*** IN THE HIGH COURT OF DELHI AT NEW DELHI**

Reserved on: 01.05.2014
Pronounced on : 23.05.2014

\+ **ITA 475/2012**

COMMISSIONER OF INCOME TAX-I .....Appellant
Through: Sh. Sanjeev Sabharwal, Sr. Standing Counsel with Sh. Ruchir Bhatia, Jr. Standing Counsel.

Versus

M/S. CUSHMAN AND WAKEFIELD (INDIA) PVT. LTD.
.....Respondent
Through: Sh. S. Ganesh, Sr. Advocate with Ms. Preeti Bhardwaj, Advocate.

CORAM:
HON'BLE MR. JUSTICE S. RAVINDRA BHAT
HON'BLE MR. JUSTICE VIBHU BAKHRU

MR. JUSTICE S. RAVINDRA BHAT
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1. This is an appeal by the Revenue against an order of the Income Tax Appellate Tribunal ("ITAT"). The impugned order reversed the order of the Assessing Officer ("AO") in respect of disallowance of reimbursement of costs and expenses incurred by the assessee, Cushman and Wakefield (India) Ltd. ("the assessee"). These had been claimed by the assessee as having been costs incurred towards services performed by its two Associated Enterprises, Cushman and Wakefield, Singapore ("CWS") and Cushman and Wakefield, Hong Kong ("CWHK").

2. The brief facts are that the assessee, an Indian company, is engaged in the business of rendering services connected to acquisition, sales and lease of real estate and other services such as the provision of advice and research on such matters, project management etc (hereafter "services"). These services are provided to several clients within and outside India. The assessee filed its return of income declaring an income of ₹20,46,62,822/-, and reporting six international transactions under Section 92B of the Income Tax Act, 1961 ("the Act"). Of these, two are important in the present proceedings: payment of referral fee of ₹ 1,73,26,631/- by the assessee to several foreign AEs for referring clients, and ₹ 1,06,39,865/- as reimbursement to CWS and CWHK for costs incurred by them for certain coordination and liaison services in respect of their client, IBM.

3. The return was selected from scrutiny through a notice under Section 143(2) of the Act, and was processed under Section 143(1). Since the assessee had entered into international transactions, the AO referred the matter to the Transfer Pricing Officer ("TPO") under Section 92CA(3) of the Act for determination of the arm's length price ("ALP") of the transactions. The TPO by an order recommended an increase in the taxable income by ₹ 1,06,02,930/-, after considering the transfer pricing report provided by the assessee. As regards the payment of the referral fee, the TPO stated that "*no adverse inference is drawn*". However, in respect of the reimbursement of costs to the AEs, the TPO disallowed deduction of the expenditure. The AO, basing himself on this order, made a draft assessment order disallowing the reimbursement. Additionally, the AO disallowed the

referral fees as a deductible expenditure, stating that no benefit was derived by the assessee from the referral fees paid to the AEs.

4. The assessee preferred objections before the Dispute Resolution Panel ("DRP"), against both findings. The DRP concurred with the AO, leading to a final assessment order under Section 143(3) read with Section 144C. The assessee then appealed to the ITAT, which held in its favour.

5. In its return, the assessee had claimed deductions for payment to AEs as reimbursement for costs incurred by them (₹ 1,06,02,930/-) and payment of referral fees for the referral of clients (₹ 1,73,52,922/-). The validity of the ITAT's findings – allowing both expenses – is in question today. The Court will address each in turn.

6. On the issue of reimbursement expenses, this was based on contracts concluded between the assessee and CWS/CWHK. The agreement with CWS stipulated as follows:

> "B. *C&W Singapore has at the request of C&W India agreed to undertake liaisoning and support activities in relation to one of C&W India's clients viz. IBM regional headquarters. C&W Singapore shall assist C&W India in maintaining relationship with IBM regional headquarters located in Singapore, whereby C&W Singapore would liaise with IBM regional headquarters on routine basis.*"
>
> *XXXXXX XXXXXX XXXXX*
>
> "2.1 *In consideration of services provided or to be provided by C&W Singapore to C&W India hereunder, C&W India shall pay to C&W Singapore such costs (including salary and other attributable costs for concerned employees) as may be allocated by C&W Singapore to C&W India on a reasonable basis taking*

into account the activities actually performed by C&W Singapore and the benefits derived by C&W India therefrom."

Similarly, the agreement with CWHK stated:

"*B. C&W HK is the coordinating entity for Cushman & Wakefield entities in Asian region and is responsible for coordinating the activities of 'client solutions group' of Cushman & Wakefield Inc. ("C&W US"), located in the US for the Asian Region.*

C. The parties have resolved to record the terms upon which C&W India has agreed to share the costs of Client Solutions Group."

"*1. Role of the Client Solution Group*

The group will be responsible for undertaking the following activities on behalf of C&W India:

(a) to liaise and coordinate with offices of clients of C&W India;

(b) to develop from time to time a marketing plan in respect of potential clients, with likely revenue for C&W India

(c) to identify potential opportunities to provide additional services to existing clients and obtain instructions thereof; and

(d) to assist C&W India in setting out business brochures, financial planning and strategy in respect of Corporate Services generally for the India region.

3. <u>Payment</u>

3.1 In consideration of activities of Client Solutions Group, C&W US would recharge the actual costs to

C&W HK (including salary and other attributable costs for concerned employees). As part of its share of total costs, C&W India shall pay to C&W HK such costs as may be allocated by C&W HK to C&W India on a reasonable basis taking into account the services actually performed by Client Solution Group and the benefits derived by C&W India therefrom."

7. On the basis of these agreements, the reimbursement claimed, as per the assessee's Transfer Pricing Study, submitted along with its return of income, included "*expenses incurred by the AEs on behalf of the assessee and were subsequently charged by the AEs to the assessee*". However, no benchmarking or a transfer pricing analysis was conducted by the assessee. In this respect, the transfer pricing study submitted by it stated:

"4.6 Reimbursement of expenses to AE's

During FY 2005-06, the AE's of the assessee incurred certain expenses on behalf of the assessee. We understand that these expenses were incurred in connection with travel, boarding & lodging etc. of employees. We also understand that these expenses have been charged back based on actual cost incurred by AE's. In this regard, the AE's provide no additional service.

