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IN THE HIGH COURT OF DELHI AT NEW DELHI

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ITA 350/2016

AVENUE ASIA ADVISORS PVT. LIMITED Appellant

Through : Mr. M.S. Syali, Senior Advocate with
Mr. Vishal Kalra and Mr. Mayank
Nagi, Advocates.

versus

DEPUTY COMMISSIONER OF INCOME TAX Respondent

Through : Mr. Rahul Chaudhary, Senior
Standing Counsel with Mr. Sanjay
Kumar, Junior Standing Counsel.

**CORAM: JUSTICE S. MURALIDHAR
JUSTICE PRATHIBA M. SINGH**

ORDER

18.09.2017

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Prathiba M. Singh, J.

1. This appeal under Section 260A of the Income Tax Act, 1961 ('the Act') arises out of an order dated 22nd January, 2016 passed by the Income Tax Appellate Tribunal ('ITAT') in ITA No. 6638/Del/2013 for the Assessment Year ('AY') 2009-10.

2. On 26th April, 2017, this court framed the following questions of law for determination:

"(i) Was the Income Tax Appellate Tribunal (ITAT) justified in re-characterizing the function of the Assessee as a merchant banker and was this in conformity with the sub-advisory agreement dated 1st

February 2006?

(ii) Whether the ITAT was in error in upholding the inclusion of the comparable companies by the TPO considering the business profile of the Assessee as outlined in the transfer pricing documentation?

(iii) Whether the ITAT erred in upholding the addition of notional interest on the ground of it being an international transaction?”

Case of the Assessee

3. The Appellant-Assessee (*hereafter ‘Assessee’*) is a company incorporated in India, *inter alia* providing non-binding investment advisory services to its Associated Enterprise (‘AE’) viz., Avenue Asia Capital Management LP, (Avenue US’), an investment management firm based in New York, US under the agreement dated 1st July, 2016 along with the addendum dated 5th December, 2008. According to the said agreement, the consideration /remuneration to the Assessee is cost plus 20% mark up of the services rendered by the Assessee which included providing research reports and other material to assist the AE in carrying out assessment of potential investment opportunities in India.

4. The Assessee filed its return of income for AY 2009-10 on 30th September, 2009 declaring a total income of Rs.5,87,81,405/-. Pursuant to a notice dated 8th September, 2010, issued under Section 143 (2) of the Act, a reference under Section 92 CA (1) of the Act was made to the Transfer Pricing Officer (‘TPO’) in order to determine the arm’s length price (‘ALP’) qua the international transactions between the Assessee and its AE. In view

of this, the Assessee identified 8 (eight) comparable companies, having a net average margin of 17.48% as against the net margin of the Assessee being 21.93% for the instant AY. The comparable companies chosen by the Assessee are as under:

S. No	Comparable	Weighted Average Margin (%)	Updated Margins for FY 2008-09 (%)
1.	Ambit Capital Private Limited	27.33	Not Available
2.	CRISIL Limited	32.03	41.79
3.	Future Capital Holdings Limited	17.20	21.00
4.	ICRA Management Consulting Services Limited	9.75	(0.56)
5.	IDFC Investment Advisors Limited	(11.65)	(54.02)
6.	Mecklai Financial & Commercial Services Limited	14.74	13.29
7.	SREI Capital Markets Limited	6.68	(17.44)
8.	Sumedha Fiscal Services Limited	43.78	Not Comparable
Arithmetic Mean		17.48	0.68

5. In the show cause notice ('SCN') dated 18th December, 2012, issued by the TPO, a new set of comparables were proposed. However, he rejected one of them. The TPO finally chose 10 comparable companies having an average margin of 39.13%, as against the aforementioned margin earned by the Assessee.

6. On 29th January, 2013, the TPO passed an order under Section 92 CA (3) of the Act recommending an upward adjustment of Rs.3,20,29,913/-. The TPO also recommended an adjustment of Rs. 51,34,309/- being the notional

interest at 15.77% on the outstanding receivables from its AE on the basis that the same constituted an international transaction. Pursuant to the TPO's order, the AO passed a draft assessment order on 28th February, 2013 and assessed the income of the Assessee at Rs. 9,59,45,630 as against the return income of INR 5,87,81,405/-. Objections were filed by the Assessee against the said draft order with the Dispute Resolution Panel ('DRP').

