ITAT: Accepts Indian clients as comparables, grants 40% ‘discounting’ adjustment for Morgan Stanley's brokerage-services

Jul 27, 2020

Morgan Stanley India Company Private Limited (Formerly known as J.M. Morgan Stanley Securities Private Limited) [TS-369-ITAT-2020(Mum)-TP]

Conclusion

Mumbai ITAT upholds CIT(A)’s order holding CUP as the MAM for broking services provided by Morgan Stanley India, allowing both domestic and overseas independent entities to be considered for comparison, further allows ‘discounting factor’ of 40% as adjustment to the brokerage charged by assessee (a broking entity) to its Mauritius-AE for AY 2002-03; CIT(A) rejected assessee’s claim of TNMM and upheld TPO’s CUP as MAM, however, CIT(A) accepted assessee’s contention that its domestic Indian clients could be considered as comparable to its Mauritius-AE since the broking service was rendered in India, making the geographical location of the service recipient irrelevant; Further, CIT(A) accepted assessee’s contentions that appropriate adjustments need to be made if CUP is to be applied and accordingly granted adjustments at 40% as a ‘discounting factor’ on the brokerage charged towards savings on lower research activities for the AE, high volume and loyalty of the AE; Considering that the Mauritius-AE was giving a very high volume (15%) of business to the assessee, the CIT(A) granted volume adjustment, further, noting that the AE traded in securities only through assessee, CIT(A) granted adjustment towards loyalty; Considering no fact or law being bought on record by Revenue to take a different view, ITAT upholds CIT(A)’s decision and thereby dismisses Revenue’s appeal.:ITAT Mum

Decision Summary

ALP in respect of brokerage rate charge for Morgan Stanley Dean Witter Mauritius Limited (AE)

The assessee, Morgan Stanley India Company Private Limited, a broker/dealer of Bombay Stock Exchange and National Stock Exchange having institutional clients, locally and globally.

Assessee had benchmarked its transaction by adopting TNMM as MAM in its TP study whereby net margin earned by assessee (35.38%) at entity level as compared was higher than the profit margin earned by comparables (21.63%) engaged in similar broking business, thus making assessee’s transaction with ALP. During the TP proceedings, TPO rejected TNMM and computed ALP by applying CUP, thereby making TP-adjustment of Rs.1.18 crores. Thereafter, on appeal, CIT(A) accepted assessee’s contention and reduced the TP-adjustment to Rs.658 only. Assessee had explained that TPO granted an adjustment of marketing cost of 0.1076% which was approximately 30% of the weighted average rate charged to third party clients. CIT(A) granted adjustment of 40% with respect to marketing cost adjustment for significant volume and research cost and granted relief to assessee. Assessee had submitted that geographical location of the market was of no consequence in judging comparability of an uncontrolled transaction for the purpose of CUP application and that difference in geographical location couldn’t be reason enough to discard comparables. It was also submitted that geographical location of service recipients was an irrelevant consideration, because the consulting services provided by assessee would remain the same whether the service receiver was located in ‘X’ country or ‘Y’ as long as the service provider was in India.

Assessee accordingly submitted that CIT(A) was right in taking the average brokerage rate charged by assessee to its overseas and Indian clients irrespective of geographical location of service recipients. It was also explained that volume traded/executed by assessee on behalf of Mauritius-AE was Rs.1.316 crores for Clearing House (CH) trade which constituted approximately 34% of total CH trade executed by assessee to its clients. And on the other hand the highest third party client had executed a volume of CH trade of Rs.396.84 crores which constituted 10% of total CH trades executed by assessee to all its clients. Assessee further submitted that adjustment of research cost should be allowed for computing ALP.

