आयकर अपीलीय अधिकरण, 'डी' न्यायपीठ, चेन्नई

IN THE INCOME TAX APPELLATE TRIBUNAL , 'D' BENCH, CHENNAI

श्री एम बाला गणेश, लेखा सदस्य एवं श्री धुव्वुरु आर.एल रेड्डी न्यायिक सदस्य के समक्ष

BEFORE SHRI M. BALAGANESH, ACCOUNTANT MEMBER AND
SHRI DUVVURU RL REDDY, JUDICIAL MEMBER

आयकर अपील सं./**I.T.A.No.2825/CHNY/2017**

(निर्धारण वर्ष / Assessment Year: 2013-14)

M/s. Synergy Maritime Pvt. Ltd., Door No.3-381, AKDR Towers, 9th Floor, Rajiv Gandhi Salai, OMR, Mettukuppam, Chennai – 600 097.	Vs	The Deputy Commissioner of Income Tax, Corporate Circle 6(2), Chennai.
PAN: AAJCS9976R		
(अपीलार्थी/Appellant)		(प्रत्यर्थी/Respondent)

अपीलार्थी की ओर से/ Appellant by	:	Shri T. Banusekar, CA
प्रत्यर्थी की ओर से/Respondent by	:	Dr. M. Srinivasa Rao, CIT

सुनवाई की तारीख/Date of hearing	:	03.06.2019
घोषणा की तारीख /Date of Pronouncement	:	07.06.2019

आदेश / O R D E R

PER M. BALAGANESH, ACCOUNTANT MEMBER:

This appeal by the assessee is arising out of the directions issued by the learned Dispute Resolution Panel-2, Bengaluru dated 26.09.2017 and the assessment order passed by the learned Deputy Commissioner of Income Tax, Chennai dated 25.10.2017 passed U/s. 143(3) r.w.s. 92CA(4) r.w.s. 144C(5) of the Act for the assessment year 2013-14.

1. The Ground Nos.1 & 2 raised by the assessee are general in nature and does not require any specific adjudication.

2. <u>Determination of Arm's Length Price (ALP) for Ship / Vessel Management Services and Recruitment Services</u>

The brief facts of this issue are that the assessee is subsidiary of Synergy Marine Private Limited, Singapore (Synergy Singapore) and is engaged in provision of vessel management and ship consultancy services. Headquartered in Singapore, the Synergy Group is engaged in provision of a comprehensive range of ship consultancy services which consists of crew management, technical management, risk management, marine insurance, ship broking etc. The assessee has reported international transaction with Synergy Singapore, the Associated Enterprise (in short 'AE') during the year and the same was referred to the Learned Transfer Pricing Officer (in short 'ld TPO') u/s 92CA of the Act for determination of ALP. The assessee submitted transfer pricing study with FAR analysis and information required u/s 92D(1) of the Act before the ld TPO.

3.1 The assessee submitted before the ld TPO that Synergy Singapore, the AE entered into agreements with ship owners for rendering vessel management services. It was submitted that the assessee acted as a captive service provider to its AE and also provided vessel management services to third parties as per the requirement of the AE based on agreement entered between the assessee and AE. The assessee submitted that the AE had outsourced similar services to third parties apart from the assessee and hence the assessee had adopted internal Comparable Uncontrolled Price (CUP) Method as the Most Appropriate Method (MAM) for benchmarking the international transaction with AE.The assessee submitted agreements entered between AE and assessee and also agreements entered between AE and Filharmony Shipmanagement Limited Inc, the third party, providing vessel management and recruitment services to the AE, to prove that similar services as that of assessee were provided by the third party to AE, and such third party was compensated at USD 4500 per vessel per month as against USD 6800 per vessel per month received as compensation by the assessee from AE. Hence it was the submission of assessee that the transaction with its AE was at ALP.

3.2 The ld TPO rejected internal CUP method and adopted Profit Split Method (PSM) as the MAM for determination of the Arm's Length Price (ALP) in respect of the international transaction with AE. In this regard, the summary of observations of the ld TPO are as under:-

(i) There was significant difference in the terms and conditions of the agreement entered by the assessee with AE and agreement entered by the third party with the AE. Further in the agreement, the assessee is characterized as 'Agent' whereas the third party is characterized as 'Manager'.