7. On 16th August, 2013, the DRP upheld the transfer pricing adjustments made by the AO/TPO. Subsequently, on 10th October, 2013, the AO passed the final assessment order under Section 143 (3) read with Section 144C of the Act, computing the total income as Rs. 9,59,45,630/- as per the directions issued by the DRP. This assessment order was challenged by the Assessee before the ITAT.

8. The ITAT has, by a detailed order, analysed the various comparables and remanded the matter to the TPO in respect of a few comparables for further analysis. The ITAT has also rejected some of the comparables suggested by TPO/AO but retained some of them. The ITAT, thus, partly allowed the appeal of the Assessee on the issue of comparables. Insofar as the adjustments for receivables were concerned, the ITAT upheld that the outstanding receivables constitute an international transaction by relying on the decision in ***Logics Micro System v. ACIT (2011) 8 ITR 159*** (hereafter '*Logics Micro System*'). The ITAT, thus, restored the matter of computation of the adjustment to outstanding receivables, to the TPO with a direction to compute the interest for receivables on a day to day basis beyond the period available as per the industry standard and apply LIBOR rate of interest.

9. The Assessee is aggrieved by the impugned order to the extent it has retained three of the comparables namely Sumedha Fiscal Services Limited (*hereafter 'Sumedha'*), Brescon Advisors Limited (*hereafter 'Brescon'*) and Ladderup Corporation Limited (*hereafter 'Ladderup'*) and on the issue of outstanding receivables being treated as international transactions and interest being computed thereon.

10. Arguments have been heard on behalf of the Assessee's counsel Mr. M.S. Syali, Senior Advocate and Mr. Rahul Chaudhary, Senior Standing Counsel for Revenue.

Submissions of the Appellant-Assessee

11. Mr. M.S. Syali, learned Senior Advocate for the Assessee has submitted that the ITAT has committed a grave error by characterizing the services rendered by the Assessee as investment/merchant banking services. Mr. Syali relies upon the order of the TPO wherein the services of the Assessee have been squarely termed as being investment advisory services. He submits that a perusal of the agreement dated 1st July, 2006 along with its addendum clearly reveals that the role of the Assessee is of a non-binding advisory nature which primarily involves advising the AE in preparing reports, making non-binding recommendations etc. Mr. Syali submits that the Assessee merely provides information to its AE and is not involved in the decision making process of the AE. The active role is of the AE and not of the Assessee. Mr. Syali categorized the services provided by the Assessee as contained in the TPO's report under the following heads:

- (i) Identification of investment opportunity and relevant research;
- (ii) Recommendation on the mode of financing;
- (iii) Engagement of third party service provider;
- (iv) Recommendation for exchange of investment;
- (v) Recommendation of exit strategies;
- (vi) Identifying the opportunities for investment;
- (vii) Recommendation for the provision of equity or debt or similar financing for investment companies;
- (viii) Recommendation in relation to debt or similar financing;
- (ix) Purchase of preferred securities;
- (x) Investment in asset-back securitisation of vehicles and issuance of guarantees;
- (xi) Giving advice and opinions in connection with reorganisation, recapitalization, splitting of shares, change of par value, conversion otherwise;
- (xii) Engage and remunerate third party service providers.

12. Thus, the Assessee company's activities are that of a fee based investment/financial advisory service provider. Unlike merchant bankers who are involved in active financing transactions, the Assessee is only advising on financial issues. Thus, according to Mr. Syali, the activities of the Assessee cannot be compared to that of the merchant bankers. Mr. Syali submits that since an exact comparable was not available, the cut based method ('CUP') cannot be used for determining the ALP and the TNMM method is rightly used. However, while agreeing that the TNMM method is the correct method, Mr. Syali relies upon the judgment of this court in

Rampgreen Solutions Private Limited v. Commissioner of Income Tax (2015) 377 ITR 533 (Del) (hereafter ‘Rampgreen Solutions’) to submit that while selecting the comparable transactions or entities, the basis should be one of similarity with the controlled transaction/ entity and a mere broad similarity is not sufficient. Mr. Syali has broadly summarised the findings of the DRP and the ITAT qua the 10 comparable companies chosen by the TPO, in the following table:

