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IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION
CENTRAL EXCISE APPEAL NO.219 OF 2007

McKinsey & Company, Inc ...Appellant
vs.
The Commissioner of
Central Excise ...Respondent

Mr.V.Sridharan, Senior Counsel a/w Mr.Prakash Shah and Mr.Jas Sanghvi i/b PDS Legal for the appellant
Mr.M.Dwivedi a/w Mr.Sham Walve for the respondent

CORAM : A.S.OKA, & A.K.MENON,JJ.
DATE : DECEMBER 5, 2017

ORAL JUDGMENT(PER A.S.OKA,J.)

1 With a view to appreciate the submissions made across the bar, it will be necessary to make a note of the factual controversy. According to the case of the appellant, it is a branch in India of a company `McKinsey and Company Inc, USA'. The appellant is engaged in providing management consultancy services in India and it is registered as a management consultant for the purposes of service tax.

2 On 19th March 2002, a show cause notice was issued to the appellant alleging that the appellant had made contravention of the provisions of section 68 of Chapter V of the Finance Act,1994 read with Rule 8 of the Service Tax Rules. The breach alleged was in respect of six half yearly returns for the periods ending March 1999, September 1999, March

2000, September 2000, March 2001 and September 2001. A demand was made for interest and penalty.

3 Generally, before commencing assignment, the appellant has a written understanding with its clients specifying the nature of services and the consultancy fees for the same. Agreement typically narrates the nature of expenses that may be incurred incidental or ancillary to providing consultancy services that would be claimed as reimbursement from the clients. According to the case of the appellant, such agreements do not necessarily give an extensive list of all expenses which are required to be reimbursed by the clients. The expenses are in the nature of the expenses incurred on travel, lodging and boarding, courier, stationery, telephone and other communications. These expenses are referred as Out of Pocket Expenses (OPE). According to the case of the revenue, the appellant could not provide satisfactory explanation and supportive documents for OPE of an amount of Rs.35,68,38,421/- out of total sum of Rs.40,82,55,661/- for the period between October 1998 to March 2003. Accordingly, a show cause notice containing a demand of service tax amounting to Rs.1,78,41,921/- in respect of inadmissible OPE was issued. These expenses mainly related to travel, lodging and boarding expenses except for a sum of Rs.6,32,92,925/- which amount was disallowed as being expenses related to infrastructure and service charges unrelated to traveling,lodging and boarding.

4 Apart from aforesaid amount, according to the case of the respondent-revenue, the appellant had obtained certain core documents from its head office and borrowed services from its subsidiary as well as its head office for which total sum of Rs.89,27,55,541/- was paid by the appellant to its head office and subsidiaries of Mckinsey. The allegation of the respondent-revenue is that these services were critical to the job undertaken by the assessee and were vital to carry out the assignment. Therefore, it was alleged that core documents charges and borrowed service charges as well as market research charges incurred by the appellant-assessee were liable to service tax. It was alleged that as the appellant was subsidiary of its principal, it has acted as an agent in providing the said services. A demand of Rs.4,46,37,777/- was raised in that behalf.

5 It is the case of the respondent-revenue that the appellant-assessee recovered a sum of Rs.21,96,35,560/- from its clients towards core documents charges, borrowed service charges and market research charges. By treating the said charges as OPE, the appellant had not paid service tax. According to the case of the respondent-revenue, The evasion was in respect of a sum of Rs.1,09,81,778/-.

6 Thus, total service tax amounting to Rs.7,34,61,477/-was demanded from the appellant for the period between 16th October 1998 to 31st March

2003. By the show cause notice, total service tax amount of Rs.7,34,61,476/- (Rs.1,78,41,921/- plus Rs.4,46,37,777/- plus Rs.1,09,81,778/-) was demanded. Interest and penalty under sections 75, 76 and 78 were also proposed.

7 After a reply was submitted by the appellant, the show cause notice was adjudicated upon by the Deputy Commissioner who confirmed the entire demand of service tax along with interest and penalty.

8 The appeal preferred by the appellant before the Customs, Excise and Service Tax Appellate Tribunal, West Zonal Bench, Mumbai (for short `CESTAT') was decided by the impugned judgment and order. Following issues were considered by the CESTAT:

(1) Disallowance of abatement of traveling, lodging and boarding expenses on account of insufficient documentary evidence.