ITAT noted that while filing return of income, assessee reported transaction in Form 3CEB, consequent to

which AO made a reference to TPO vide reference dated 24-09-2003 for ALP determination. TPO vide its order dated 22-02-2005 suggested an TP-adjustment of Rs. 1.18 crores. Thereafter TPO rejected assessee's TNMM method and instead applied CUP as MAM. On receipt of TPO's order, AO made TP-adjustment of Rs.1.18 crores. Aggrieved assessee approached CIT(A) and inter alia submitted that CUP was not the appropriate method as it was for ALP determination of assessee's trading transactions and as it was difficult to make accurate adjustments for itself as compared to other transactions and TMMM on the overall basis should have been considered being more reliable and accurate method. CIT(A) however concluded that CUP should be held as MAM instead of TNMM which is an indirect method.

ITAT further noted that on grounds of comparability of comparables, CIT(A) concluded that domestic independent clients should be considered for comparability purpose. Further, assessee submitted that if CUP is applied, the appropriate adjustment required to be lesser function performed/ asset utilised and risk assumed. Assessee also submitted that it did not perform any marketing and sales activities while executing trade for Mauritius-AE. It was further submitted that even the levels of other activities such as research, trade relationship etc were lower as compared to independent clients. It was also submitted that while fixing the brokerage rate of Mauritius-AE (trusted client of assessee providing substantial volume of business), assessee had to consider all the concerned factors. Accordingly, assessee urged that if CUP was accepted, then a discounting factor of 50% should be applied as an adjustment to brokerage rate charged to all Indian clients.

ITAT observed that CIT(A) accepted the aforesaid claim of assessee by stating that if CUP was applied, then appropriate adjustment was required to be made for all differences.CIT(A) further noted that TPO had made adjustment for marketing function by making adjustment considering part of marketing cost and had not made any adjustment to research activities on the premise that Mauritius-AE would get research related services from the assessee. Accordingly, CIT(A) rejected TPO's view that no adjustments were required to be made for research activities based on assumption and possibility and not on actual facts. After considering the high volume of business profit of Mauritius-AE to assessee which was 15% of assessee's total volume of business and the other highest client account was only 3.7% of total business volume, CIT(A) held that it was settled commercial principle that volume increases, price decreases.

CIT(A) considered certain facts, inter alia, that assessee carried out CH and DVP trades for Mauritius-AE and that the average brokerage charged to all independent clients of CH trade was 0.3511%. CIT(A) observed that TPO had already considered an adjustment of 0.1076% on account of marketing cost and thereby granted an adjustment amounting to approx. 30% of average brokerage charged to all independent clients. Considering assessee's plea that a discounted factor of atleast 50% should be applied as an adjustment to the brokerage rate charged to all independent clients, CIT(A) in order to meet ends of justice to both the parties, held that for comparability purpose, all the independent entities i.e domestic as well as overseas should be considered and a discounted factor of 40% as adjustment should be applied.

Considering no fact being bought on record by Revenue to take a different view as well as no law, ITAT upheld CIT(A)'s decision and dismissed Revenue's appeal.

The ruling was delivered by ITAT bench of Shri R.C Sharma and Shri Pawan Singh.

Dr Sunil M. Lala argued on behalf of the assessee while Revenue was represented by Mr A. Mohan.

Click here to read the ITAT observation on corporate tax grounds.

Case Law Information

Taxpayer Name

- Morgan Stanley India Company Private Limited (Formerly known as J.M. Morgan Stanley Securities Private Limited)

Judicial Level & Location

- Income tax Appellate Tribunal Mumbai

Date of Ruling

- 2020-02-25

Ruling in favour of

- Assessee

Nature of Issue

- ALP computation
- Comparable Uncontrolled Price Method (CUP)
- CUP more appropriate than TNMM
- Transaction Net Margin Method

Judges

- Shri R. C. Sharma$Accountant Member#Shri Pawan Singh$Judicial Member
- Shri R. C. Sharma
- Shri Pawan Singh

Counsel for Tax Payer

- Dr. Sunil M Lala

Counsel for Department

- Mr. A Mohan

Industry

- Investment / Finance & Related Advisory

IN THE INCOME TAX APPELLATE TRIBUNAL "J", BENCH MUMBAI

BEFORE SHRI R.C.SHARMA, AM & SHRI PAWAN SINGH, JM

ITA No. 266/Mum/2006 (AY: 2002-03)