Sr. No.	Final set chosen by the TPO	Margin (%)	Direction by DRP	Decision of Delhi Tribunal
1.	Future Capital Holdings Limited	23.39	Not challenged before DRP	Not challenged before ITAT
2.	ICRA Management Consulting Services Limited	(1.02)	Not challenged before DRP	Not challenged before ITAT
3.	Mecklai Financial & Commercial Services Limited	13.29	Not challenged before DRP	Not challenged before ITAT
4.	Sumedha Fiscal Services Limited	56.85	Retained	Retained
5.	Khandwala Securities Limited	39.80	Retained	Rejected
6.	Brescon Corporate Advisors Limited	116.70	Retained	Retained
7.	Ladderup Corporation Limited	66.05	Retained	Retained
8.	Birla Sunlife Asset Management Company Limited	11.31	Retained	Rejected
9.	Almondz Global Securities Limited	34.57	Retained	Rejected
10.	Axis Private Equity Limited	30.42	Retained	Rejected
Mean		39.13		

13. Thus, he submits that the selection of comparables must be done keeping in view the comparability factors as specified. Mr. Syali submits that the

ITAT has erred in retaining Sumedha, Brescon and Ladderup as according to him that has led to an incorrect conclusion and marking up of the ALP to a higher percentage of margin. According to Mr. Syali, the said entities were not functionally similar to the Assessee.

14. Mr. Syali submits that the ITAT has rightly held in para 6.2 of the impugned order that the activity of the Assessee had to be characterised as a fee based financial advisory service provider. However, according to him, having done so, the retention of these three comparables does not match the criteria set down by the ITAT itself. He submits that though the TNMM method is sufficiently tolerant to a wide variety of functions, there should not be broad comparability between the comparables and the functional differences ought to be taken note of. Mr. Syali relies upon details of the accounts of the comparable entities of Sumedha, Brescon and Ladderup filed before the ITAT to argue that these three had completely different functional profiles. He also submits that even if a part of their services overlap with the services provided by the Assessee, the segmental data for the comparable services was not available and hence they ought to have been excluded by the ITAT. The Assessee further relies upon clause 12.1 of the sub-advisory agreement that the nature of the services being merely advisory is established from this clause as the Assessee could not conduct any transaction or conduct any negotiation or enter into any agreement qua any transaction on behalf of its AE. This clause, according to him, established that the Assessee merely conducted research and made recommendations and did not have any role in the decision making or any right to take decisions.

15. Insofar as the issue of notional interest on receivables is concerned, Mr. Syali relies upon the submission made by the Assessee before the DRP to argue that if the working capital adjustment is given as per the margin of the final set of comparables proposed by the TPO, the outstanding receivables would be automatically factored in and separate adjustment on account of interest on receivables would not be required. Mr. Syali, thus, submits that the approach of the ITAT on this issue is also erroneous.

Submissions of the Revenue

16. Mr. Rahul Chaudhary, learned Senior Standing Counsel for the Revenue, submitted that the adoption of the TNMM method is not faulted by the Revenue. He submits that there is no flaw in the approach of the ITAT or the DRP, inasmuch as, the ITAT was quite conscious of the difference between the merchant banking services and the financial advisory services rendered by the Assessee. In any case, he submits that the ITAT has noticed that a merchant banker performed two types of services namely - First, management and issuance of shares, under-writing, portfolio management etc. and secondly, advisory or consultancy services. The ITAT has taken the latter segment as being comparable to the services rendered by the Assessee and thus has committed no error.

17. According to Mr. Chaudhary, the ITAT also noted that while private equity funds have higher yield, merchant banking services do not have the same level of yield and thus, comparing merchant bankers would not prejudice the interest of the Assessee. Mr. Chaudhary further submits that

though the activities of the Assessee are not that of a merchant banker, the term consultancy, encompasses the larger gamut of services, which would be included. The ITAT, has, in fact undertaken an in-depth analysis of each of the comparables chosen by the TPO and while retaining three of them has also rejected four of the comparables. This shows that the ITAT has exercised its powers in a judicious manner. Mr. Chaudhary draws the attention of this Court to what he considers an increasing trend of Assesseees to themselves suggest several comparables and when the TPO chooses to include the comparables which perform similar functions as those suggested by the Assesseees, the same are objected to if the percentage margin is high. Further, according to Mr. Chaudhary, Assesseees tend to only challenge the comparables which have high margins on the ground of dissimilarity of functions, though they may in fact possess the same functions as those comparables chosen by the Assessee itself. In fact, this kind of trend ought not to be encouraged by this Court according to him.