(2) Liability to pay service tax on miscellaneous expenses incurred on items other than traveling, lodging, boarding and described an infrastructural and establishment expenses.

(3) Liability to service tax in respect of payments received in foreign exchange

(4) Liability to service tax on expenses incurred in procuring core document and borrowing other services from Head Office and other McKinsey entities for which no recovery was made from clients and service tax has been

charged as agent of the principal.

(5) Liability to service tax on expenses incurred on core documents and borrowed service charges of which recovery was made from the client.

(6) Limitation.

9 As far as first issue relating to travel, lodging and boarding expenses to the extent of Rs.35,68,38,421/- is concerned, CESTAT passed an order of remand. Even on the second issue concerning miscellaneous expenses incurred on items other than traveling,lodging,boarding described as infrastructural and established expenses, an order of remand was made. As regards the third issue, again an order of remand was made by the Appellate Tribunal under the impugned Judgment and order. As far as fourth issue is concerned, demand of Rs.4,46,37,777/- was set aside. As far as fifth issue is concerned, service tax demand of Rs.1,09,81,778/- was confirmed. As regards sixth issue, a finding was recorded that the extended period of limitation was rightly invoked. However, as a substantial part of the demand was set aside and as some part was remanded for re-consideration of the abatement claim, a direction was issued for re-determination of the penalty after taking into consideration total service tax headed as liable to be paid.

10 The present appeal was admitted by order dated 24^{th} July 2008. Appeal was admitted on five

substantial questions of law which read thus:

(i) Whether in facts and circumstances of the case, the Hon'ble CESTAT was right in its conclusion that the show cause notice dated 20.4.2004 in so far related to the period October 1998 to March 2002 rightly invoked the extended period of limitation?

(ii) Whether in the facts and circumstances of the case Hon'ble CESTAT was right in concluding that the Appellant did not have any bonafide belief?

(iii) Whether the Hon'ble CESTAT is right in law in concluding that the protection conferred by Section 80 is not available in this case?

(iv) Whether in the facts and circumstances of the case, Hon'ble CESTAT was right in upholding levy of penalty on the Appellant?

(v) Whether in the facts and circumstances of the case, Hon'ble CESTAT was right in upholding the demand of Service Tax of Rs.1,09,81,778/-?"

11 The learned senior counsel appearing for the appellant submitted that taxable event for the purpose of levy of service tax is the service rendered within the territory of India except territory of Jammu and Kashmir. He pointed out that the appellant had remitted total amount of Rs.89,27,55,541/- to the overseas of entities for expenses on core documents and borrowed service

charges. Out of the aforesaid amount, an amount of Rs.21,96,35,580/- was recovered by the appellant from the clients in India. He pointed out that the demand on this aspect has been set aside. However, the Tribunal has upheld the liability of the appellant to pay service tax on the expenses incurred on core documents and borrowed service charges for which recovery was made only by the appellant from the clients. The learned senior counsel submitted that irrespective of the normal location of the service providers or service receivers, levy of service tax can be made when the service is rendered in India, the even if the service providers do not have offices in India. He, therefore, submitted that if the service is rendered outside India, provisions relating to levy of service tax are not applicable. Relying upon the circular dated 8th October 2001 issued by the Central Board of Excise and Customs, he would urge that the services provided beyond the territorial limit of India are not liable to service tax. He submitted that this legal position arises as the legislature is not competent to make extra territorial law. He placed reliance on the decision of the Apex Court in the case of Popatlal Shah Vs. State of Madras[1]. He submitted that in the case in hand, foreign entities have rendered valid services/market research services outside India and hence, no service tax is payable in respect of services rendered. He pointed out the alternative submission made in the memorandum of appeal filed before the Appellate

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1 1953 Vol.IV STC 188

Tribunal that even assuming that the amount reimbursed by the clients forms a part of the value of the taxable services, the services were rendered outside India. He submitted that assuming that services were rendered to the appellant and then the appellant in turn rendered services to its customers, no tax is payable to the extent of services performed outside India and therefore, the principle of apportionment ought to have applied in this case. On the principle of apportionment, he relied upon the decision of the Apex Court in the case of Ishikawajma-Harima Heavy Industries Limited vs. Director of Income Tax, Mumbai[2]. Relying upon the decision of the Apex Court in the case of Commissioner of Income Tax, Bombay vs. Ahmedbhai Umberbhai & Company[3], he urged that the service tax is leviable only for that part of the service which is rendered in India and the amount related thereto on the basis of apportionment. He urged that in the present case, charges have been separately identified in the documents.