A.C.I.T.-4(3), 6th Floor, Room No. 649, Aayakar Bhavan, Mumbai-20	Vs.	Morgan Stanley India Company Private Limited (Formerly known as J.M. Morgan Stanley Securities Private Limited), 18F/19F, Tower-2, One Indiabulls Centre, 841, Senapati Bapat Marg, Mumbai-400013.
PAN/GIR No.AAACJ 4998 F		
(Appellant)	..	(Respondent)

C.O. No. 215/Mum/2008 in ITA No. 266/Mum/2006)(AY2002-03)

Morgan Stanley India Company Private Limited (Formerly known as J.M. Morgan Stanley Securities Private Limited), 18F/19F, Tower-2, One Indiabulls Centre, 841, Senapati Bapat Marg, Mumbai-400013.	Vs.	A.C.I.T.-4(3), 6th Floor, Room No. 649, Aayakar Bhavan, Mumbai-20
PAN/GIR No.AAACJ 4998 F		
(Appellant)	..	(Respondent)

ITA No. 7057/Mum/2008(AY: 2002-03)

Morgan Stanley India Company Private Limited (Formerly known as J.M. Morgan Stanley Securities Private Limited),18F/19F, Tower-2, One Indiabulls Centre, 841, Senapati Bapat Marg, Mumbai-400013.	Vs.	A.C.I.T.-4(3), 6th Floor, Room No. 649, Aayakar Bhavan, Mumbai-20
PAN/GIR No.AAACJ 4998 F		
(Appellant)		(Respondent)

Revenue by	Shri A. Mohan (CIT-DR)
Assessee by	Shri Sunil M Lala (AR)
Date of Hearing	07/01/2020
Date of Pronouncement	**25/02/2020**

आदेश / O R D E R

PER: PAWAN SINGH, JUDICIAL MEMBER:

1. These two appeal out of which one appeal by revenue against the order of ld. CIT(A)-XIV, Mumbai dated 28/10/2005 and appeal by assessee against the order of ld. CIT(A)-XIV dated 11/11/2008 for the A.Y. 2002-03. The assessee has also filed Cross Objection in revenue's appeal. As both the appeals and C.O. of the assessee relates to same A.Y., therefore, both the appeal and C.O. were clubbed, heard and are decided by common order for the sake of convenience and to avoid the conflicting decision.

2. First we are taking the revenue appeal and assessee's C.O. for the A.Y. 2002-03, wherein following grounds have been taken:

Grounds of Revenue's appeal:

"(i) On the facts and in the circumstances of the case and in law, the CIT(A) erred in deleting the disallowance of Rs. 10,94,87,945/- on account of overseas support fees.

(ii) On the facts and in the circumstances of the case and in law, the CIT(A) erred in deleting the disallowance of Rs. 3,06,988/- on account of Club Membership.

(iii) On the facts and in the circumstances of the case and in law, the CIT(A) erred in deleting the disallowance u/s 40A(2)(b) in respect of salary payment to Ashitkumar Kampani on the strength of evidence not produced before the A.O.

(iv) On the facts and in the circumstances of the case and in law, CIT(A) erred in deleting the disallowance of Rs. 30,00,000/- relating to interest free deposit given to sister concern for office premises.

(v) On the facts and in the circumstances of the case and in law, CIT(A) erred in deleting the disallowance of Rs. 49,56,360/- relating to I.T. & T interest without appreciating the fact that the department has not accepted the decision relating to transaction loss on these shares.

(vi) On the facts and in the circumstances of the case and in law, CIT(A) erred in reducing the Arm's Length price in respect of brokerage rate charged for DVP trades to MSDW Mauritius from Rs. 1,18,59,779/- to Rs. 658/-.

(vii) Further placed in the above factual and legal scenario, the impugned order of the ld. CIT(A) is, the appellant prays, penalty perverse and contrary to law and consequently merits to be set aside and that of the Assessing Officer be restored.

(viii) The appellant craves leave to amend or alter any ground or add a new ground which may be necessary."