Further the amount of reimbursements also includes cost shared between the assessee and its AE's. The assessee shares the cost of certain employees of its AE's who assist Cushman & Wakefield group entities in maintaining relationships with its global clients. Such a cost sharing agreement is a commercial decision of the company and helps the company liaise with international clients; it helps create a better understanding of client needs and disseminate information of the real estate market in India.

> *The effort of these individuals is not a full marketing effort but provides a liaison and market access basis for the Company. The strong international presence of the Cushman and Wakefield group places it is a better position to identify and engage such a professional in a more cost effective manner than for the Company to do so directly with its own efforts.*"

8. The TPO found that no intra-group services existed in this case. It was observed, *inter alia*, that since:

> "*the assessee did not file any evidence to support a claim that these services were actually provided to the assessee at its request to meet the specific need of the assessee and that benefit actually accrued to the assessee*",

the amount claimed as reimbursement was disallowed, treating the ALP as Nil. The DRP concurred with this finding, which formed the basis of the AO's final assessment order. The ITAT reversed this finding. It held that

> "*it cannot be said that there is complete absence of evidence submitted by the assessee in respect of services obtained by it from the said Mr. Royden Braganza, in respect of the revenue earned by the assessee.*"

This evidence included a detailed break-up for the cost incurred by Mr. Braganza in providing the services stipulated under the assessee-CWS agreement, and copies of several e-mails sent by Mr. Braganza containing references to services obtained by IBM as a result of his efforts. The TPO's holding that "*there is no documentary evidence*" to support the rendering of services (apart from incidental benefits) was thus reversed. A similar conclusion was returned as regards

reimbursement of costs to CWHK for services rendered by Mr. Ashpreet Choudhary.

9. In respect of this issue, the following question of law arises for the Court's consideration:

> "*Is the Tribunal correct in holding that benchmarking was not necessary in respect of the cost reimbursement reported by the assessee that was later subject to disallowance by the AO, since the TPO held that ALP in respect of this component was nil?*"

10. Impugning the order of the ITAT, learned counsel for the Revenue, Mr. Sanjeev Sabharwal, argued that – through the entire exercise – no benchmarking of the costs claimed as reimbursement has been conducted. It was argued that the costs paid by CWS to the two AEs must be compared to costs paid on other similar transactions, on the basis of one of the methods of calculating the ALP. In the absence of such an exercise by the TPO – who only concerned himself with whether a service was rendered or not – the finding of the ITAT is incorrect. The allowance of any expenditure as a deduction for an international transaction with an AE must pass through the funnel of ALP determination, and cannot be permitted without that exercise. This, it is argued, would amount to a by-pass of the provisions of Section 92 of the Income Tax Act, 1961 ("the Act"). It was submitted that the absence of any determination by the AO and the TPO meant that the ITAT could not have taken upon itself the primary task of determining the ALP and holding that the costs claimed by the assessee were reasonable.

11. Mr. S. Ganesh, learned senior counsel appearing for the assessee on the other hand, argued that the ITAT's approach, is statutorily sanctioned under Section 92(3), which states that the provisions of Section 92 will not apply if the result of the ALP determination is a reduction of the overall tax incidence. This, it is submitted, is the case in the present facts, since it is undisputed that the AEs have – in accordance with the agreements concluded – only charged costs without any mark up. It is submitted that on reference to any other controlled transaction, the amount payable by the assessee would necessarily be greater, as the cost would be supplemented with some profit margin for the international entity.

12. It is contended that in the present case, the AEs have not charged any amount for their services, but only recovered costs, which means that the ALP for such a transaction would – at a minimum – be above or equal to what was claimed. Learned senior counsel placed special emphasis on the fact that the costs incurred by the AEs remained undisputed by the revenue in all previous proceedings. In such event, it is argued, Section 92(3) clearly mandates that no ALP is to be considered, since the effect would be a total reduction in the tax incidence in India. It is argued in this context that the purpose of transfer pricing provisions is to ensure that income is not shifted outside India through wrongly valued transactions with associated enterprises in foreign jurisdictions. In this case, quite to the contrary, it is argued that the minimum possible amount – actual cost incurred – is

paid by the assessee to the AEs, placing the case squarely within the four corners of Section 92(3).

13. The arguments advanced before this Court appears to divide this issue in two parts: first, whether services have indeed been provided by CWHK and CWS to the assessee, and second, whether these services ought to be benchmarked to determine to ALP considering the provisions of Section 92(3).

14. The TPO, in this case, and so the AO, denied the reimbursement deduction claimed from the taxable income on the ground that no services were provided, whereas arguments advanced at the Bar concerned whether benchmarking ought to have been done, considering the services *were* provided (as held by the ITAT).

15. This distinction however divides two fundamentally connected matters (as the TPO's Report correctly notes). Deduction of business expenditure under Section 37 for work undertaken by the AEs allows only for deduction of *such* amounts as incurred *for the benefit* of the assessee. The reimbursement claimed by the assessee, therefore, should relate to work done by the AEs that has benefited it – the presence of a benefit and the costs incurred in creating that benefit form part of the same matrix of consideration under Section 37. They cannot be segregated, as is the repercussion of the assessee's argument. Quintessentially, only those costs incurred by CWS and CWHK which led to a benefit to the assessee can be claimed by it under Section 37. Creating a distinction would lead to an illogical

position where once the *factum* of benefit is established, the amounts claimed as a deduction for creating that benefit would be considered autonomously.

16. The Court notes that even under the agreements concluded, CWS was to provide "*liaisoning and support activities in relation to one of C&W India's clients viz. IBM regional headquarters*", whilst CWHK was to coordinate activities of the Client Solution Group. The assessee produced material and evidence of work done under both agreements by Mr. Braganza and Mr. Choudhary, respectively, to substantiate its argument that such services were indeed rendered. Under both agreements, the assessee had to reimburse CWS and CWHK for costs incurred by them for its benefit. The agreement between the assessee and CWS stipulated that the costs were to

> "*be allocated by C&W Singapore to C&W India on a reasonable basis taking into account the activities actually performed by C&W Singapore and the benefits derived by C&W India therefrom*". (emphasis supplied)

Similarly, the agreement between the assessee and CWHK stipulated that

> "*C&W India shall pay to C&W HK such costs as may be allocated by C&W HK to C&W India on a reasonable basis taking into account the services actually performed by Client Solution Group and the benefits derived by C&W India therefrom.*"
> (emphasis supplied)

The agreements thus only contemplate reimbursement of costs incurred for the actual benefit of the assessee.