12 He relied upon the decision of the House of Lords in the case of Customs and Excise Commissioner vs. Plantiflor Limited[4]. He pointed out that three categories of relationship/arrangements have been considered by the House of Lords. He submitted that appellant had paid an amount of Rs.89,27,55,541/- to the overseas entities and recovered an amount of Rs.21,96,580/- from its customers in India. He

2 (2007) 3 SCC 481
3 1950 SCR 335
4 [2002] UKHL 33

submitted that the sum of Rs.21,96,35,580/- represents consideration of supply being arranged and not the consideration for the arranged services. He submitted that the amount recovered from the customers is in the nature of reimbursement of expenditure and is not for providing services. He placed reliance on the decision of Calcutta High Court in the case of Commissioner of Income Tax vs. Dunlop Rubber Company Limited[5]. Alternatively, he urged that the charges will also quantify as deduction on account of OPE.

13 He relied upon sub-clause (r) of clause 105 of section 65 of the Finance Act,1994. He submitted that the service involved in the present dispute is merely in the nature of an arrangement for procuring information/data available with the agency from which it has been borrowed. The appellant did not undertake any analysis which could be used in connection with management of any organization and therefore, cannot be levied in the taxable category of management consultancy services. Lastly, he submitted that in view of the aforesaid submissions, even issue of limitation will have to be re-considered by passing an order of remand.

14 The learned counsel for the respondent supported the impugned Judgment and Order and submitted that the impugned Judgment and Order is based on findings of fact and hence, no interference is called for.

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5 [1983] 142 ITR 493 (Calcutta)

15 We have given careful consideration to the submissions. At the outset, we may note here that in the written submissions, the learned senior counsel has referred to the ground taken in paragraph 2.2.9(c) of the appeal preferred before the CESTAT and contended that the said ground is not taken into consideration. It is not the case of the appellant that the said ground was agitated before the Appellate Tribunal and was not considered. If the case of the appellant is that the ground was agitated but has not referred and considered, the remedy of the appellant is before the Appellate Tribunal. Hence, the said contention does not merit any consideration.

16 Coming to the finding on the fifth issue with which we are concerned, the submissions of the appellant have been specifically recorded while dealing with the said issue. The contention noted in the Judgment is that the services have been borrowed on account of the client who is required to submit necessary data and on his inability to do so, the same is borrowed from other Mckinsey entities and its head office. Therefore, the expenses are in the nature of OPE. A concession by the learned counsel for the appellant has been recorded in the Judgment and Order which reads thus:

> “....The appellants however conceded that the charges recovered towards expenses paid to the Head Office in respect of core documents

> <u>and borrowed service charges from its Head Office can be charged to service tax as Mckinsey Indian being branch of Mckinsey, U.S.A., the branch Office was providing the service on behalf of its principal</u>. But charges recovered in respect of borrowed services from other Mckinsey entities cannot be charged to service tax.”
>
> (underline added)

17 We must note that a photo copy of the original certified copy of the impugned Judgment and Order is annexed in which after the word “that” and before the words “the charges” the words “at best” were incorporated earlier which have been clearly struck out. Thus, as far as the expenses paid to the head office in respect of the core documents and borrowed service from the head office are concerned, there is a concession and the appellant is bound by the said concession. Thus, the only dispute is about the charges recovered in respect of the borrowed services from other Mckinsey entities.

