



Reimbursement of cost from AE (without mark-up) excluded from operating costs while computing arm's length price. In the absence of a specific plea and supporting documents, Revenue's general plea dismissed

Background

Recently, the Delhi High Court (High Court) in the case of CPA Global Services Private Limited¹ (the taxpayer) dismissing tax department's appeal upheld the decision of the Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) regarding exclusion of reimbursement of costs (without mark-up) from Associated Enterprise (AE) in respect of cost incurred by the taxpayer towards maintenance of spare capacity while computing taxpayer's operating costs. The High Court also held that unless there is a specific plea to the effect that the factual finding by Tribunal is perverse, the Court cannot entertain such a ground of appeal.

Facts of the case

- The taxpayer is a wholly-owned subsidiary of CPA Mauritius Ltd. which in turn is a subsidiary of CPA Jersey. It offers legal support services to its AEs as well as to independent third party customers. During the year under consideration, the taxpayer had undertaken international transactions of provision of Information Technology enabled Services (ITeS) and reimbursement of expenses to AEs for which the Transactional Net Margin Method (TNMM) was used for benchmarking. For another international transaction of reimbursement of expenses from AEs, the Comparable Uncontrolled Price (CUP) method was used.
- The taxpayer received reimbursement from its AEs as 'cost recharge on account of spare capacity' which the taxpayer did not route through its profit and loss account. The Transfer Pricing Officer (TPO) held that the taxpayer had not given any evidence in support of its claim that the expenditure was towards maintenance of spare capacity at the instance of the AEs. The Dispute Resolution Panel (DRP) held that the Arm's Length Price (ALP) of the receipts from the AEs should include all the costs and that the taxpayer did not give sufficient reasons for excluding certain costs for the purposes of computing the ALP.
- The taxpayer demonstrated before the Tribunal with reference to its agreement with AE that there were two kinds of reimbursements. One was towards the cost of the service which had a mark-up and had been accounted for in working out the ALP in the transfer pricing study and the other was towards the cost of infrastructure on which there was no mark-up. The reimbursement towards the cost of infrastructure on which there was no mark-up was sought to be excluded by the taxpayer from the operating costs while working out the ALP.

¹ CIT v. CPA Global Services Private Limited (ITA 266/2017) – Delhi High Court

Tribunal's decision

- The Tribunal agreed with the contention of the taxpayer that there is no mark-up on the reimbursements (for maintenance of spare capacity).
- The Tribunal referred to the principles laid down in *Cheil Communications India P. Ltd.*² and in *Four Soft Limited*³ and held that such reimbursement costs should be excluded from operating costs as they do not involve any functions to be performed so as to be considered for profitability purposes.

Tax department's contention

- The impugned order of the Tribunal was perverse. Tribunal overlooked the binding precedent of the Delhi High Court in the case of *Cushman and Wakefield (India) (P.) Ltd.*⁴ where, in similar circumstances, the Court had agreed with the Revenue and remanded the matter to the TPO for re-determination of the transfer pricing adjustment.

Taxpayer's contention

- Even though the reimbursement related to maintenance of spare capacity is considered as international transaction for the purposes of transfer pricing, since there is no mark up on these reimbursements, these transactions are to be excluded for working out the operative margins. The taxpayer placed reliance on the Tribunal ruling in *HSBC Electronic Data Processing India Ltd.*⁵

High Court's decision

- The case of *Cushman and Wakefield (India) (P.) Ltd.* involved an instance of reimbursement by the Indian entity, i.e. the taxpayer of the costs incurred by the AE whereas the situation in the present case is the converse. Further, in *Cushman and Wakefield (India)* there was no categorization of the reimbursement costs as cost of infrastructure and cost of services on which there was a mark-up.
- Ultimately, each case will have to turn on the peculiar facts considering the clauses of the agreement and the arrangement between the Indian entity and its AE. No parallels can be drawn where the terms of the agreement would by themselves be different.

- In the present case, after the examination of the agreement, the Tribunal came to a definite factual conclusion with regard to reimbursement of the infrastructure costs of the taxpayer by the AE without any mark up. Thus, the decision was made purely on facts.
- The High Court observed that Revenue had contended that the impugned order of the Tribunal was perverse by referring to a ground in the memorandum of appeal which had a general plea that the impugned order of the Tribunal 'is perverse and bad in law as it failed to consider the reasons provided for in the orders of TPO which were upheld by DRP while deciding the case.' High Court held that unless there is a specific plea to the effect that the Tribunal's factual finding is perverse, the Court cannot, at the instance of a general plea of perversity, entertain such a ground of appeal by the Revenue. The ground of perversity should not be casually pleaded and requires a detailed study of the entire record by the Appellant. Such a plea must be made responsibly and averred with specificity in relation to the facts of the case. Also, it should be accompanied by a reference to the relevant document which formed part of the record of the case before the Tribunal.
- The High Court found that no substantial question of law arose and the appeal was accordingly dismissed.

Our comments

This High Court's ruling distinguishes the present case from the case of *Cushman and Wakefield (India) (P.) Ltd.* and reiterates that ultimately, peculiar facts of each case should be looked into considering the clauses of the relevant agreement and the arrangement between the Indian entity and its AE.

Further, High Court emphasised on the fact that unless there is a specific plea to the effect that the Tribunal's factual finding is perverse, the Court cannot entertain such a ground of appeal. This may serve as a deterrent in cases where the Revenue as a norm contends that Tribunal's orders are perverse wherever they are favorable to taxpayers without providing due evidence supporting such claim.

² DCIT v. Cheil Communications India P. Ltd. (2010 TII-60-ITAT-Del-TP)

³ Four Soft Limited v. DCIT (ITA No.1495/Hyd./2010)

⁴ CIT v. Cushman and Wakefield (India) (P.) Ltd. [2014] 367 ITR 730 (Del)

⁵ HSBC Electronic Data Processing India Ltd. v. ACIT (ITA No.1624/Hyd./2010)

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