(ii) The similarity of services should be of very high order for adopting CUP method. The assessee could not demonstrate that services provided by the third party and assessee were identical with suitable evidences when there are difference in the terms and conditions and functions performed as per the agreement.

(iii) Huge difference in compensation received from the AE by the assessee and the third party (i.e USD 2200 (9000-6800) per vessel per month as referred supra), further substantiates the additional services performed by the assessee and so comparable selected by assessee is not perfect CUP.

(iv) Entire work related to vessel management is performed by the assessee and the work carried out by AE are mere headquarter functions of planning, laisoning and supervision.

(v) The functions performed by AE and assessee are so interrelated that they cannot be evaluated separately for the purpose of determining the arm's length price of any one transaction and managing vessels all over the world involves use of unique human intangibles and accordingly the Most appropriate Method was the Profit Split Method (PSM).

3.3. The ld. TPO concluded that Synergy Singapore is providing proper head office support to the assessee and placing reliance on section 44C of the Act, which caps allowability of maximum head office expenses at 5% of total income, the ld TPO attributed 100% markup on 5% and stated that the AE can retain 5.25% of the total management fee and the remaining 94.75% of the total management fee was attributable to the assessee. Based on the above observations, the ld TPO has taken 94.75% of management fee of USD 9000 per vessel per month, as attributable to the assessee and the total ships managed by the assessee being 41, has arrived at Rs.19,21,23,320/- as the actual management fee which should have been recognized as revenue by the assessee. With this the ld TPO has compared the actual revenue recognized from vessel management services in the books of the assessee and the ld TPO has made an upward adjustment of 3,89,20,320/-.

3.4. The ld Dispute Resolution Panel (DRP) observed that the AE is appropriating 24.45% of the gross receipts which is not commensurate with the kind of headquarter functions provided by AE, whereas most of the functions are provided in India. It was observed that the functions performed by India are not suitably compensated and therefore there is a need to allocate receipts / profits among the assessee. The ld DRP has observed that the question to be considered in the case was the proportion in which the service revenue was to be split between the AE and the assessee, taking into account the functions of the AE which is purely headquarter services. It was concluded by the ld DRP that the headquarter functions provided by the AE are deemed to be deserving of 5% of revenue towards cost with a mark-up of 100% i.e., 100% on 5%, thus aggregating to 10%, which was mistakenly mentioned by the AO as 5.25% instead. Thus the ld DRP took the service revenue attributable to the AE at 10% as against 5.25% taken by the ld TPO and determined the upward adjustment at Rs.2,89,00,148/- as against Rs.3,89,20,320/- proposed by the ld TPO.

3.5. Aggrieved, the assessee is in appeal before us on the following grounds:

3. *For that the Assessing Officer erred in making an upward adjustment of Rs.2,89,00,148/- to the international transactions in arriving at the Arm's Length Price.*

4. *For that the Assessing Officer erred in rejecting the study conducted by the assessee.*

5. *For that the Assessing Officer failed to appreciate that Internal CUP is the Most Appropriate Method for benchmarking the international transactions and consequently erred in rejecting the same.*

6. *For that the Assessing Officer failed to appreciate that the appellant does not fall within the four categories specified in section 92C(3), but for which the Arm's length price cannot be determined independently by him.*

7. *For that the Assessing Officer erred in adopting "Profit Split Method" for benchmarking the International transactions.*

8. *For that the Assessing Officer failed to appreciate that the "Profit Split Method" is not appropriate and cannot be applied to the instant case of the appellant.*

9. *For that without prejudice, having adopted "Profit Split Method" for benchmarking, the Assessing Officer has erred in not computing the Arm's Length Price as envisaged in Rule 10B(1)(d).*

4. The ld AR vehemently relied on the agreements between the AE and the assessee and between the AE and third party, placed on record in the paper book filed by the assessee, and argued that since similar services were provided by the third party and the assessee to the AE, CUP method was the MAM for determining the ALP. The ld AR furnished comparative analysis of the agreements entered by

Synergy India and third party (Filharmony Shipmanagement Limited Inc) and the same is reproduced hereunder:-