18 In this case, we are concerned with the provisions of section 66 of the Finance Act,1994. As per sub-section 4 of section 66, service tax can be levied at the rate of 5% of the value of the taxable services. Sub clause (r) of clause 48 of section 65 provides that the taxable service means any service provided to a client by management consultant in connection with the management of any organization in any manner. Section 67 deals with

the valuation of taxable service for charging service taxes. Clause (q) of section 67 provides that in relation to service provided by management consultant to a client, the valuation of taxable service shall be on the basis of the gross amount charged by the such consultant from the client for services rendered in connection with the management of any organization in any manner. Thus, the service tax is required to be charged on the gross amount charged by the management consultant to his client. The CESTAT has recorded following finding on this aspect.

> “**...Core documents and other borrowed services are essentially one which form necessary input for providing the management consultancy services.** When a client engage Mckinsey at a high premium, he does so because he knows that Mckinsey has branches all over world and therefore it will have the benefit of research undertaken all over the world by it and therefore it cannot be expected of him to pay for the data which has been procured by the appellant from its Head Office and other Mckinsey entities. **No material has been produced before us to show that such data is normally supplied by the client and they merely act as an agent of the client for procuring such data/services. The fact that the clients have been charged only Rs.21,96,35,580/-as against Rs.89,27,55,541/- absorbed by the appellant themselves, shows**

> **that these charges are massive and that they are normally not provided by the client. If that would have been the case, that it is the client's job to provide such data, the agreement would not have limited the reimbursement to the extent of 15% only and would have recovered the entire amount. We therefore hold that this information and data was essential for providing management consultancy service and therefore once these charges have been recovered from the client, its abatement cannot be allowed..."**
>
> (emphasis added)

19 The case of the appellant is that to enable the appellant to render service to its client, it was necessary for the client to submit necessary data. As the client did not provide the data, the appellant was required to borrow the said data from other Mckinsey entities and other entities. As a matter of fact, the Appellate Tribunal found that no material has been placed on record to show that the data which is procured from other Mckinsey entities was required to be supplied by the client and that due to inability of the client to supply the said data, the appellant obtained it acting as an agent of the client. We must note here that in case of charges recovered towards expenses paid to the head office in respect of the core documents and borrowed service charges, there is a concession made by the appellant which we have noted earlier. Therefore, separate treatment cannot be given to the expenses

paid to the other Mckinsey entities.

20 Section 67 of the Finance Act,1994 deals with the value of taxable service. Clause (q) in section 67 is material. It provides that in relation to the service provided by a management consultant to his client, the value of taxable service shall be the gross amount charged by such consultant from the client for services rendered in connection with the management of any organization in any manner. As stated earlier, under sub-clause(r) of clause 48 of section 65, service provided to a client by a management consultant in connection with the management of any organization *in any manner* is a taxable service. We have already referred to clause 21 of section 65 of the Finance Act,1994 which defines management consultant. It includes a person who is engaged in providing any service, either directly or indirectly, in connection with the management of any organization in any manner. A management consultant includes any person who renders any advice, consultancy or technical assistance, in relation to financial management, human resources management, marketing management, production management, logistics management, procurement and management of information technology resources or other similar areas of management of any working system of any organization. As narrated earlier, we are dealing with the expenses incurred on core documents and borrowed service charges for which recovery was made from the client. The claim of the appellant as regards expenses incurred on

core documents and borrowed service charges for which no recovery was made from the clients has been already accepted by the Appellate Tribunal under the impugned Judgment.

21 In our view, the Appellate Tribunal rightly applied a test whether the expenses which were normally required to be incurred by the client were incurred by the consultant on the request of the client. If answer to the said question is in the affirmative, then the expenses will become eligible for abatement. As stated earlier, there is a concession by the appellant that the charges recovered towards expenses paid to the head office in respect of the core documents and borrowed service charges can be charged to service tax. It is in this context that the CESTAT has recorded a finding of fact that nothing is placed on record to show that the data which was procured by the appellant from its head office in U.S.A and from other Mckinsey entities ought to have been normally supplied by the appellant's client and therefore, for procuring the said data, the appellant acted as mere agent of the client. The finding of fact recorded is that the core documents and borrowed services are essential one and which form necessary input for providing consultancy services. The Appellate Tribunal, therefore, observed that when a client engages a company like appellant, he does so because the appellant will have the benefit of research undertaken all over the world as its branches are all over the world. We may note here