17. The core of argument advanced by learned senior counsel for the assessee is that once the accrual of benefit to the assessee is established, the expenditure falls within Section 37, and there is no need for further assessment of the ALP under Section 92(3). The relevant portions of Section 92 are extracted below:

> "***Computation of income from international transaction having regard to arm's length price.***
>
> *92. (1) Any income arising from an international transaction shall be computed having regard to the arm's length price.*
>
> *Explanation.—For the removal of doubts, it is hereby clarified that the allowance for any expense or interest arising from an international transaction shall also be determined having regard to the arm's length price.*
>
> *(2) Where in an international transaction or specified domestic transaction, two or more associated enterprises enter into a mutual agreement or arrangement for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises, the cost or expense allocated or apportioned to, or, as the case may be, contributed by, any such enterprise shall be determined having regard to the arm's length price of such benefit, service or facility, as the case may be.*
>
> *XXXXXX XXXXXX XXXXXX*

> *(3) The provisions of this section shall not apply in a case where the computation of income under sub-section (1) or sub-section (2A) or the determination of the allowance for any expense or interest under that sub-section, or the determination of any cost or expense allocated or apportioned, or, as the case may be, contributed under sub-section (2) or sub-section (2A), has the effect of reducing the income chargeable to tax or increasing the loss, as the case may be, computed on the basis of entries made in the books of account in respect of the previous year in which the international transaction or specified domestic transaction was entered into.*"

18. As far as CWS went, an invoice of SGD 74,330/- (Singapore Dollars) was raised. This, as noticed by the ITAT, was the reimbursement of 75% of SGD 99,107/-, which is Mr. Royden's cost incurred from January to June, 2006, in the Singapore office. In respect of CWHK, the revenue generated by the activities of the Client Solution Group to the assessee was US $ 3,037,398/-, which was 82.44% of the total revenue generated for Cushman & Wakefield Asia, US $ 3,684,497/-. The cost allocated to the assessee was US $ 203,931, as compared to a total cost of US $ 281,265 to Cushman & Wakefield Asia. Thus, for a 82.44% share of the revenue from the services of the Client Solution Group, the relatable cost allocation was 72.5%. Noting these figures, the finding of the ITAT held as below:

> "*23. It can be seen from the above chart that the main revenue earned is by the assessee only which is 82.44% of the total revenue and re-imbursement of cost is only to the extent of $ 2,81,265/- out of which cost allocated to the assessee is $ 2,03,931. The revenue relatable to such cost allocation is $ 3,037,398. Evidence in the shape of various e-mails sent by Mr. Arshpreet Choudhary to the assessee*

company with regard to various clients from whom the assessee has earned income are placed at pages 193 onwards. These e-mails were produced by the assessee before the Assessing Officer, TPO and DRP. Thus, it cannot be said that there is absence of evidence submitted by the assessee and it will be incorrect to say that the assessee did not furnish evidence to support its contention that it has reimbursed the cost in respect of revenues earned by it on account of services rendered by CWHK. All the details have been furnished on record. The reasons given for upholding the adjustment to arm's length price are same as have been given in respect of CWS. Those reasons are already discussed for the adjudication of reimbursement to CWS and adopting same criteria, we find no justification in the adjustment of 92,25,838/- to the TP adjustment in respect of payments made by the assessee to CWHK."

Analysis and Conclusions

19. The Court notes that the costs incurred by CWS and CWHK have not been disputed by the revenue. They were actually incurred. Equally, it is an admitted fact that the assessee did not attempt to benchmark this international transaction through any of the methods indicated under Rule 10C of the Income Tax Rules, 1961, to determine the ALP for these transactions. Neither was such an exercise conducted by the TPO, and accordingly, till date, that vacuum exists. This vacuum remains despite Section 92(3) of the Act. Section 92 creates a regime for determining the true value of a transaction between two related parties, in this case, the assessee and CWS/CWHK, to ensure that taxable income is not transferred to another entity or jurisdiction. The very purpose of Section 92 thus is to ensure that the total taxable income is reported correctly to increase

tax collection. Naturally, clause (3) provides that *if* such an ALP results in a decrease in the tax incidence in India, the true value of the transaction will be the value stated by the assessee and not the ALP. In other words, if an assessee is paying greater income tax than would otherwise be paid in an uncontrolled transaction, Section 92 will not alter the income stated in the return. This conclusion, however, can only be reached after an assessment of the ALP and comparison with the income stated in the return.

20. The existence of different tax rates and rules in different countries offers a potential incentive to multinational enterprises to manipulate their transfer prices to recognise lower profit in countries with higher tax rates and vice versa. This can reduce the aggregate tax payable by the multinational groups and increase the after tax returns available for distribution to shareholders. In India, the Act had hitherto not dealt with this problem in a detailed manner. The erstwhile section 92 sought to determine the amount of profits which may reasonably be deemed to have been derived from a business carried on between a resident and a non-resident which, owing to the close connection between them is so arranged that it produced, to the resident, either no profits or less than the ordinary profits which might be expected to arise in that business. Besides, sections 40A(2), 80IA(10) and 80IB(13) of the Act provide powers to the AO to interfere with the pricing or costing of certain transactions in certain cases in order to determine the correct quantum of deduction permissible.

21. The Finance Act, 2001, recognized that international transactions between associated enterprises may not be subject to the same market forces that shape relations between two independent firms, and, therefore introduced a set of provisions in Chapter X of the Act under the title 'special provisions relating to avoidance of tax'. The statutory framework attempts to monitor transfer prices for goods, facilities and services in order to determine that they conform to the "arm's length principle". Not only has section 92 of the Act been completely recast but new sections 92A to 92F have also been introduced to meet the desired objective of ensuring that the local tax base of an assessee is fair.

22. Section 92D provides that every person who has entered into an international transaction or specified domestic transaction, during a previous year, shall keep and maintain such information and documents, prescribed by the Board, as will assist the Assessing Officer/Transfer Pricing Officer to compute the income arising from that transaction, having regard to the arm's length price. This obligation of an enterprise to keep and maintain prescribed documents arises because of its unique position of being in control and custody of information that is necessary to verify whether the international transactions or specified domestic transaction to which it was party were carried out on the arm's length principle.