Grounds of assessee's C.O.

"1. On the facts and in the circumstances of the case, the ld. A.O. has legally erred in not allowing depreciation of Rs. 87,46,875/- on computer software capitalized in the assessment order for Assessment Year 2000-01.

It is prayed that the ld AO be directed to allow the depreciation on computer software capitalized in Assessment Year 2000-01.

The respondent craves leave to add, alter, amend or withdraw the above ground of cross objection and to submit such statements, documents and papers as may be considered necessary either at or before the appeal hearing."

3. Rival contentions have been heard and record perused. Facts in brief are that the assessee is engaged in the stock broking business and is a member of the stock exchange, Mumbai as well as the National Stock Exchange of India. The assessee filed its return of income for the year under consideration on 21/10/2002 declaring total income of Rs. 17,89,79,871/-. The A.O. passed assessment order and assessed total income at Rs. 32,06,27,094/- after making various disallowances/additions. By the impugned order, the ld. CIT(A) has given part relief, against which, both

the assessee and the revenue are in appeal and the assessee has also filed C.O. before us.

4. First, we are taking revenue's appeal being ITA No.266/Mum/2006. Ground 1 relates to deletion of disallowance of overseas support fees. At the outset of hearing, the Ld.AR of the assessee submits that ground 1 raised by the revenue is covered in favour of the assessee by the decision of Tribunal for AYs 2000-01 and 2001-02, wherein the Tribunal decided similar issue on the appeal of revenue for AYs 2000-01 and 2001-02. The Ld.AR furnished the copy of decision of Tribunal.

5. On the other hand, the Ld. DR for the revenue supported the order of AO.

6. We have considered the submission of both the parties and perused the record. We have seen that the assessee claimed an amount of Rs.10,94,87,945/- as a business expenditure on account of overseas support fees paid to Morgan Stanley India Securities Private Limited. The AO held that overseas support services are not in the business interest of the assessee. These expenses were neither necessitated nor justified by commercial expediency. The AO further held that no businessman will part its income by way of overseas support fees. The AO held that these are the transactions between sister concerns and covered by provisions of section 40A(2) being not incurred wholly and exclusively. The AO also held that no businessman will part its income by way of overseas support

fees. The AO held that these are the transactions between sister concerns and covered by provisions of section 40A(2) being not incurred wholly and exclusively. On appeal, the Ld. CIT(A) deleted the addition by following the decision of his predecessor for AYs 2000-01 and 2001-02.

7. We have noted that in assessee's own case for AYs 2000-01 and 2001-02, the Tribunal on similar ground of appeal (ITA No.7070/Mum/2004 – AY 2001-02 order dated 25-01-2008) while following the decision in assessee's s own in assessee's own case for AY 2000-01 in ITA No.3053/Mum/2014 deleted similar disallowance. We have note that facts for the year under consideration are not at variance. Otherwise, no contrary facts or material has been brought before us to take a different view. Therefore, respectfully following the earlier decision of the Tribunal, we do not find any infirmity in the order passed by the Ld. CIT(A), which we hereby affirm. In the result this ground of appeal is dismissed.

8. Ground No.2 relates to deletion of disallowance of club membership fees. While making addition, the AO in the assessment order held that the club membership expenditure amounting to Rs.3,06,988/- is a payment for life membership the benefit of which spreads over the life of the membership and, therefore, the expenditure is capital / personal expenditure and do not fall under the ambit of revenue expenditure. On appeal, the Ld. CIT(A)

found that these are the annual club membership fees and not life membership fees and deserved to be allowed as business expenditure.

9. The Ld.AR of the assessee submits that the club expenditure fees is allowable as revenue / business expenditure as has been held by Hon'ble jurisdictional High Court in Otis Elevator Co. Ltd vs CIT 195 ITR 682 and CIT vs Johnson & Johnson Ltd (2012) 80 taxmann.com 337 (Bom).

10. On the other hand, the Ld. DR further submits that expenses incurred on account of membership fee for club or maintenance fees was not incurred wholly and exclusively for the purpose of business.