18. The Revenue further relies upon specific findings of the ITAT in respect of Sumedha to submit that the ITAT has merely restored the matter to the TPO to examine if the income from management and issuance of shares of Sumedha is substantial and if so, then to exclude the said comparable. Insofar as Brescon is concerned, the ITAT has given a finding that the consultancy or advisory services in respect of debt syndication is similar to advisory services in investment in distressed debt. The question of merchant banking does not arise in the case of Brescon. In the case of Ladderup, Mr. Chaudhary points out that the ITAT's finding that there is not much of a difference in the extended support services offered by the Assessee and the

comparables cannot be faulted with as the ITAT noted specifically that the Assessee is not engaged in merchant banking services.

Analysis of the decision in Rampgreen Solutions

19. The first and the foremost issue that arises in this case is with respect to the applicability of tests laid down in ***Rampgreen Solutions (supra)***, which was rendered on 10th August, 2015. This decision has clearly laid down the various principles on the basis of which determination of comparables needs to be undertaken while fixing the ALP and the margin that needs to be assigned. This Court had specifically rejected the proposition that broad functionality is sufficient to find the comparable entity though the TNMM method allows broad flexibility tolerance in the selection of comparables. This proposition having been rejected, the Court in ***Rampgreen Solutions (supra)*** held as under:

“43. In our view, the aforesaid approach would not be apposite. In so far as identifying comparable transactions/entities is concerned, the same would not differ irrespective of the transfer pricing method adopted. In other words, the comparable transactions/entities must be selected on the basis of similarity with the controlled transaction entity. Comparability of controlled and uncontrolled transactions has to be judged, inter alia, with reference to comparability factors as indicated under rule 10B(2) of the Income Tax Rules, 1962. Comparability analysis by the transactional net margin method may be less sensitive to certain dissimilarities between the tested party and the comparables. However, that cannot be the consideration for diluting the standards of selecting comparable transactions/entities. A higher product and functional similarity would

strengthen the efficacy of the method in ascertaining a reliable arm's length price. Therefore, as far as possible, the comparables must be selected keeping in view the comparability factors as specified. Wide deviations in profit level indicator must trigger further investigations/analysis.

44. Consideration for a transaction would reflect the functions performed, the significant activities undertaken, the assets or resources used/consumed, the risks assumed. Thus, comparison of activities undertaken /functions performed is important for determining the comparability between controlled and uncontrolled transactions/entity. It would not be apposite to ignore functional dissimilarity only for the reasons that its impact may be reduced on account of using arithmetical mean of the profit level indicator.”

20. A perusal of the above decision reveals that the following steps ought to be undertaken in identification of comparable transactions/entities.

- The principle governing the identification of comparable transactions would be the same, irrespective of whichever transfer pricing method is adopted.
- Comparable transactions must be selected on the basis of a similarity with the controlled transaction/entity.
- Rule 10B (2) of the Income Tax Rules, 1962 ought to be borne in mind while choosing the factors of comparability in respect of uncontrolled transactions.
- Even while adopting the TNMM method, the standard for selection of the comparable transactions/entities cannot be diluted.
- Wide deviation in the Profit Level Indicator ('PLI') would require further investigation/analysis.

- For comparison of transactions, factors such as the nature of capital, resources used, the risks assumed, etc. ought to be considered.

Broadly, therefore, the dictum by this Court was that though in the TNMM method there is sufficient tolerance, mere broad functionality is by itself insufficient.

Question (i)

21. In the backdrop of the principles laid down in ***Rampgreen Solutions (supra)*** and the analysis of the ITAT's order with respect to each of the comparables disputed by the Assessee, is as follows:

(i) **Sumedha Fiscal Services Limited** - In the case of Sumedha, the ITAT clearly acknowledged that if it had handled management of rights issues and the revenue from such service was substantial, then the services provided by Sumedha would be dissimilar to that of the Assessee. However, having held so, the ITAT restored the matter to the TPO to again examine whether the revenue of Sumedha was substantial from handling the said services of rights issues and with a direction to exclude it if the TPO found it in the affirmative. Such an approach of the ITAT is not in accordance with the principles laid down in ***Rampgreen Solutions (supra)***. The ITAT's findings acknowledge that Sumedha may not be functionally similar to the Assessee, as admittedly, the Assessee does not render services relating to rights issues. Starting the entire exercise of comparability analysis from the stage of the TPO would result in an unending cycle of proceedings especially when the relevant material in the form of annual reports etc. was available on the record. The ITAT ought to itself have determined whether Sumedha is to be

retained at all in view of its own findings. Remanding the issue to the TPO was an incorrect approach.

