

CNK & Associates LLP

News Flash – February, 2019

Supreme Court dismisses Special Leave Petition filed by assessee against order of Delhi High Court upholding characterization of Research & Information services as KPO. The charging of notional interest on outstanding receivables from AE was also treated as international transaction

Mckinsey Knowledge Centre India Pvt. Ltd vs. Pr. Commissioner of Income-tax Delhi, 6 [TS-49-SC-2019-TP] (In favor of Revenue)

Characterization of Research and Information (R&I) Services as Knowledge process outsourcing (KPO)

Relevant Facts

1. The assessee, an Indian company and wholly owned subsidiary of McKinsey Holding Inc., USA was engaged in the business of R&I Services and IT Support Services. The R&I Services Division was divided into 3 sub-groups-
 - a. **Knowledge on Call Group** – Provided journalistic research information support including financial analysis;
 - b. **Practice Research Group** – Provided domain specific services including sector data and analysis, capital market insights, perspectives and industry trends; and
 - c. **Analytics Group** – Provided time intensive analysis requiring expertise and analytical tools and techniques including data analysis, model/tool development, proprietary database management and practice specialized analytics.
2. **Assessee's contentions for characterizing R&I Services as Business Process Outsourcing Services (BPO):**
 - a. McKinsey group of companies were engaged in providing management consultancy services. To render the consultancy services to third parties, these companies sought assistance from the assessee.
 - b. The assessee carried out research from the internet based database or other source. The said data was compiled and, further customized according to the requirement of the requestor before transmission to the group companies, so that assessee's group companies could consider them for providing consultancy services.
 - c. The assessee also relied on earlier Tribunal orders in its own case where its activities were held to be in nature of 'back-office' services which are in essence BPO and not KPO.

3. Tribunal's view on characterization of R&I Services as KPO:

The Tribunal based on examination of Master Service Agreement concluded that the assessee was providing knowledge-based research and information services. There was clearly a form of knowledge intensive analysis that was rendered by the assessee which is more nuanced than that which was provided by a BPO. Accordingly the R&I services were KPO services. On coming to the said conclusion, Tribunal relied on decision of Delhi High Court in case of Rampgreen Solutions (P) Ltd. v. CIT 60 Taxman.com 255 (Del) from which the following rationale emerged:

- KPO is understood as a high value added process chain wherein the processes are dependent on advanced skills, domain knowledge and the experience of the persons carrying on such processes.
- KPO is in essence allocation of relatively high-level tasks to an outside organization or a different group (possibly in a different location) within the same organization. On the other hand BPO is defined to mean "the transfer of an organization's entire noncore but critical business process/function to an external center which uses an IT based service delivery". In other words, KPO is, essentially, high-end Business Process Outsourcing (BPO).
- Thus the expression 'KPO' in common parlance is used to indicate an ITeS provider, providing a completely different nature of service than any other BPO service provider.
- A KPO service provider would also be functionally different from other BPO service providers, in as much as the responsibilities undertaken, the activities performed, the quality of resources employed would be materially different.

4. High Court Decision

Characterization of R&I Services Comparability under Transactional Net Margin Method (TNMM):

High Court confirmed the findings of the tribunal and held that the services rendered by assessee were specialized and require specific skill based analysis and research that is beyond the more elementary nature of services rendered by a BPO. Therefore, it would be incorrect to slot the services provided by the Assessee into that of a BPO, when it is more akin to a KPO.

Issue Involved:

Aggrieved by the decision of Delhi High Court, assessee filed Special Leave Petition before Supreme Court

Held:

Dismissing assessee's appeal the Supreme Court held that "*we are not inclined to entertain these SLP, under Article 136 of the constitution of India. The SLP are accordingly dismissed*"

CNK Comments:

From the above it appears that the Supreme Court is not inclined to review orders of the High Court on fact based Transfer Pricing issues where the Tribunal has done detailed fact finding. Accordingly, it is important that assessee's involved in litigation with the income-tax department on such issues ensure that all relevant facts are correctly brought on record and explained before the Tribunal which is the last fact finding body. Special attention may also be given to clauses of the inter-service agreement with the AE. In case the Tribunal's understanding of facts is divergent from the facts claimed by the assessee, there is possibility that practically no relief would be granted by the subsequent appellate authorities.

Levy of Notional interest on overdue receivables from Associated Enterprises (AEs)

Relevant Facts

The Transfer pricing officer treated overdue receivables from AE as a separate international transaction and made an adjustment of notional interest on the overdue receivables. This was confirmed by the Tribunal.

On appeal to the High Court, assessee contended that early or late realization of sale/service proceeds was incidental to the transaction of sale/service, and thus, if the ALP in respect of an international transaction is determined, then there can be no question to benchmark interest separately on overdue receivable.

The high court held that if there was any delay in the realization of a trading debt arising from the sale of goods or services rendered in the course of carrying on the business, the same would be treated as a separate international transaction and would attract transfer pricing adjustment.

Issue Involved:

Aggrieved by the decision of Delhi High Court, assessee filed Special Leave Petition before Supreme Court

Held:

Dismissing the assessee appeal on the above ground the Supreme Court held that *“we are not inclined to entertain these SLP, under Article 136 of the constitution of India. The SLP are accordingly dismissed”*

CNK Comments /Analysis:

Since the Supreme Court has dismissed the SLP, going forward tax authorities may take a stand that interest income on outstanding receivables from associated enterprises beyond the stipulated period mentioned in the inter service agreement needs to be benchmarked separately.

DISCLAIMER AND STATUTORY NOTICE

This e-publication is published by CNK & Associates, LLP, Chartered Accountants, India, solely for the purposes of providing necessary information to employees, clients and other business associates. This publication summarises important SC decisions. Whilst every care has been taken in the preparation of this publication, it may contain inadvertent errors for which we shall not be held responsible.

This document is a proprietary material created and compiled by CNK & Associates LLP. All rights reserved. This newsletter or any portion thereof may not be reproduced or sold in any manner whatsoever without the consent of the publisher.

This publication is not intended for advertisement and/or for solicitation of work.

Our Offices in India

Mumbai

Mistry Bhavan, 3rd Floor,
Dinshaw Vachha Road, Churchgate
Mumbai 400020
Tel No. +91 22 6623 0600

Mumbai (Suburban Office)

501/502, Narain Chambers,
M.G. Road, Vile Parle (East)
Mumbai 400 057
Tel No:91 22 6457 7600/01/02

Bengaluru

96, 7th Cross,
Domlur,
Bengaluru - 560 071
Tel. No.+91 80 2535 1353

Chennai

Kochu Bhavan
Ground Floor, Old No 62/1, New No 57,
McNichols Road, Chetpet
Chennai 600031
Tel No. +91 44 4384 9695

Pune

4, Kumar Panorama, 1st Floor
45/18 Shankersth Road
Pune 411 037
Tel No: 91 20 2645 7251/52

Vadodara

C-201/202, Shree Siddhi Vinayak Complex,
Faramji Road,
Alkapuri,
Baroda - 390 005
Tel. No. +91 265 234 3483

Our Overseas Office

Dubai

Suite#17.06 Dubai World Trade Centre
Shaikh Zayed Road, Dubai, P.O.Box.454442
Tel. No. +971 04 355 9533