11. We have considered the submission of both the parties, perused the record. We have noted that during the assessment, the AO held that payment of club membership fees is for life membership, the benefit of which is spread over the life of member and, therefore, the expenditure is capital in nature. The personal expenses for membership did not fall within the ambit of revenue expenditure. The Ld. CIT(A) allowed relief to the assessee by following the decision of jurisdictional High Court in case of Otis Elevator Co Ltd (supra). Before us, the Ld. DR failed to bring any contrary material or law to take other view. Therefore, respectfully following the decision of Hon'ble jurisdictional High Court in CIT vs Johnson & Johnson Ltd (supra) and Otis Elevator Co Ltd (supra), we affirm the order of Ld. CIT(A). In the result, ground of appeal is dismissed.

12. Ground 3 relates to deletion of disallowance of payment made to Ashish Kampani u/s 40(A)(2)(b). The Ld.AR of the assessee submits that the assessee obtained the approval of Central Government for payment of salary, allowances, bonus and perquisites and accordingly made payment in accordance with the approval accorded by Central Government u/s 314(1B) of Companies Act. The AO disregarded the approval obtained by the assessee from Central Government and the fact that payment made to Ashish Kampani (employee) is not in excess having regard to his qualification, experience and nature of services rendered by him. Further, the housing loan was not interest free. The assessee charged interest @10% which is evidenced by the document furnished at page 446 of the paper book.

13. On the other hand, the Ld. DR for the revenue supported the order of assessing officer. The Ld. DR submits that the AO passed the detailed order substantiating the disallowances.

14. We have considered the submissions of the parties and perused the order of the lower authorities. We noted that during the assessment before AO, the assessee stated that they have paid remuneration of Rs.48,88,261/- to Shri Ashish Kampani for the year under consideration. The remuneration consists of basic salary of Rs.10 lakhs p.a. allowance of Rs. 5.00 lakhs p.a., bonus of Rs. 32,41,261/-. The assessee also furnished the interest bearing

housing loan of Rs.66.50 lakhs. The assessee also contended before the AO that they have obtained the approval of Central Government u/s 314(1B) for payment of salaries of Rs.10 lakhs p.a., bonus and perquisites was subject to a maximum value of Rs.7.67% and allowance of Rs.5 lakhs and bonus of 15.71%. The AO disallowed only Rs.10,49,299 u/s 40A(2)(b) by taking view that remuneration paid is in excess of limit prescribed by Ministry of Law in its letter dated 24-02-2001 and 05-09-2005, having regard to his qualification, experience and the nature of service rendered being more than reasonable. The AO treated the 10% of housing loan as interest. Accordingly, the AO disallowed Rs.10,49,299 and interest on housing loan of Rs.64,500/- totaling Rs.16,94,299/-. The Ld. CIT(A) deleted the addition by taking view that the person is in the field of capital markets, command a very high price. Further, the payment made to employee is within the limits prescribed by Companies' Act and satisfies the test of reasonableness. We have noted that the AO, while making the disallowance disregarded the approval granted by central government under the statutory provisions of Companies Act. The AO made addition / disallowance without considering the qualification, experience and reasonableness with regard to his past and position in the field of capital market. So far as interest disallowance of Rs. 645,000/- is concerned, we have noted that the housing loan was not interest free the assessee charged interest on such loan as evident from page No. 446 of the paper book.

Which has not been disputed by ld. DR while making his submissions before us. Therefore, we do not find any justifiable reason to interfere with the finding of Ld. CIT(A), which we affirm. In the result, this ground of appeal is also dismissed.