(ii) **Brescon Advisors Limited** – In the case of Brescon, the ITAT analysed the annual reports and noticed that the income of Brescon is from fee based financial services, from debt resolution and debt syndication. Brescon also earned revenue from sale of investments. The ITAT has equated 'Advisory services related to debt financing' with 'financial services from debt resolution and debt syndication'. These two are not identical services. Whereas the former is advisory in nature, the latter is executory in nature. While there could be some overlap between the former and latter, the matter requires deeper analysis and examination.

(iii) **Ladderup Corporation Limited** – The ITAT noticed that Ladderup had shown operational income from financial and management consultancy services as also fee based activities such as 'Debt Syndication, IPO Advisory, Private Equity Placement, Merger and Acquisitions, Corporate Restructuring and a host of other corporate advisory services.' The ITAT, thereafter, simply held that Ladderup had similar functions as that of the Assessee and was a comparable that deserved to be retained.

22. Broadly, it appears that the ITAT has gone on the usage of several terms such as debt syndication, debt financing, IPO advisory, corporate restructuring, mergers, acquisitions etc, appearing in the annual reports of the comparable to hold that the Assessee and the said comparables perform similar functions. The analysis at such a broad level, based upon the

appearance of such similar terminologies, does not by itself make the functions similar in nature.

23. The argument of the Assessee appears to be that while the Assessee was merely advising on these issues and providing advisory services to its AE, these three comparables appear to be actually involved in the providing of services relating to debt restructuring, debt financing, issuance of IPOs, mergers and de-mergers, etc. There is a difference between giving advice on these matters and actually undertaking the said services. A similar illustration, in the context of litigation, would be the difference between giving advice on what to argue in Court and actually arguing the matter in the Court. This difference needs to be borne in mind and the mere appearance of similar sounding words does not by itself constitute similar functions. Further, as laid down in *Rampgreen Solutions (supra)*, all these three companies demonstrated a wide deviation in the percentage of margins. Thus, it requires a deeper analysis to determine as to whether they were in fact comparables to be retained for the purpose of fixing the ALP.

24. Insofar as the argument of Mr. Chaudhary regarding the trend of Assessee's to challenge the inclusion of comparables which show a higher percentage margin, is concerned, the same cannot be faulted with in as much as every Assessee is entitled to make submissions as to the selection of comparables and choose what is advantageous to it. So long as the same can stand the test of legal scrutiny, it cannot be held that such challenges are not maintainable.

25. In this backdrop, when sub-advisory agreement dated 1st July, 2006 along with the addendum thereto, is examined, the services of the Assessee cannot be termed as that of merchant banking though there may be some overlap in the advisory segment of the services provided by merchant bankers. In view of the services rendered by the Assessee, Question (i) is answered in the negative i.e. in favour of the Assessee and against the Revenue.

Question (ii)

26. In view of the above discussion on the various comparables, the findings of the ITAT in respect of Sumedha, Brescon and Ladderup are set aside. We have been informed by the learned counsel for the parties that subsequent to the order of the ITAT, the TPO passed an order which resulted in a final assessment order being passed by the AO. The matter is currently pending in appeal, by the Assessee, before the CIT (A). All those consequential orders would not survive in view of the present order.

27. In order to not brook any further delay, this matter may be placed before the CIT (A) to consider as to whether these three companies can be held to be comparables in the light of observations made in ***Rampgreen Solutions (supra)*** and in this order. The CIT (A) would, thereafter, pass a comprehensive order and determine the ALP for the international transactions. Question (ii) is answered in the affirmative i.e. in favour of the Assessee and against the Revenue.

Question (iii)

28. On the question of notional interest, it was incorrect on the part of the ITAT to hold that the entire outstanding receivables constitute an international transaction. The reliance by the Assessee on the decision of this Court dated 25th April, 2017 in ITA 765/2016 [*Pr. Commissioner of Income Tax v. Kusum Health Care Pvt. Ltd.*] (hereafter 'Kusum Health Care') is apt. There are several factors which need to be considered before holding that every receivable is an international transaction and it requires an assessment on the working capital of the Assessee. Applying the decision in *Kusum Health Care (supra)*, Question (iii) is answered in the affirmative i.e. favour of the Assessee and the CIT (A) is directed to study the impact of the receivables appearing in the accounts of the Assessee; looking into the various factors as to the reasons why the same are shown as receivables and also as to whether the said transactions can be characterized as international transactions.

29. The appeal is allowed in the above terms. There will be no order as to the costs.

PRATHIBA M. SINGH, J.

S. MURALIDHAR, J.

SEPTEMBER 18, 2017

j/dk