23. Section 92C (1) of the Act prescribes the procedure to calculate the arm's length price for an international transaction. As per Section 92C (1) the arm's length price in relation to an international

transaction shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe, namely: (a) Comparable uncontrolled price method; (b) Resale price method; (c) Cost plus method; (d) Profit split method; (e) Transactional net margin method; (f) Such other method as may be prescribed by the Board.

Section 92C (2) of the Act provides that the most appropriate method referred to in sub-section (1) shall be applied, for determination of arm's length price, in the manner as may be prescribed. The proviso to Section 92C (2) provides that where more than one price is determined by the most appropriate method, the arm's length price shall be taken to be the arithmetical mean of such prices, or, at the option of the assessee, a price which may vary from the arithmetical mean by an amount not exceeding five per cent of such arithmetical mean. Section 92C (3) of the Act provides that where during the course of any proceeding for the assessment of income, the Assessing Officer is, on the basis of material or information or document in his possession, of the opinion that:

> (a) The price charged or paid in an international transaction has not been determined in accordance with sub-sections (1) and (2); or

(b) Any information and document relating to an international transaction have not been kept and maintained by the assessee in accordance with the provisions contained in Section 92-D (1) and the rules made in that regard; or

(c) The information or data used in computation of the arm's length price is not reliable or correct; or

(d) The assessee has failed to furnish, within the specified time, any information or document which he was required to furnish by a notice issued under sub-section (3) of section 92D, the Assessing Officer may proceed to determine the arm's length price in relation to the said international transaction in accordance with sub-sections (1) and (2), on the basis of such material or information or document available with him. The Proviso states that an opportunity shall be given by the Assessing Officer by serving a notice calling upon the assessee to show cause, on a date and time to be specified in the notice, why the arm's length price should not be so determined on the basis of material or information or document in the possession of the Assessing Officer.

24. Section 92C (4) of the Act provides that where an arm's length price is determined by the Assessing Officer under sub-section (3), the Assessing Officer may compute the total income of the assessee having regard to the arm's length price so determined. However, no deduction under section 10A [or section 10AA] or section 10B or

under Chapter VI-A shall be allowed in respect of the amount of income by which the total income of the assessee is enhanced after computation of income under the said provision. Furthermore, the second proviso states that where the total income of an associated enterprise is computed under this sub-section on determination of the arm's length price paid to another associated enterprise from which tax has been deducted [or was deductible] under the provisions of Chapter XVIIB, the income of the other associated enterprise shall not be recomputed by reason of such determination of arm's length price in the case of the first mentioned enterprise.

25. Section 92CA (1) of the Act provides that where any person, being the assessee, has entered into an international transaction in any previous year, and the Assessing Officer considers it necessary or expedient so to do, he may, with the previous approval of the Commissioner, refer the computation of the arm's length price in relation to the said international transaction under section 92C to the Transfer Pricing Officer. Section 92CA (2) of the Act provides that where a reference is made under sub-section (1), the Transfer Pricing Officer shall serve a notice on the assessee requiring him to produce or cause to be produced on a date to be specified therein, any evidence on which the assessee may rely in support of the computation made by him of the arm's length price in relation to the international transaction referred to in sub-section (1).

26. Section 92CA (3) of the Act provides that on the date specified in the notice under sub-section (2), or as soon thereafter as may be,

after hearing such evidence as the assessee may produce, including any information or documents referred to in sub-section (3) of section 92D and after considering such evidence as the Transfer Pricing Officer may require on any specified points and after taking into account all relevant materials which he has gathered, the Transfer Pricing Officer shall, by order in writing, determine the arm's length price in relation to the international transaction in accordance with sub-section (3) of section 92C and send a copy of his order to the Assessing Officer and to the assessee.

27. Section 92D (1) of the Act provides that every person who has entered into an international transaction shall keep and maintain such information and document in respect thereof, as may be prescribed. Section 92D (2) of the Act provides that without prejudice to the provisions contained in sub-section (1), the Board may prescribe the period for which the information and document shall be kept and maintained under that sub-section. Section 92D (3) of the Act provides that the Assessing Officer or the Commissioner (Appeals) may, in the course of any proceeding under this Act, require any person who has entered into an international transaction to furnish any information or document in respect thereof, as may be prescribed under sub-section (1), within a period of thirty days from the date of receipt of a notice issued in this regard. This period is extendable. Section 92E obliges every person who has entered into an international transaction during a previous year shall obtain a report from an accountant and furnish such report on or before the specified date in the prescribed form duly

signed and verified in the prescribed manner by such accountant and setting forth such particulars as may be prescribed.

28. By virtue of Section 92D (2) the Board is empowered to prescribe the period for which the assessee must maintain the prescribed information and records. Pursuant thereto, the Board has stipulated that the prescribed information and documents be kept and maintained for a period of eight years from the end of the relevant assessment year - Rule 10D (5). Under section 92D (3), the Assessing Officer or the Commissioner (Appeals) during the course of any proceeding under the Act may require a person who has entered into an international transaction or specified domestic transaction to furnish any information or document, which he was expected to maintain under section 92D (1). The person shall furnish the information or document called for within thirty days from the date of receipt of a notice issued in this regard. If, for any reason, the person is unable to produce the required information or documents within the stipulated period of thirty days, the Assessing Officer or Commissioner (Appeals) may, on an application made by the person, extend the period by a further period or periods not exceeding, in all, thirty days. Under section 92E, every person who has entered into an international transaction or specified domestic transaction during a previous year shall obtain a report from an accountant and furnish such report on or before the specified date in the prescribed form duly signed and verified in the prescribed manner by such accountant and setting forth such particulars as may be prescribed. “Specified date”

shall have the same meaning as assigned to due date in the second Explanation to Section 139 (1).