15. Ground 4 relate to deletion of disallowance of interest free deposit to sister concern. The Ld.AR of the assessee submits that the assessee has not debited an amount of Rs.300 lakhs to the P&L Account and accordingly there cannot be disallowance of notional interest as computed by AO in respect of interest free security deposit provided by assessee to its sister concern. Notional interest does not fall within the ambit of exception u/s 40A(2)(b) of the Act. The Ld.AR submits that onus is on the AO to prove that the rent paid by the assessee should be considered as excess within the meaning of section 40A(2). The AO has not brought any material to substantiate the disallowance. The Ld.AR submits that vide submission dated 22-12-2004, the assessee explained the complete fact before the AO. The Ld.AR submits that the Ld. CIT(A) rightly appreciated the fact that no case for disallowance of notional interest on interest free deposit was made out by the AO. In support of his submissions the ld AR for the assessee relied on the decision of Bombay High Court in Karma Energy [2015] 57 taxmann.com 235(Bom), Gujarat High Court in Ashok J Patil [2014] 43 taxmann.com 227 (Guj).

16. On the other hand, the Ld. DR for the revenue supported the order of AO.

17. We have considered the submissions of parties and perused the order of lower authorities. During the assessment, the AO noted that assessee has paid rent of Rs.1.41 crores to its sister concern for occupying of 12,030 sq.ft. of office premises in Forbes building. The assessing officer further noted that assessee has paid deposit of Rs.3.00 crore with its sister concern. The AO noted that no explanation was given for such deposit with sister concern. The AO calculated interest @10% amounting to Rs.30 lakhs and made addition on account of interest free deposit. The AO concluded that even the rent paid is reasonable, the interest on deposits has to be considered as an excess within the meaning of section 40A(2) of the Act. On appeal before ld. CIT(A), ld. CIT(A) took his view that the AO has not made a case for disallowance of any expenditure and made addition for notional return of interest from deposit. It was further held that the AO made addition to the income of assessee which has not been earned and, therefore, deleted the addition. Before us, neither the Ld. DR brought any contrary law nor any comparable rate of rent in similarly situated property. Moreover, the AO has not made a case of disallowance on the basis of any comparable and simply made addition for notional return of interest free deposit. The Hon'ble *Bombay High Court in Karma Energy* [2015] 57 taxmann.com 235(Bom) held that where assessee paid lease rent to a group

company in respect of wind farm taken on lease, since lease rent was fixed in accordance with formula provided by Indian Renewable Energy Development, a Government of India Company, impugned disallowance made by Assessing Officer under section 40A(2)(b) was to be set aside. Thus, keeping in view the decision of Bombay High Court (supra) and when no contrary fact or law is brought to our notice, we affirm the finding of ld CIT(A). In the result the Ground No. 4 is dismissed.

18. Ground 5 relates to deletion of disallowance of interest relating to loss on underwriting transaction. The Ld.AR of the assessee submits that loss on [illegible] transaction pertaining to AY 2001-02 which was disallowed in the assessment order for AY 2001-02 and on appeal was allowed by Tribunal in ITA No.7060/Mum/2011. Therefore, disallowance of interest does not survive.

19. On the other hand, the Ld. DR for the revenue supported the order of AO.

20. We have considered the submissions of the parties and seen the orders of the lower authorities. For the year ended 31.03.1001, the assessee and JP Morgan Stanley Pvt Ltd were appointed as one of the joint lead merchant banker and the under writer for the IPO of IT & IT. Due to under subscription, the loss attributed to the undersubscribed shares were to be borne by the assessee and JP Morgan Stanley Pvt Ltd in 50: 50 shares each. JP Morgan Stanley Pvt Ltd paid full consideration for development,

which was on account of assessee and thus the assessee paid interest @12% amounting to Rs.49,56,360/-. The AO disallowed interest of Rs.49,56,360/-, by taking view that underwriting transaction of IT & T share was disallowed in the earlier assessment year being not related to the business. On appeal the Ld. CIT(A) held that since the loss of transaction of IT & T of AY 2001-02 has been allowed as business loss by his predecessor and accordingly, the interest component is married to such loss also assumes the character of business expense and is accordingly allowable and resultantly allowed relief to the assessee. We have further noted that the co-ordinate bench of Tribunal while considering the disallowance in AY 2001-02 in its order dated 25.01.2008 in ITA No.7060 held that loss suffered by assessee out of its business of earning commission income and on the principle of matching concept of income and expenditure, the entire loss was allowed in AY 2001-02. We are further in agreement that allowance of interest of Rs.49,56,360/- is merely consequential in the year under consideration. Therefore, we do not find any merit in the ground of appeal. The same is dismissed.