PARTICULARS	SYNERGY INDIA	THIRD PARTY (Filharmony)
Characterization	Agent	Manager
Basic Services	- Crew management - Technical Management - Accounting - Visits to vessels at regular intervals	- Crew management - Technical Management - Accounting - Visits to vessels at regular intervals
Additional services	- Keep the company informed of Government Polices and introductions to the relevant authorities, businesses and individuals as appropriate - Arrange to deliver funds out of their wages to the accounts of beneficiaries as requested by the crew. This is done by the AE and Synergy India only assists in verifying the correctness	- Report trouble affecting seaworthiness of the vessel
Liability	- Upto one month's management fee	- USD 60,000 per vessel
Responsibility	- Reportable to Synergy Singapore. Acts only as an agent. - Can take responsibility only on request by Synergy Singapore	- Overall responsibility of Filharmony with regard to management of vessel and authority to take decisions in their discretion.
Sub-contracting	- Synergy India cannot sub-contract or appoint agents	- Can sub-contract any of their obligations

Insurance	- Assist in Insuring the vessel at the owner's expense	- Insured by Filharmony at the expense of Synergy Singapore
Remuneration	- USD 6,800 per vessel per month	- USD 4,500 per vessel per month

5. The ld AR drew attention to relevant pages of the agreements placed in Paper Book of the assessee and explained that the services provided in the form of crew management and technical management are similar in the case of third party and the assessee and for such services, the assessee is remunerated at USD 6800 per vessel per month, whereas the third party receives USD 4500 per vessel per month and therefore, the services provided by assessee is at ALP. The ld AR relied on the clause (a) of Rule 10(B)(1) of the Income Tax Rules, 1962 and argued that under CUP method, adjustment can be made for differences in the agreement. It was noted that the third party was at disadvantage in comparison to the assessee on considering the liability clause. Thus it was submitted that only a downward adjustment can be made to the revenue of the assessee on the sums received from the AE if these are factored and hence will not result in any upward adjustment so as to affect the income of the assessee. The ld AR further vehemently argued that the internal comparable cannot be rejected merely because the assessee is described as "Agent" and the

third party is described as “Manager”, when the nature of services rendered are similar.

6. Without prejudice to the claim of the assessee that CUP method is to be adopted as the MAM, the ld AR argued that Profit Split Method (PSM) should not have been applied since is applicable only when the international transactions involve unique intangibles or when there are multiple international transactions which are so interrelated that they cannot be evaluated separately. It was submitted that in the instance case, the international transaction does not involve unique intangible nor are the international transactions so interrelated in order to apply PSM. It was submitted by the ld. AR that the relationship between the AE and assessee was that of Manager and Agent and the contractual obligations of the assessee were clearly defined in the agreement and further there cannot be unique human intangibles as assumed by the ld. TPO since the intangibles should arise through R&D activities and two AEs should have contributed their respective intangibles to develop a new product or process. It was submitted that in applying PSM, the combined net profit should be split between the AE and the assessee based on the relative contribution and the ld. TPO has

erroneously split revenue instead of following the prescribed procedure under the Rules.

7. Without prejudice, it was further submitted that assuming but not conceding PSM was applicable, the ld TPO and the ld DRP should not have resorted to benchmarking the revenue to be attributed to AE at 5% based on section 44C which provides for maximum expenditure to be allowed for head office operations. The ld AR vehemently argued that in applying PSM, the ALP should be determined based on procedure prescribed under Rule 10B(1)(d) and it was outside the scope to invoke section 44C.

7.1. The ld. AR pleaded that the AE is not merely performing headquarter function and the ld. TPO and ld. DRP failed to consider other direct expenses such as commission incurred by the AE for procuring contracts which is a vital direct expenditure.

8. In response to this, the ld DR stated that assessee has not furnished any other documents other than the agreements to establish comparability of services rendered by the assessee and third party. The ld DR vehemently argued that though the services rendered by

the assessee and third party are similar, the assessee is referred as "Agent" in the agreement with Synergy, Singapore, whereas the third party is referred as "Manager" in the agreement with Synergy, Singapore and therefore the assessee and the third party cannot be compared. He further stated that the assessee has given only one comparable and even that comparable is not based in India but Singapore and hence the comparable is not to be considered as proper. The ld DR argued why the AE should remunerate the assessee more and third party less, if similar services are provided by both to Synergy Singapore and pleaded that the difference in remuneration indicates some additional services provided by assessee which makes comparison with third party redundant. He further argued that PSM was the MAM for arriving at ALP in the case of assessee and since the AE performs mere head quarter functions, the appropriation of 10% of revenue to the AE i.e., 5% of revenue based on section 44C of the Act for the head quarter function along with mark-up of 100% on 5%, was the right method for arriving at ALP.

