Management Support Services vis-à-vis Intra Group Services

– An Analysis under Transfer Pricing – Part III

Introduction:

In previous parts of Article (Part I[1] and Part II[2]), the concept of taxability of management support services under treaty and Income Tax Act ('IT Act') has been analysed in detail. Previous Parts of Article deal with taxability of such services in India in the hands of recipient.

However, the issue may not be said completely analyzed, without analyzing the deductibility of such expenses in the hands of the payer from the standpoint of transfer pricing.

Let us proceed to continue with the same example considered in the previous parts.

> ***ABC Inc a company incorporated in USA has entered into license agreement with ABC India Private Limited for manufacturing of goods in India. Subsequent to such license agreement, ABC Inc has entered into another agreement for providing various MSS.***
>
> ***Now, let us proceed, to understand computation of Arm's Length Price under the Indian TP Regulations.***

The above services are termed as 'intra group services' under the TP Regulations. Section 92 of IT Act provides that any income or expense arising from international transaction shall be computed having regard to the Arm's Length Price ('ALP'). Section 92 further provides that allocation, apportionment or contribution of any allowance, expenses between the AE shall be computed having regard to the ALP. However, such computation of Income or allocation of expense or allowance shall not reduce the total Income or Increase in loss computed by the assessee under normal provisions of the IT Act.

The issue arises with regard to intra group services is substantiating the fact that services are actually provided by the AE and benchmarking the payment made for such services under arm's length principle.

i. Whether intra group services are actually provided?

ii. Whether payment to such services is at ALP?

Whether intra group services are actually provided?:

As discussed above, services provided by AE would be termed as 'intra group' services. As payment would be paid to AE for those services, the question arises is whether the AE has actually provided services, or it is merely a fictitious entry to remit the amount to AE to avoid other taxes. Hence, it is required to establish that services are actually received by the entity.

OECD has in its TP Guidelines[3] provided detailed guidelines with regard to intra-group services. OECD has stated that the 'benefit test' has to be applied for determining whether the services are actually received from the AE.

[1] Management Support Services vis-à-vis Ancillary and Subsidiary Clause–An Analysis on position under Treaties - Taxmann

[2] Management Support Services vis-à-vis Other Income – An Analysis on position under Treaties – Part II - Taxmann

[3] OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, 2017

Benefit Test:

Under the arm's length principle, the question whether an intra-group service has been rendered would depend on whether the activity provides the assessee with economic or commercial value to enhance or maintain it business position.

This can be determined by considering whether an 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 answer to the aforementioned is not affirmative then, such services may not be considered to be intra group services at ALP.

Some intra group services are performed to meet an identified need of one or more enterprises of MNE group. Ex - an intra group services to repair an equipment used in the manufacturing. In such a situation, it is a straightforward case to identify the intra group services.

OCED has further stated that it is essential to provide reliable documentation to the tax administrations to verify that the costs have been incurred by the service provider.

It further stated that mere description of payment as, for example, management fee should not be expected to be treated prima facie evidence that such services have been rendered. In other words, the assessee has to bring in record to substantiate the claim of services are actually utilised by the assessee exclusively for the purpose of its business.

In order to establish that the intra group services are actually received by the entity, it is required to satisfy the benefit test. However, this concept has to be interpreted from the standpoint of business expediency to incur a particular expense.

The Hon'ble Delhi High Court of in the case of EKL Appliances Ltd[4], while interpreting OECD guidelines, has held that ***it is not for the revenue authorities to dictate to the assessee as to how he should conduct his business and it is not for them to tell the assessee as to what expenditure the assessee can incur***. The High Court further held that it is not necessary for the assessee to show that any legitimate expenditure incurred by him was also incurred out of necessity. It is also not necessary for the assessee to show that any expenditure incurred by him for the purpose of business carried on by him has actually resulted in profit or income either in the same year or in any of the subsequent years. The only condition is that the expenditure should have been Incurred 'wholly and exclusively' for the purpose of business and nothing more.

The Hyderabad Tribunal in the case Air Liquide Engineering India Private Limited[5] has relied on the High Court decision in the case of EKL Appliances Ltd (supra) and held that TPO sitting on judgment on business and commercial expediency of the assessee is erroneous as per the provisions of IT Act.

The Delhi High Court in the case of Cushman and Wakefield (India) (P.) Ltd.[6] has held that the power of TPO is limited to conduct a transfer pricing analysis to determine ALP and not to determine whether there is a service or not from which assessee benefits.

The Bangalore Tribunal in the case of Volvo India (P.) Ltd.[7] has relied on the Delhi Court decision

[4] [2012] 24 taxmann.com 199 (Delhi)

[5] [2014] 43 taxmann.com 299 (Hyderabad - Trib.)