29. The argument in this case is that the assessee only paid for the cost incurred, while an uncontrolled transaction would involve an additional element of profit, thus leading to a greater claim for reimbursement. If true, this would no doubt place this transaction within Section 92(3). However this cannot be the case. Undoubtedly certain amounts were charged by the AEs as reimbursement for actual costs incurred. Nevertheless, whether a third party – in an uncontrolled transaction with the assessee would have charged amounts lower, equal to or greater than the amounts claimed by the AEs, CWS and CWHK has to perforce be *tested* under the various methods prescribed in Section 92C of the Act. The question thus required to be addressed - and determined, is whether an independent entity – for the same liaisoning and client interaction services as were provided by CWS and CWHK – charges an amount less than or equal to or more than SGD 74,330/- and SGD 281,265/-. An independent entity would quite possibly include a mark-up over and above the cost, and thus, exceed the value charged by the AEs in this case. The sequitur cannot be that the cost incurred by those entities would be the same as the AEs in this case. It may be greater (in which case Section 92(3) would clearly apply), or lower. This cannot be a matter of speculation. Nor is the application of Section 92(3) a logical inference from the fact that CWS and CWHK have only asked for reimbursement of cost. This being a transaction between related parties, whether that cost itself is

inflated or not only is a matter to be tested under a comprehensive transfer pricing analysis. The assessee did not benchmark these costs in its transfer pricing study. Neither was any transfer pricing study conducted by the TPO, who, crucially, did not say that the ALP was lower than the amount claimed. He, instead disallowed the expenditure altogether on the ground that there were no services rendered to begin with. The ITAT overruled the TPO on that limited ground, but did not concern itself with a transfer pricing analysis as contemplated under Section 92; to the contrary, it accepted the assessee's stated return (absent any benchmarking) as the true and correct value under an implicit (and incorrect) understanding of Section 92(3).

30. As regards the costs incurred by CWHK, a further issue arises. Whilst the costs incurred by Mr. Braganza, for CWS, for the benefit of the assessee were detailed, no such details were provided for the services rendered by CWHK, acting as the coordinating entity for the Client Solutions Group. The cost allocation to the assessee is on the basis of a percentage of the cost relatable to the revenue generated by Cushman & Wakefield Asia. This is explained through the following chart, on which the ITAT placed reliance:

NY Revenue Estimate			**C&W Asia Revenue Estimate**				**Allocation**		
Country	Net fee to local office (US$)	% Allocation	Asia Revenue Allocation	$ Allo-cation	75% NY revenue allocation	25% Gross revenue Allocation	Total Allo-cation	BP % Allocation	BP Alloc-ation

			(US$)				on US $		US$
India	3037398	82.44%	11220932	42.7%	173990	30031	203931	72.5	150.360
China	369000	10.01%	5859619	22.3%	21126	15682	36809	13.1	146.243
Hong Kong	120065	3.26%	4292851	16.3%	6874	11489	18363	6.5	124.770
Korea	24252	0.66%	3244992	12.4%	1389	8685	10073	3.6	47.784
Singapore	133782	3.63%	1655239	6.3%	7659	4430	12089	4.3	47.926
C&W Asia	3684497	100 %	26273633	100%	210949	70316	281265	100 %	517.083

31. As explained, for 82.44% share of the revenue from the services of the Client Solution Group, the relatable cost allocation was 72.5%. The precise activities conducted by the Client Solutions Group for the benefit of the assessee out of the entire range of activities conducted by it, and the cost applicable to *such* activities have not been provided. Instead a broad-brush approach at flatly 'equating' the costs relatable to the revenue generated has been provided. Whilst several e-mails from Mr. Arshpreet Choudhary were placed on record, they evidence the fact that certain services were rendered. That constitutes only the first part of the exercise – the second aspect is to relate the cost of specific activities conducted to the benefit incurred by the assessee, rather than allocate cost from a common pool or basket of revenue

generated through an unexplained percentage relation to the revenue generated. The basis for the costs incurred, the activities for which they were incurred, and the benefit accruing to the assessee from those activities must all be proved to determine first, whether, and how much, of such expenditure was for the purpose of benefit of the assessee (deductible under Section 37 of the Act), and secondly, whether that amount passed muster under a transfer pricing analysis.

32. Having made these observations, the Court also notes that the contrary findings of the TPO, that no services were rendered, and those of the ITAT, that services were rendered, must be viewed in this context. The ultimate analysis has to disclose whether the service rendered has a value and if so, determine that. Particular reliance has been placed by the TPO, and the ITAT, on the 2009 Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations of the Organization for Economic Cooperation and Development ("OECD"), specifically paragraphs 7.4-7.6. These concern intra-group services (i.e. services provided by one member of a group to another, such as the case presently), and factors relevant to determine whether such a service exists. The Court notes, first, that the 2009 OECD Guidelines are not binding, and further, that paragraph 7.4. of the Guidelines itself recognizes that each case depends on its facts and circumstances. Whilst the factors enumerated in paragraph 7.6 are relevant, strict adherence to the OECD guidelines, bordering on rigidity, is antithetical.

33. The TPO, in this case, noted that the services of the Client Solutions Group did not create any specific benefit for the assessee, but rather, that the relationship between Cushman & Wakefield, United States and IBM predated the assessee's involvement. The assessee thus received only an incidental benefit from that relationship. The TPO further noted that no independent enterprise would be willing to engage a third party for such a transaction, and in any case, the AE's means to conduct market research vis-à-vis the Indian market was questionable in the absence of any evidence to the contrary. Moreover, the TPO noted that the assessee itself had many offices in India which conducted market research, and in that sense, this was merely a duplication of services. The ITAT reversed this finding:

> "*The assessee has been shown to have earned substantial revenues from IBM and that cannot be the result of only incidental benefit received by the assessee and IBM. If one wants to obtain revenue upon dealing in real estate, certain work has to be done. All the primary facts were submitted to the Assessing Officer as well as the TPO. The names of the parties were mentioned. Without examining any such details, it cannot be said that the revenue earned by the assessee was only on account of incidental benefit. There is a force in the claim of the assessee that to enable it to earn revenue from IBM, it was necessary to provide services to IBM outside India. If such services are provided by employees of the assessee company, then, it has to incur the cost of its employee who has to travel to the destination and that would result in extra expenditure …*"

34. The Court first notes that the authority of the TPO is to conduct a transfer pricing analysis to determine the ALP and *not* to determine

whether there is a service or not from which the assessee benefits. That aspect of the exercise is left to the AO. This distinction was made clear by the ITAT in *Dresser-Rand India Pvt. Ltd.* v. *Additional Commissioner of Income Tax*, 2012 (13) ITR (Trib) 422:

