition to the above, various marketing analysis are undertaken by DMG GmbH, which include quote analysis, cockpit analysis, lost order analysis, study of market potential and distribution of clients etc. The aforesaid services help DMG the assessee in identifying and tapping potential new clients in India. The assessee has also submitted that the assessee also obtains public relation services, which includes press, sponsoring, public relations work and work with trade associations. Regarding human resource management services the assessee has submitted that it enabled the assessee to focus on its core activity (i.e. marketing support services), while the HR activities of recruiting and training of employees are undertaken by DMG GmbH. In the absence of availing these services, the assessee would have to either recruit HR managers to render all the aforesaid activities; or outsource the personnel support work to third-party service providers in India. Hence, by availing the same services from DMG GmbH, the Assessee is ensuring cost optimisation and improving the effectiveness of their core activities. In respect to inventory management services the assessee says that the assessee avails inventory management services from DMG GmbH which include obtaining of information pool, making the desired information readily available to DMG India and co-ordination of inventory. The assessee has further submitted that all the aforesaid services were rendered by personnel of DMG GmbH either via correspondences, telephone, tele-fax, e-mails and periodic visits of the personnel or through any other means as agreed between the assessee and DMG GmbH from time-to-time. To render the aforesaid services, various personnel from DMG GmbH have visited India during FY 2006-07. The writes about the billing for management fees by the AE that for the aforesaid services, DMG GmbH follows a consistent inter-company transfer pricing policy across all Group entities availing such management services. As per the policy, DMG GmbH charges a '*budgeted cost*' plus '*an arm's length markup*'. After identification of the basic costs, an appropriate allocation formula is applied to allocate such basic costs. The allocation formula is reflective of the total expected benefits for each of the Group entities. Therefore, the fees for services provided by personnel of DMG GmbH are calculated on a cost

plus a mark-up basis. The Assessee also submits that during the course of the assessment proceedings, detailed workings, invoices, agreements etc. were provided to the TPO which clearly established that the Assessee has received services from its AE during FY 2006-07. However, the TPO did not consider any of the documents filed and made a transfer pricing adjustment on account of the support service fee paid. For the said services, AE is compensated on a cost plus 5% mark-up.

In respect to the TPO's comment that the services have been taken by the assessee from the AE without carefully considering whether the services rendered by the AE are worth taking or not the assessee writes in the paper book that in this regard, it would be relevant to note that DMG India had been availing such services since January 2004. Since the cost allocation agreement was duly agreed and signed on 8 January 2007, the agreement was effective retrospective from 1 January 2004. Therefore, DMG India had entered into the agreement only after availing such services for a period of 2 years. Considering DMG India has availed such services, prior to entering into the agreement, the Assessee has evaluated the quality and benefits of such services. The TPO in his order has mentioned that *no economic/tangible benefits have accrued to the Assessee by availing such support services*. In the above context, the Assessee has submitted that the turnover of DMG India has been increasing since FY2006-07. This has been possible only due to the support services availed by DMG India.

In view of the above, the Assessee would like to submit that the conclusions drawn by the TPO are erroneous and without considering the facts of the case. The assessee has therefore requested this Panel that the transfer pricing order must be quashed.”

6. Having examined the evidence and submissions of the assessee in this regard, the DRP has observed that the assessee has not produced any evidence regarding the services availed by the assessee in FY 2004-05 & 2005-06. Even in the current assessment year, evidence was not filed with regard to managerial services rendered by the AE for the assessee. The

DRP accordingly confirmed the action of the TPO. The relevant observations of the DRP is extracted herein for the sake of reference:-

“We find that the assessee has not produced any evidence regarding the services availed by the assessee in FY 2004-05 & 2005-06. The assessee says that the AE has rendered the services during these two years. But no evidence whatsoever has been produced which may explain to our satisfaction that the AE rendered services and the services were found satisfactory by the assessee and therefore the assessee agreed to avail these services in FY 2006-07. Without any contract in advance in respect to such services in FY 2004-05 itself, we don't find the argument of the assessee that the services were rendered by the AE and the assessee was availing them for continuously two years prior to FY 2006-07, as convincing. Further, if the services were rendered on trial basis for last two FYs then why the bill was raised for such trail services and also debited in the Profit and loss account for FY 2006-07 by the assessee. Though we are of a firm belief that the services have not been rendered by the AE in FY 2004-05 & 2005-06, but even if it is accepted for a moment that services were rendered how the bills can we raised for such test services and that too post-facto and debited in P&L for FY 2006-07 and claimed for three years in AY 2007-08. In any case the amount related to last two FYs deserve to be excluded in this year. Reverting to the issue of rendering of services by the AE in the relevant previous years for the assessment year under consideration we may say that except Invoices raised by the AEs and the Chart of allocation of costs among users of services no other documents have been produced by the assessee before the TPO. All the facts brought to our knowledge, and earlier before the TPO, would show that the Principle has introduced services worldwide for the introducing common practices for the whole group. How much individual member enterprises in the group are benefitted is not known. However, it is certain that due to these practices DMG GmbH definitely is benefitted. On other members such services have been imposed without caring as to whether on a stand alone basis such services were really called for. It is not proved that such services were really required by the assessee and how much the assessee was involved in decision making while introducing these services. This panel holds the view that once these services have been introduced by the Principal DMG