[6] [2014] 46 taxmann.com 317 (Delhi)

[7] [2017] 77 taxmann.com 207 (Bangalore - Trib.)

in the case of EKL Appliances Ltd (Supra) and held that ALP cannot be determined as NIL. However, the Tribunal has pointed out that onus lies on the assessee to prove that the services are actually rendered by the AE. The failure by the assessee to discharge the onus can be presumed that the assessee had no evidence to establish that services of management support are rendered by its AE. Same view has been upheld by the Bangalore Tribunal in the case of Taegu Tec India (P.) Ltd.[8].

The Bangalore Tribunal in the case of Adcock Ingram Ltd.[9] has outlined the concept of benefits test as provided in OECD TP Guidelines. The Tribunal has held that while OECD guidelines seem to indicate the "Benefit test" to be actual rendition of services which provides economic or commercial value, the Indian TPOs insist on positive demonstration of actual benefit accruing to the service recipient from the services rendered. The tribunal stated that in their considered opinion the Revenue could not decide what was necessary for a taxpayer and what was not. The requirement of services should have been judged from the viewpoint of the taxpayer as a businessman.

Accordingly, the Tribunal has held that the 'benefit' needed to be identified from the taxpayer's viewpoint, which could be potential, reasonable, foreseeable, may not be quantifiable in money alone, and may be strategic, but could not be incidental. The benefit also could not have qualifications such as "substantial", "direct" and "tangible" because these qualifications were not given in section 92(2) of the Act. There are several non-monetary terms other than profitability, like usefulness, enhancement in value, sustainability and enhancement of business interest, which were required to be seen while judging the benefit test.

Further, Bangalore Tribunal in the case of United Breweries Ltd[10] has held that in the matter of coming to the conclusion on the benefit that the assessee received, clear evidence cannot be insisted upon and the overall business scenario and type of services rendered have to be looked into.

Given the above analysis, the burden of proof lies with the assessee to establish that the services are actually rendered by the AE. However, once it is established that services are actually rendered, TPO cannot sit on the position of the assessee to determine whether a particular service is required for its business or not. The benefit need not be established on monetary terms as held by the Bangalore Tribunal in the case of Adcock Ingram Ltd (Supra).

Further, OECD has stated that services which are in the nature of shareholder activities, duplication of services, incidental benefits cannot be considered as intra-group services and provided illustrative list of services which are not covered under intra group services and for which no amount is allowed to be paid by the recipient.

Shareholder Activities:

An intra group activity may be performed relating to group members even though those group members do not need the activity (and would not be willing to pay for it were they independent enterprises). Such an activity would be one that a group member performs solely because of its ownership interest in one or more other group members. This type of

[8] [2017] 83 taxmann.com 81 (Bangalore - Trib.)

[9] [2018] 90 taxmann.com 298 (Bengaluru – Trib)

[10] TS-353-ITAT-2022(Bang)-TP

activity would not be considered to be an 'intra group' services and would not justify a charge to other group members. Following activities may be considered as shareholder activities:

- Activities relating to juridical structure of the parent company viz. meetings of shareholder, issue of shares of parent company, listing shares of parent company.
- Activities relating to reporting requirements of the parent company viz. consolidated financials.
- Activities of parent company relating to raising of funds for the acquisition of shares in subsidiary.
- Activity relating to compliance of the parent company with the relevant tax laws.
- Activities which are ancillary to the corporate governance of the MNE Group.

However, if parent company performed activities other than solely because of an ownership interest in group members then, such activities may not be considered as shareholder activities.

The Mumbai Tribunal in the case of Ipsos Research (P.) Ltd.[11] has held that support services from AE under shared resources allocation agreement in the field of commercial, financial, accounting cannot be categorized as shareholder activities.

Same view has been upheld by the Pune Tribunal in the case of Carraro India (P.) Ltd[12].

Duplication:

When a group member merely duplicates a service that another group member is performing for itself, or that is being performed for such other group member by a third party cannot be considered an intra group services to charge a fee. However, OECD provides some exceptions to duplicate services:

- When an activity (duplicate services) is performed to reduce the risk of a wrong business decision.
- When regulated sectors require control function to be performed locally as well as on a consolidated basis by the parent.
- When an activity is performed at different levels.
- When additional benefits are received on such duplicate services by applying the benefit test.

If services provided AE are in duplicate in nature, amount paid against such services may be disallowed. Hence, it required to establish that no such duplication of activity is involved in management support services.