9. We have heard the rival submissions and perused the materials available on record. We find that Rule 10B of the Income Tax Rules provides the methods by way of which ALP of international transaction

or specified domestic transaction can be determined for the purpose of section 92C of the Act. The main dispute in the impugned appeal is on whether CUP or PSM is to be adopted as the most appropriate method for determining the ALP in the facts and circumstances of the case. On perusing the agreements, we find that the third party internal comparable in the instant case is providing similar function as what is provided by the assessee to its AE and this fact was not controverted by the ld DR before us. The agreement of assessee and the third party with Synergy, Singapore are elaborate with clauses on services to be provided, rights and duties under the agreement, liability of service provider, insurance and remuneration for service. The main contention of the revenue is that the assessee is defined as “Agent” in the agreement with AE whereas the third party is providing the services in the capacity of “Manager”. It can be seen that it cannot be the case that the two parties, namely, the tested party i.e., the assessee before us and the third party i.e., Filharmony cannot be considered as not comparable merely because the agreements use different terminologies to describe them. What has to be seen is the nature of service rendered by the tested party to the foreign AE viz-a-viz the services rendered by the comparable i.e., Filharmony to Synergy, Singapore. That being so, the comparable cannot be denied merely

on account of difference in the nomenclature used in the agreement to describe the service provider when the nature of service is similar.

10. It can be noted that Rule 10B(1)(a) of the Rules states as follows on determination of ALP using CUP method:-

"(a) comparable uncontrolled price method, by which,—

(i) the price charged or paid for property transferred or services provided in a comparable uncontrolled transaction, or a number of such transactions, is identified;

(ii) such price is adjusted to account for differences, if any, between the international transaction [or the specified domestic transaction] and the comparable uncontrolled transactions or between the enterprises entering into such transactions, which could materially affect the price in the open market;

(iii) the adjusted price arrived at under sub-clause (ii) is taken to be an arm's length price in respect of the property transferred or services provided in the international transaction [or the specified domestic transaction] ;"

11. We note that Rule 10B(1)(a) of the Rules clearly provides that adjustments can be made for differences between the international transaction and the comparable uncontrolled transaction. The ld DR stated that Filharmony cannot be considered as third party internal comparable since the jurisdiction of Filharmony is Singapore whereas the assessee is located in India. We hold that Rule 10B of the Rules does not prohibit comparable being taken from outside India

particularly when data is available and the method used is internal CUP. Further the differences in obligation under liability clause where the liability of the assessee is capped at upto one month's management fee i.e., USD 6800 per vessel viz-a-viz the liability of third party at USD 60,000 per vessel was cited as reason for non-comparability of the third party. In this regard, we hold that, if at all required, adjustment to price could be made for differences in the international transaction and the comparable uncontrolled transaction but the comparable should not be rejected on account of such differences, when the nature of services are similar. Further we note that any adjustment for jurisdiction or the liability of third party viz-a-viz assessee would only go to further decrease the revenue payable by Synergy, Singapore to the assessee since it is common knowledge that Singapore is a higher cost territory as compared to India and further since the comparable has larger liability than the assessee to Synergy, Singapore. We note that the remuneration for service rendered by assessee is fixed at USD 6800 per vessel per month and for the third party it is fixed at USD 4500 per vessel per month. Hence the international transaction of the assessee with AE is at more than the ALP and no upward adjustment is required to be made in the facts of the instant case.

12. On the remuneration paid to the third party versus the assessee, we note that on one hand, the ld. TPO states that the AE is merely providing headquarter functions and the revenue attributable to AE at 24.4% is not commensurate with functions performed by AE, which has been upheld by the ld DRP, thereby attributing the revenue to the assessee at USD 8100 per vessel per month under PSM; while on the other hand, for rejecting CUP, the ld TPO and the ld DRP state that the remuneration for the third party is much lower when compared to the AE. We find that that this contradictory stand does not come to the rescue of the revenue.