> *"8. We find that the basic reason of the Transfer Pricing Officer's determination of ALP of the services received under cost contribution arrangement as 'NIL' is his perception that the assessee did not need these services at all, as the assessee had sufficient experts of his own who were competent enough to do this work. For example, the Transfer Pricing Officer had pointed out that the assessee has qualified accounting staff which could have handled the audit work and in any case the assessee has paid audit fees to external firm. Similarly, the Transfer Pricing Officer was of the view that the assessee had management experts on its rolls, and, therefore, global business oversight services were not needed. It is difficult to understand, much less approve, this line of reasoning. It is only elementary that how an Assessee conducts his business is entirely his prerogative and it is not for the revenue authorities to decide what is necessary for an Assessee and what is not. An Assessee may have any number of qualified accountants and management experts on his rolls, and yet he may decide to engage services of outside experts for auditing and management consultancy; it is not for the revenue officers to question Assessee's wisdom in doing so. The Transfer Pricing Officer was not only going much beyond his powers in questioning commercial wisdom of Assessee's decision to take benefit of expertise of Dresser Rand US, but also beyond the powers of the Assessing Officer. We do not approve this approach of the revenue authorities. We have further noticed that the Transfer Pricing Officer has made several observations to the effect that, as evident from the analysis of financial performance, the assessee did not benefit, in*

terms of financial results, from these services. This analysis is also completely irrelevant, because whether a particular expense on services received actually benefits an Assessee in monetary terms or not even a consideration for its being allowed as a deduction in computation of income, and, by no stretch of logic, it can have any role in determining arm's length price of that service. When evaluating the arm's length price of a service, it is wholly irrelevant as to whether the assessee benefits from it or not; the real question which is to be determined in such cases is whether the price of this service is what an independent enterprise would have paid for the same. Similarly, whether the AE gave the same services to the assessee in the preceding years without any consideration or not is also irrelevant. The AE may have given the same service on gratuitous basis in the earlier period, but that does not mean that arm's length price of these services is 'nil'. The authorities below have been swayed by the considerations which are not at all relevant in the context of determining the arm's length price of the costs incurred by the assessee in cost contribution arrangement. We have also noted that the stand of the revenue authorities in this case is that no services were rendered by the AE at all, and that since there is No. evidence of services having been rendered at all, the arm's length price of these services is 'nil'."

35. The TPO's Report is, subsequent to the Finance Act, 2007, binding on the AO. Thus, it becomes all the more important to clarify the extent of the TPO's authority in this case, which is to determining the ALP for international transactions referred to him or her by the AO, rather than determining whether such services exist or benefits have accrued. That exercise – of factual verification is retained by the AO under Section 37 in this case. Indeed, this is not to say that the TPO cannot – after a consideration of the facts – state that the ALP is

'nil' given that an independent entity in a comparable transaction would not pay any amount. However, this is different from the TPO stating that the assessee did not benefit from these services, which amounts to disallowing expenditure. That decision is outside the authority of the TPO. This aspect was made clear by the ITAT in *Delloite Consulting India Pvt. Ltd.* v. *Deputy Commissioner of Income Tax*, [2012] 137 ITD 21 (Mum):

> *"37. On the issue as to whether the Transfer Pricing Officer is empowered to determine the arm's length price at "nil", we find that the Bangalore Bench of the Tribunal in Gemplus India P. Ltd. 2010-TII-55-ITAT-BANG-TP, held that the assessee has to establish before the Transfer Pricing Officer that the payments made were commensurate to the volume and quality service and that such costs are comparable. When commensurate benefit against the payment of services is not derived, then the Transfer Pricing Officer is justified in making an adjustment under the arm's length price.*
>
> *38. In the case on hand, the Transfer Pricing Officer has determined the arm's length price at "nil" keeping in view the factual position as to whether in a comparable case, similar payments would have been made or not in terms of the agreements. This is a case where the assessee has not determined the arm's length price. The burden is initially on the assessee to determine the arm's length price. Thus, the argument of the assessee that the Transfer Pricing Officer has exceeded his jurisdiction by disallowing certain expenditure, is against the facts. The Transfer Pricing Officer has not disallowed any expenditure. Only the arm's length price was determined. It was the Assessing Officer who computed the income by adopting the arm's length price decided by the Transfer Pricing Officer at "nil"."*

This is a slender yet crucial distinction that restricts the authority of the TPO. Whilst the report of the TPO in this case ultimately noted that the ALP was 'nil', since a comparable entity would pay 'nil' amount for these services, this Court noted that remarks concerning, and the final decision relating to, benefit arising from these services are properly reserved for the AO.

36. In this case, the issue is whether an independent entity would have paid for such services. Importantly, in reaching this conclusion, neither the Revenue, nor this Court, must question the *commercial wisdom* of the assessee, or replace its own assessment of the commercial viability of the transaction. The services rendered by CWS and CWHK in this case concern liaising and client interaction with IBM on behalf of the assessee – activities for which, according to the assessee's claim – interaction with IBM's regional offices in Singapore and the United States was necessary. These services cannot – as the ITAT correctly surmised – be duplicated in India insofar as they require interaction abroad. Whether it is commercially prudent or not to employ outsiders to conduct this activity is a matter that lies within the assessee's exclusive domain, and cannot be second-guessed by the Revenue.

37. At this point, it is noteworthy that the circumstance that the assessee had market research facilities in India does not correspond to the performance of services abroad, especially in relation to client interaction services located outside India - albeit for ultimately sourcing them into the Indian market. The e-mails considered by the

ITAT from Mr. Braganza and Mr. Choudhary so far as they deal with specific interaction with IBM by those persons, and relate it to benefits obtained by the assessee, provide a sufficient basis to hold that benefit accrued to the assessee. However, this determination remains unclear and inchoate. The devil here lies in the details. The details of the specific activities for which cost was incurred by both CWS and CWHK (for the activities of Mr. Braganza and Mr. Choudhary), and the attendant benefit to the assessee, have not been considered till date. This must be provided, in addition to a consideration of the ALP vis-à-vis the total cost claimed by these AEs. To this extent, for the consideration of ALP in respect of these transactions, the matter is remanded back to the file of the concerned AO, for an ALP assessment by the TPO, followed by the AO's assessment order in accordance with law.