In this regard, the Delhi High Court in the case of Mitsui Prime Advanced Composites India (P.) Ltd.[13] has held that services received from the AE in relation to acquiring of 'business' (securing business) cannot be considered as duplication of services. SLP filed against the HC has been dismissed by the Supreme Court[14].

the Delhi Tribunal in the case of Metalsa India (P.) Ltd.[15] has held that management support services provided by AE cannot be considered as duplicate in nature. Similar view has been expressed by the Delhi Tribunal in the case of Cargill Global Trading India (P.) Ltd.[16]

The Mumbai Tribunal in the case of L'Oreal India (P.) Ltd.[17] has held that the jurisdiction of TPO is

[11] [2020] 114 taxmann.com 732 (Mumbai - Trib.)
[12] [2020] 113 taxmann.com 257 (Pune - Trib.)
[13] [2017] 79 taxmann.com 283 (Delhi)
[14] [2017] 79 taxmann.com 283 (Delhi)
[15] [2022] 134 taxmann.com 160 (Delhi - Trib.)
[16] [2020] 113 taxmann.com 389 (Delhi - Trib.)
[17] [2021] 133 taxmann.com 487 (Mumbai - Trib.)

limited to ascertain whether the international transaction carried out by the assessee with its AE is at arm's length by applying most appropriate method as specified under section 92C(1) of the Act. The TPO can neither question commercial expediency of the transaction nor examine whether service was needed or is duplicate in nature. Further, the TPO cannot question the quantum of benefit derived by the assessee from the payment made for international transaction. The TPO has no authority to disallow the expenditure for any extraneous reasons. The jurisdiction of the TPO is only to examine international transaction and make suitable adjustment after benchmarking the transaction in line with the provisions of section 92C of the Act.

Incidental benefits:

In certain situations, where an intra group services performed by a group member such as a shareholder or co-ordinate center relates only some group members but incidentally provides benefits to other group members.

The incidental benefits ordinarily would not cause entity to be treated as receiving intra group services because the activities producing the benefits would not be ones for which an independent enterprise ordinarily would be willing to pay.

Similarly, when an entity receives incidental benefits solely because of such entity is a part of large concern (incidental benefits from passive association with large concern), such benefits shall not be considered receipt of intra group services.

On reading the above analysis, the question that arises is whether management support services would satisfy the above three tests?

OECD in para 7.14 of TP Guidelines has stated that in certain situations, parent company may provide centralised services viz. planning, coordination, budgetary control, financial advice, accounting, auditing, legal, factoring, computer services, financial services such as supervision of cash flows and solvency, capital increases, loan contracts, management of interest and exchange rate risks, and refinancing; assistance in the filed of production, buying, distribution and marketing; and services staff matters such as recruitment and training, order management, customer service and call center, research and development or administer and protect intangible property.

In respect of above services, OECD has stated that these types of services ordinarily will be considered intra group services because they are the type of services for which independent enterprise would be willing to pay.

If above mentioned conditions are satisfied, amount paid by the assessee for administrative, management, consultancy service shall not be disallowed merely because such services are availed from AE.

The Delhi Tribunal in the case of GE Money Financial Services (P.) Ltd.[18] has explained the concept of intra group services in depth. In this case, the assessee has availed various services consulting and administrative services from AEs. The Tribunal after discussing each issue in detail, held as under:

- **Need Test:** The Tribunal by noting the size and volume of the business operations of the assessee and accepting the fact that assessee is part of MNE, held the assessee is required various services for its operations and same were acquired from its group companies.

- **Test of rendition:** The Tribunal has accepted the evidence produced by the assessee viz. emails exchanged in day-to-day operations, correspondences,

[18] [2016] 69 taxmann.com 420 (Delhi - Trib.)

documents received, planning studies conducted, strategies developed by the AE and held that merely because the assessee has availed those services from AE, it shall not be held responsible for providing more evidence.

- **Benefit Test:** After the detailed analysis, the Tribunal considering the complexity of business operations held that assessee requires such services. Meaning thereby that the "benefit" needs to be identified from the viewpoint of the assessee which can be potential, reasonably foreseeable, may not be quantifiable in money alone, may be strategic but it cannot be incidental.

- **Shareholder's Activities:** In this context Tribunal has rightly noted that shareholders activities are those activities which are not required by the assessee, but the parent company has provided the same for safeguarding its ownership interest.

- **Test of duplicative:** The Tribunal has held that in absence of any instances of services provided by the AE and services availed by the assessee from independent parties are similar in nature and it creates any redundancy, such services availed from AE shall not be considered as duplicative in nature.

The above view is upheld by various judicial fora wherein, it is held that assessee has to prove the genuineness of the service received by the assessee from its AE. Once the assessee has proved the genuineness of the transactions and paid the amount for such transaction, TPO has to accept the transaction and proceed to benchmark the transaction under TP regulations.

In other words, if above mentioned conditions are satisfied, amount paid by the assessee for administrative, management, consultancy service shall not be disallowed merely because such services are availed from AE.

Once it is established that the entity has received intra group services, the next step is determination of remuneration for such services at ALP. This aspect will be discussed in the next part.