13. Moreover, we note that on Profit Split Method (PSM), Rule 10B(1)(d) of the Rules states as follows on rules for determination of ALP:-

*"(d) profit split method, which may be applicable mainly in international transactions **[**or specified domestic transactions**]** involving transfer of unique intangibles or in multiple international transactions **[**or specified domestic transactions**]** which are so interrelated that they cannot be evaluated separately for the purpose of determining the arm's length price of any one transaction, by which—*

*(i) the combined net profit of the associated enterprises arising from the international transaction **[**or the specified domestic transaction**]** in which they are engaged, is determined;*

(ii) the relative contribution made by each of the associated

enterprises to the earning of such combined net profit, is then evaluated on the basis of the functions performed, assets employed or to be employed and risks assumed by each enterprise and on the basis of reliable external market data which indicates how such contribution would be evaluated by unrelated enterprises performing comparable functions in similar circumstances;

(iii) the combined net profit is then split amongst the enterprises in proportion to their relative contributions, as evaluated under sub-clause (ii);

(iv) the profit thus apportioned to the assessee is taken into account to arrive at an arm's length price in relation to the international transaction ***[****or the specified domestic transaction****]*** *:"*

14. We further note that the CBDT vide Circular No.02/2013 dated 26th March 2013, has given the following clarification on application of profit split method:

"It has been brought to the notice of CBDT that clarification is needed for selection of profit split method (PSM) as most appropriate method. The issue has been examined in CBDT. It is hereby clarified that while selecting PSM as the most appropriate method, the following points may be kept in mind:

1. Since there is no correlation between cost incurred on R&D activities and return on an intangible developed through R&D activities, the use of transfer pricing methods [like Transactional Net Margin Method] that seek to estimate the value of intangible based on cost of intangible development (R&D cost) plus a return, is generally discouraged.

2. Rule 10B(1)(d) of Income-tax Rules, 1962 (the Rules) provides that profit split method (PSM) may be applicable mainly in

international transactions involving transfer of unique intangibles or in multiple international transactions which are so interrelated that they cannot be evaluated separately for the purpose of determining the arm's length price of any one transaction. The PSM determines appropriate return on intangibles on the basis of relative contributions made by each associated enterprise.

3. Selection and application of PSM will depend upon following factors as prescribed under rule 10C(2) of the Rules:

- *the nature and class of the international transaction;*
- *the class or classes of associated enterprises entering into the transaction and the functions performed by them taking into account assets employed or to be employed and risks assumed by such enterprise;*
- *the availability, coverage and reliability of data necessary for application of the method;*
- *the degree of comparability existing between the international transaction and the uncontrolled transaction and between the enterprise entering into such transactions;*
- *the extent to which reliable and accurate adjustments can be made to account for differences, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprise entering into such transactions;*
- *the nature, extent and reliability of assumptions required to be made in application of a method.*

4. It is evident from the above that rule 10C(2) of the Rules stipulates availability, coverage and reliability of data necessary for the application of the method as one of the several factors in selection of most appropriate method. Accordingly, in a case, where the Transfer Pricing Officer (TPO) is of view that PSM cannot be applied to determine the arm's length price of international transactions involving intangibles due to non-availability of information and reliable data required for

application of the method, he must record reasons for non-applicability of PSM before considering TNMM or comparable uncontrolled price method (CUP) as most appropriate method depending upon facts and circumstances of the case.

5. Application of Profit Split Method requires information mainly about the taxpayer and associated enterprises. Section 92D of the Income-tax Act, 1961 provides for maintenance of relevant information and documents by the taxpayer as prescribed under rule 10D of the Rules. Therefore, there should be good and sufficient reason for non-availability of such information with the taxpayer.

6. Depending upon facts and circumstances of the case, TPO may consider TNMM or CUP method as appropriate method by selecting comparables engaged in development of intangibles in same line of business and make upward adjustments taking into account transfer of intangibles without additional remuneration, location savings and location specific advantages."