38. The second issue which arises in these proceedings concerned the disallowance of referral fees paid by the assessee to various AEs, for the referral of clients in the real estate business to the assessee. This was referred by the AO to the TPO, who in this Report stated that "*no adverse inference is drawn*". The assessee had – in its own Transfer Pricing analysis – conducted a benchmarking for these transactions, through the Comparable Uncontrolled Prices ("CUP") method, with which the TPO found no infirmity. The AO subsequently, however, found that no services were actually rendered for which referral fees was to be paid. The findings of the AO are extracted below:

"*4.5 Repeatedly during the course of the hearings, the assessee company bad been asked to match each transaction in the list to work done by the group entity specifically in relation to the property transaction done but this has not been given by the assessee in its submissions. This makes it clear that the assessee company is in no position to clarify or substantiate the work done or services rendered by the group concerns to men this payment of referral fee to them at a high rate of 30%.*

4.6 In the submissions given the assessee company has simply filed some invoices raised on the group entities where it is written that the referral fee @ 30% of the gross fee earned by C&W India……..…None of the agreements filed by the assessee company specify the exact percentage of fee to be received by CWS. No prudent business person will leave the issue of payment of fee open. The assessee has not been able to demonstrate the genuineness of the transaction, the services rendered by the group entities to merit this referral fee at a high rate nor the business purpose of the same.

4.8 On close scrutiny of the e-malls, copies of which have been given in the submissions, it is seen that most of them are cryptic mails in that most of them do not clearly mention either the client or the requirements of the client which is the mandatory requirement for any entity referring to any other entity. There is no evidence submitted regarding the services provided by the group entities to merit the referral fee. Copies of some invoices are also given but again raising invoices does not substantiate or gives proof of the work done by the group entities.

4.9 The assessee has not been able to demonstrate as to how the Indian entities from whom income was generated on account of rendering off services etc. is linked to the associate enterprise of the assessee to whom referral fee is paid. In simpler words the link between the clients based in

> *India and the associate enterprises of the assessee company which could enable their referral in the first instance has not been established. The assessee's case is a pure and simple case of tax planning …*"

39. The ITAT reversed this finding on two grounds. The first was that the AO, after having referred the matter to the TPO, could not re-open or re-examine the transaction, which was done in this case. This, it was argued by the assessee, and held by the ITAT, amounts to doing something indirectly which cannot be done directly; secondly, on merits, the ITAT held that "*[t]he assessee has submitted ample evidence to support the expenditure and it was shown that such expenditure is incurred with respect to revenue earned by the assessee on property transaction referred to the assessee by its associate enterprise.*"

40. On the first ground, this Court notes that the jurisdiction of the AO, under Section 37, and the TPO, under Section 92CA, are distinct. A referral by the AO to the TPO is only for the limited purpose of determining the ALP, based on a *prima facie* view that such a referral is necessary. It does not imply a concrete view as to the existence of services, or the accrual of benefit (such that allowance under Section 37 must be permitted). This very argument was considered and rejected by the ITAT in *Delloite* (supra):

> "*34. The second argument of learned counsel that the Transfer Pricing Officer is not empowered to disallow the expenditure and that the very reference to the Transfer Pricing Officer by the Assessing Officer presumes that the amount in question is allowable under section 37 of the Act*

and certain case laws were relied upon for this proposition.

35. We are unable to persuade ourselves to agree to this proposition for the reasons that the Central Board of Direct Taxes, by way of a circular, has directed the Assessing Officer to refer to all transactions beyond a specified limit, to the Transfer Pricing Officer for determining the arm's length price. When the Assessing Officer has no discretion in the matter, in view of the binding nature of the Central Board of Direct Taxes instructions dated 20th May 2003, directing all the officers of the Department to refer the matters to the Transfer Pricing Officer for determination of the arm's length price where the aggregate value of international transactions exceeds Rs. 5,00,00,000, the Assessing Officer has a very limited role. He has to mechanically follow these instructions. There is no application of mind. There is no formation of any opinion at the stage of reference. Thus, to presume that he has allowed a particular expenditure under section 37, does not seem to be the right view of the matter. In any event, this is not a case where the Transfer Pricing Officer or the Assessing Officer made a disallowance under section 37 of the Act. It is a case where an adjustment has been made under section 92C(4) of the Act, after the Transfer Pricing Officer determined the arm's length price at nil under section 92CA(3). Hence this argument is devoid of merit."

Indeed, a Division Bench of this Court, in *Sony India Pvt. Ltd.* v. *Central Board of Direct Taxes and Anr.*, [2007] 288 ITR 52 (Delhi) (albeit considering the law prior to the 2007 amendment to the Act), concurred with this view:

"*18 … a reading of Section 92C and 92CA does not indicate that the AO is required to form a prior considered opinion after considering all the available materials even*

before making a reference to the TPO. A prima facie opinion would suffice at the stage of making the reference.

35 … It correctly interprets the law as requiring only a formation of a prima facie opinion by the AO at the stage of the reference. Therefore, the question of the CBDT supplanting the judicial discretion of the AO does not arise. It is perfectly possible that, independent of the circular, the AO might still "consider it necessary or expedient" to refer an international transaction of such value to the TPO for determination of the ALP. At the same time it is not as if the transactions of the value of less than Rs. 5 crores cannot be referred to the TPO by the AO. Ultimately, any exercise of discretion by the AO is bound to be judicially reviewed by the statutory appellate authorities as well as by courts. Therefore, it is not as if there is no check on the exercise of discretion by the AO."

The AO can, therefore, determine under Section 37 that the expenditure claimed (in this case, the referral fees) was not for the benefit of the business, and thus, disallow that amount. This does not restrict or in any way bypass the functions of the TPO. Quite to the contrary, it represents the correct division of jurisdiction between the two entities.