that as per clause (q) of section 67 of the Finance Act,1994, service tax is payable on gross amount charged by the consultant. Thus, a finding of fact recorded is that the appellant procured data which its clients were not under an obligation to provide. The said data was acquired by the appellant for the purpose of rendering management consultancy services in India. It was used in India for rendering taxable service. Therefore, the amount charged to the client for core documents and other borrowed services is in fact on account of services rendered by the appellant in India. The said amount cannot be said to be payable on account of services rendered abroad. Therefore, we are unable to accept the submission that the taxable event did not occur in India and that the act of denying abatement amounts to invoking extraordinary territorial jurisdiction which is not in existence. The entire thrust of the submissions of the learned counsel for the appellant is on the fact that the amount recovered from the clients was not for rendering any services in India. Therefore, the decision of the Apex Court in the case of the Commissioner of Income Tax vs. Ahmedbhai Umberbhai & Company (supra) relied upon by the appellant has no application.

22 The other contention which was canvassed was that the appellant has merely arranged services of their foreign entities for and on behalf of their clients and the consideration for making such arrangement is already included in the consultancy fees. This contention based on factual assertions

has not been canvassed before the Appellate Tribunal. Therefore, reliance placed by the appellant on the decision of the House of Lords in the case of Custom and Central Excise Commissioner vs. Plantiflor Limited (supra) has no application.

23 The contention sought to be raised is that the amount recovered from the customers is in the nature of reimbursement of expenditure and not for providing of service. This factual contention is not agitated before the Tribunal as there is no reference to the such contention raised in the impugned Judgment. Therefore, the same cannot be raised in this appeal.

24 On limitation, initially the learned counsel for the revenue had shown inclination to accept the prayer of the appellant for remand. But subsequently, he has supported the impugned Judgment on the said aspect. In paragraph 7 of the impugned Judgment, the CESTAT held thus:

> "7....We find that the period under dispute is from October 1998 to March 2003. Section 70 was amended in 16.7.2001 and amended section empowered the assessee to assess tax due himself and thereafter to furnish return in the prescribed manner. Section 71 provides that the Superintendent of the Central Excise may on the basis of information contained in the return filed by the assessee under Section 70, verify the

correctness of the tax assessed by the assessee on the services provided. Thus, the verification was confined to the information contained in the return and it was in the case of doubt only that superintendent could have called for further documents. Thus, for period after 16.7.2001, there was a self assessment procedure and verification was required on the basis of information furnished in the return and not be;;yond that. Since the appellants have not claimed any abatement in their returns, the question of calling for documents relating to the same does not arise. As regard period prior to 16.7.2001, though Section 70 only required the assessees to furnish return in prescribed form without any provision of self assessment, Section 71 relating to the assessment required superintendent to assess returns as such and in case he felt that any further document was needed, he was required to obtain a written permission from the Commissioner for obtaining any documents etc from the assessee. Therefore, even earlier verification was limited to the information furnished in the service tax return and documents could be called for only with the permission of the Commissioner. The scheme of the service tax was that the assessment will be made on the basis of information furnished in the return and no invoices or bills were required to be submitted alongwith return and the verification of invoices or bills if any was to be done by the audit only as has also been done by audit in the present case. It is not the appellant's case that they have furnished the invoices but department has chosen not to verify them. The appellants admitted that no invoices or supporting documents were submitted by them alongwith the returns."

25 A finding of fact has been recorded that proforma of ST-3 shows that the assessee was required to state and declare the value of taxable services claimed/billed as well as value of taxable services received. After perusal of the trade notices, the CESTAT recorded a finding that the same do not indicate that core document charges, borrowed services charges and market research charges will be considered as OPE. The appellant was required to first declare the gross amount received from the client and claim abatement on the basis of the documents. The argument was that the appellant bonafide believed that core document charges, borrowed services charges and market research charges paid to Mckinsey entities will be considered as OPE. This argument is rightly rejected by CESTAT. Moreover as regards the charges paid to the head office, there is a concession which is noted above.

26 Hence, we find no merits in the appeal and the

same is dismissed as no substantial question of law is involved.

(A.K.MENON,J.)　　　　　　　　(A.S.OKA,J.)