GmbH, others fell in line and started bearing the cost as the authorities in the tax jurisdiction where DMG GmbH is located would not be agreeing that DMG GmbH debit the entire cost in its accounts. In our view, the benefit may be indirect but indirect benefit is not considered as the right criterion to allow the expenditure as at arm's length in the case of the assessee. In our view the benefit must be direct, must correspond to the cost incurred, beneficiary must take a conscious decision to avail these services not under the influence of others but in view of the requirements of its own business. In the circumstances existing in the case of the assessee, we find it difficult to agree with the assessee that everything is right in this case and the decision of the TPO is wrong and therefore the direction may be issued by the DRP to accept the price of the management fees determined by the assessee in the transfer pricing documents. We on the other hand find that everything is not right in this case. Why the choice fell on the group company? Whether other service providers were considered and if yes, then why other service providers were ruled out and on what criterion? These and many other issues need to be replied by the assessee. There are some evidences enclosed by the assessee in support of its claim that the services were actually availed. We, however, find that these services were rendered by the DMG GmbH for the direct benefit of DMG GmbH. Therefore, that does not call for distribution of cost amongst the group members. The arguments of the assessee that these cost were distributed in proportion to the services availed is of no avail and we cannot agree with the assessee that it should be allowed as the allocation of costs has been done on rationale basis and the markup of 5 % is also reasonable. The disallowance is based mainly on the fact that the cost does not belong to the assessee. The benefit accruing to the assessee is indirect benefit as the direct benefit has reached to DMG GmbH who has imposed these services on the group entities, including the assessee. Therefore, it is not simply the mark up alone, rather the entire cost debited to the P&L account in AY 2007-08 deserve to be disallowed. Therefore the action of the TPO is considered as fully justified and hence, upheld by us.”

7. Now the assessee is in appeal before the Tribunal with the submission that on account of financial position the assessee has not paid

the management fees to its AE in 2004-05 and 2005-06, though AE has rendered managerial services for the assessee. In support of his contentions that the AE has rendered services for the assessee, the Id. counsel for the assessee has moved an application for admission of additional evidence on the ground that this additional evidence is being filed to establish how much services were rendered by the AE for the assessee. This additional evidence comprise of e-mails and correspondence exchanged between the assessee and the AE and also invoices raised by the AE. All these evidence was not sought for by the DRP during the course of hearing. The assessee was of the impression that whatever evidence was filed by him was sufficient to convince the DRP with regard to services rendered by the AE.

8. The Id. counsel for the assessee further contended that it is not correct on the part of DRP in observing that the assessee has not filed any evidence regarding the services availed by the assessee. The Id. counsel for the assessee further contended that since additional evidence is very material and goes to the root of the case in deciding the quantum and nature of services rendered by the AE for the assessee, therefore, the same may be admitted and matter be restored to the DRP or the TPO to examine these details in order to determine the ALP of the management fees.

9. The Id. standing counsel for the revenue formerly opposed the admission of additional evidence, but later on he has agreed that in case additional evidence is relevant and is required to be examined, the matter may be restored to the TPO/AO to examine the nature of services rendered by the AE for the assessee. If it is established that AE has rendered services for the assessee on account of which management fees is required to be paid by the assessee to its AE, the TPO will determine the management fee at ALP.

10. Having carefully examined the orders of authorities below in the light of rival submissions and additional evidence filed before us, we find that this additional evidence is quite relevant to decide the nature and quantum of services rendered by the AE for the assessee in order to determine the ALP of the management fees paid by the assessee. Our attention was also invited to the written submissions filed before the TPO in which a reference to cost allocation agreement for management fees was made. Our attention was also invited to the Invoice, but date of issuance of Invoice is not clear. A copy of service agreement is also filed, where service agreement was dated 8.1.2007. Though Id. counsel for the assessee has advanced his argument that in this agreement, reference was made with regard to service rendered from January, 2004, but it is not clear as to how this agreement is effective from 1.1.2004 when it was executed in 2007. All these aspects require proper examination. Therefore, in the interest of justice, we are of the view that this issue requires fresh adjudication in the

light of additional evidence filed by the assessee. We, therefore, set aside the order of AO passed in consequence to the order of DRP in this regard and restore the matter to the TPO/AO to adjudicate the issue of management fees paid by the assessee to its AE and if it is established that the AE has rendered some services for the assessee for which management fees are required to be paid, the AO/TPO would determine the ALP of the management fees paid by the assessee, after making necessary adjustments, if necessary. Accordingly, the appeal of the assessee stands allowed for statistical purposes.

Pronounced in the open court on this 26th day of October, 2016.

Sd/-

(S. JAYARAMAN)
Accountant Member

Sd/-

(SUNIL KUMAR YADAV)
Judicial Member

Bangalore,
Dated, the 26th October, 2016.

/D S/

Copy to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR, ITAT, Bangalore.
6. Guard file

By order

Assistant Registrar,
ITAT, Bangalore.