15. At the outset, it is held that the procedure to be followed for determining the ALP under PSM is elaborately stated in Rule 10B(1)(d) and procedure has been further clarified by the CBDT vide Circular No.02/2013 dated 26th March 2013, which states that under profit split method, the combined profit of the international transaction should first be determined, then the relative contribution of the AE and assessee, has to be determined and then the ALP would be arrived by splitting the combined net profit in the proportion of the relative contribution. The Circular No.02/2013 further states that application of

Profit Split Method requires information mainly about the taxpayer and associated enterprises and where such information for application of PSM is not available, the ld TPO may consider TNMM or CUP method as MAM. In the case before us, the ld TPO has split the revenue from international transaction between that AE and the assessee based on the provisions of section 44C of the Act, holding the function of Synergy, Singapore to be merely head quarter function, instead of the prescribed method of finding the combined net profit of the international transaction and allocating such combined net profit to the AE and the assessee based on their relative contribution to the net profit. Hence we hold that the ld TPO and the ld DRP have not followed the prescribed method to be adopted in determining the ALP under PSM and we reject the determination of ALP by the ld TPO and upheld by the ld DRP.

16. We further observe that the ld TPO states the functions of AE to be mere head quarter activities for justifying invoking provisions of section 44C of the Act , but for the purpose of adopting PSM, he states that the activities of the AE and the assessee are interlinked. Therefore, it is not clear as to what is the stand of the ld TPO and on what basis the applicability of PSM has been upheld by the ld DRP.

Further there are no unique intangibles as contemplated through R&D, as made clear by the CBDT Circular No.02/2013, for applying PSM. Hence it is held that in the absence of unique intangibles or finding on multiple inter related international transactions between the assessee and AE, there is no scope for adopting PSM as the MAM for arriving at ALP.

17. We further hold that the functions of the AE are not mere headquarter activities to apply section 44C of the Act. Head office expenditure is defined in Explanation (iv) to section 44C to mean executive and general administration expenditure incurred by the assessee outside India, including expenditure incurred in respect of—

(a) rent, rates, taxes, repairs or insurance of any premises outside India used for the purposes of the business or profession;

(b) salary, wages, annuity, pension, fees, bonus, commission, gratuity, perquisites or profits in lieu of or in addition to salary, whether paid or allowed to any employee or other person employed in, or managing the affairs of, any office outside India;

(c) travelling by any employee or other person employed in, or managing the affairs of, any office outside India; and

(d) such other matters connected with executive and general administration as may be prescribed.

It can be noted that expenses for procuring orders / business do not fall under executive and general administration expenditure in section 44C of the Act. We therefore hold that procuring orders by liaisoning with ship owners is a core and crucial activity and not a mere executive or general administrative activity to be categorized as head office function covered u/s.44C of the Act. First the AE must get the order from clients and then get it executed either through the assessee or through someone else. First a person has to enter the door and open it (which is similar to procuring orders from clients, which function is performed in the instant case by AE) and thereafter sit in the chair and render services (which in the instant case is performed by the assessee or third party on some agreed consideration).

18. We find that the ld TPO and the ld DRP erred in rejecting CUP method and instead adopting PSM. We hold that the MAM in the instant case would be CUP method as the third party internal

comparable is performing similar functions as assessee. Hence the upward adjustment made by the ld TPO and upheld by the ld DRP to the extent of Rs.2,89,00,148/- is hereby directed to be deleted. Accordingly, the grounds 3 to 9 raised by the assessee are allowed.

19. In the result, the appeal of the assessee is allowed.

Order pronounced on the 7th June, 2019 at Chennai.

Sd/-	Sd/-
(ध्रुव्वुरु आर.एल रेड्डी)	(एम बाला गणेश)
(Duvvuru RL Reddy)	(M. Balaganesh)
न्यायिक सदस्य/Judicial Member	लेखा सदस्य /Accountant Member

चेन्नई/Chennai,
दिनांक/Dated 7th June, 2019

RSR

आदेश की प्रतिलिपि अग्रेषित/Copy to:

1. अपीलार्थी/Appellant 2. प्रत्यर्थी/Respondent 3. आयकर आयुक्त (अपील)/CIT(A)
4. आयकर आयुक्त/CIT 5. विभागीय प्रतिनिधि/DR 6. गार्ड फाईल/GF