41. On merits, the Court notes that the referral fees was paid according to 'international fee sharing rules and referral fees on Tenant Representation Transactions', details of which were provided by the assessee. This is extracted below:

"*Tenant Representation Transactions*
The referring party will receive the following percentage of the net commission paid to the executing

For business referred with competition:	
For the portion between $0 - $20000	*0%*
For the portion between $20001 - $150000	*20%*
For the portion between $150001 - $500000	*30%*
For the portion above $500001	*40%*
For business referred without competition:	
For the portion between $0 - $20000	*0%*
For the portion between $20001- $150000	*30%*
For the portion between $150001 - $500000	*40%*
For the portion above $500001	*50%*"

42. Whether these figures represented the ALP of such referral transactions was to be decided by the TPO, who concluded that "*no adverse inference is drawn*". This determination is binding on the AO, who cannot consider the quantum of referral fees paid, but only whether such fees was backed by an *actual* referral by the AEs. In other words, the AO's jurisdiction in such case is to only verify whether the claim of the assessee is borne out by the materials relied on by it and finalize the assessment order. This – as discussed – is the distinction between the jurisdiction of the AO and the TPO; the TPO determines whether the stated transaction value represents the ALP or not (including whether the ALP is nil), while the AO makes the decision as to validity of the deduction under Section 37. This means the decision as to whether the expenditure was "*laid out or expended wholly and exclusively for the purposes of the business*" is a fact determination or verification to be undertaken by the AO. This includes whether the referrals actually occurred (and thus took place for the 'purpose of the business'), independent of their valuation

which the TPO determines. *That* determination is not and cannot be made by the TPO. Nor is the authority of the AO under Section 37 curtailed in any manner by a reference under Section 92C. This distinction is crucial in order to maintain the statutory authority of the AO to *assess* the stated income as against the provisions of the Act, rather than accept the assessee's assertions by foreclosing the enquiry. The finding of the ITAT that the AO could not have gone into the matter of whether the referral actually took place (based on evidence provided by the assessee) after referring the matter to the TPO is thus incorrect. The AO can and indeed should conduct that exercise, lest correctly priced deductions based on non-existent paper transactions funnel through Section 37.

43. In view of the above discussion and analysis of the statutory provisions, two issues on the merits of the AO's assessment assume importance. Firstly, having regard to the TPO's stamp of approval to the fees charged for the stated (though still not proven) referral transactions, the AO was bound to accept that finding; it is, post 2007, binding. In this context, it was incorrect for the AO to remark that the

> "*assessee is in no position to clarify or substantiate the work or services rendered by the group concerns to merit this payment of referral fees to them* <u>*at a high rate of 30%*</u>"
>
> (emphasis supplied)

The quantum of payment, i.e. the value of transaction or the percentage referral fees paid was confirmed by the TPO in his

determination. The payment was at arm's length; the AO cannot reassess that issue or draw adverse conclusions from the percentage value of the referral fees. The AO *can*, however, in his assessment under Section 37 decide whether work or services were *actually* rendered as claimed by the assessee. In other words, the AO may determine whether the stated transactions are real and genuine, i.e. the *existence* of a referral from the AE to the assessee. This, as part of the broader exercise to determine whether the expenditure was for the purposes of the business, lies unquestionably within the domain of the AO. Indeed, this is also precisely what the AO did:

> *"4.5 Repeatedly during the course of the hearings, the assessee company had been asked to match each transaction in the list to the work done by the group entity specifically in relation to the property transaction done but this has not been given by the assessee in its submissions. This makes it clear that the assessee company is in no position to clarify or substantiate the work done or services rendered by the group concerns to merit this …*
>
> *4.6 … None of the agreements filed by the assessee company specify the exact percentage of fee to be received by CWS. No prudent business person will leave the issue of payment of fee open. The assessee has not been able to demonstrate the genuineness of the transaction, the services rendered by the group entities to merit this referral fee at a high rate nor the business purpose of the same.*
>
> *4.8 On close scrutiny of the e-mails, copies of which have been given In the submissions, it is seen that most of them are cryptic mails in that most of them do not clearly mention either the client or the requirements of the client which is the mandatory requirement for any entity*

> *referring to any other entity. There is no evidence submitted regarding the services provided by the group entities to merit the referral fee. Copies of some invoices are also given but again raising invoices does not substantiate or gives proof of the work done by the group entities.*
>
> *4.9 The assessee has not been able to demonstrate as to how the Indian entities from whom income was generated on account of rendering off services etc. is linked to the associate enterprise of the assessee to whom referral fee is paid. In simpler words the link between the clients based in India and the associate enterprises of the assessee company which could enable their referral in the first instance has not been established. The assessee's case is a pure and simple case of tax planning otherwise."*

(emphasis supplied)

Based on the evidence provided by the assessee, the AO found that there was no underlying referral that justified the payment of fees (which, if the transactions were genuine, would have been at arm's length as per the TPO) and thus the expenditure was not for a business purpose. This clearly lies within the AO's jurisdiction; a ruling to the contrary would mean that the expenditure cannot be tested as against the legal standard under Section 37. The ITAT reasoned that this amounts to doing something indirectly that cannot be done directly. Quite to the contrary, this is something that the AO can do, and has done, directly.

44. The other aspect is that the ITAT dismissed the assessment order on merits as well. It held that the AO's assessment of evidence was incorrect, because "*[t]he assessee had submitted ample evidence*

to support the expenditure." Having set aside the ITAT's reasoning that the TPO's report was binding on this issue, this bare assertion of 'ample evidence' remains the only reference to the merits of the AO's order. This Court notes that neither the AO (who did admittedly deal with the issue at some length) nor the ITAT (which summarily noted that presence of evidence) have discussed what such evidence is. Details of the e-mails, and why they do or do not disclose the existence of referral transactions, or any other material concerning the transactions, have not been disclosed, let alone discussed in any detail. In such a case, the Court is faced with contrary assertions of the AO and the ITAT, and nothing more. No conclusions about the correctness of either approach can be taken in this background.

45. The finding of the ITAT on this count are, therefore, liable to be set aside, and this aspect of the matter is to be remanded to the file of the AO for a detailed verification of facts and provision of reasoned conclusions, with the AO being bound by the TPO's approval of the pricing of the referral fees.

46. Accordingly, the findings of the ITAT concerning reimbursement of costs and payment of referral fees to the foreign AEs are set aside. The matter is remanded to the file of the AO, in view of the directions in the paragraphs 37 and 45 above. On the question of reimbursement of costs, the matter is remanded to the file of the AO, for an ALP assessment by the TPO, followed by the AO's assessment order in accordance with law. On the question of referral fees, the report of the TPO validating the arm's length price of the

transactions is binding on the AO, who may verify the transactions and assess the deductions under Section 37 of the Act in accordance with law. For these reasons, the appeal is partly allowed. There shall be no order as to costs.

S. RAVINDRA BHAT
(JUDGE)

VIBHU BAKHRU
(JUDGE)

MAY 23, 2014