21. Ground 6 relates to reducing the arm's length price in respect of brokerage rate charge for Morgan Stanley Dean Witter Mauritius Limited. The Ld.AR of the assessee submits that assessee is a broker / dealer of Bombay Stock Exchange and National Stock Exchange. Assessee is having

institutional clients, locally and globally. During the relevant assessment year, the assessee rendered broking services to its AE and to third party clients both, in India and overseas. The assessee benchmarked this transaction by using transaction net margin method (TNMM) in its transfer pricing study report, whereby net margin earned by assessee at entity level was compared with the profit margin earned by comparable companies engaged in similar broking business. The net margin earned by assessee is 35.38% which is higher than the net profit margin earned by comparable companies i.e. 21.63%. Accordingly, the transaction of assessee is within arm's length price (ALP). During the transfer pricing assessment proceedings, the TPO rejected the appropriate method adopted by assessee and computed the arm's length price by using comparable uncontrolled price (CUP) method thereby made an adjustment of Rs.1,18,59,779/- with regard to the international transaction. The TPO rejected the contention of assessee while computing the arm's length price under CUP. Further, on appeal before CIT(A), the contention of assessee was accepted and adjustment was reduced to Rs.658 only. The Ld.AR of the assessee furnished the working of calculation adopted by TPO and the Ld.CIT(A) in the following manner:-

Particulars	Clearing House (CH) Trades		Delivery versus payment (DVP) Trades	
	By TPO	by CIT(A)	By TPO	by CIT(A)
Arms length brokerage rate*	0.4358%	0.3511%	0.4728%	0.4622%
Less:Adjustment	0.1076%	0.1405%	0.1076%	0.2080%

made to the aforesaid rate- 30 percent/40 percent**				
Adjusted arm's length brokerage rate (A)	0.3282%	0.2107%	0.3652%	0.2542%
Rate charged by MSICPL(B)	0.2381%	0.2381%	0.2403%	0.2403%
Difference in brokerage rate (C=A-B)	0.0901%	Nil	0.1249%	0.0139%
Volume executed by MSDW Mauritius (D)	13,16,22,69,259	13,16,22,69,259	47,35,557	47,35,557
Transfer pricing Adjustment (C*D)	**1,18,53,866**	**Nil**	**5,913**	**658**

22. The Ld.AR explained that TPO granted an adjustment of marketing cost to the extent of 0.1076%, which is approximately 30% of weighted average rate charged to third party client. However, Ld. CIT(A) granted adjustment of 40% with respect to marketing cost adjustment for significant volume and research cost and granted relief to the assessee. The Ld.AR further submits that geographical location of market is of no consequence in judging comparability of an uncontrolled transaction for purpose of applying CUP method. The difference in geographical location cannot be reason enough to discard comparables. Geographical location of service recipient to be irrelevant consideration, because the consulting services provided by the assessee would remain the same whether the service receiver is located in 'X' country or 'Y' country as long as service provider is in India. Reliance is placed on the following judicial precedents to support the said contention:-

- SI Group-India Ltd v. DCIT (2016) 68 taxmann.com 158 (Mumbai-Trib)
- Bharti Airtel Ltd v. ACIT (2014) 43 TAXMANN.COM 50 (Delhi-Trib)
- Tower Watson India Pvt Ltd vs DCIT [TS-260-ITAT-2019(DEL)-TP]
- Inslico Ltd v. DCIT Ts-623-ITAT-2015(DEL)-TP
- Clear Plus India Pvt Ltd vs DCIT 30 CCH 0652 Del Trib
- BMW India Pvt Ltd vs ACIT (TS-401-ITAT-2018 (Del Trib)
- M/s Garware Polyester vs Dy.CIT-8(1), Mumbai ITA No.6169/Mum/2011
- ADIT. Circle 1(1), International Taxation, New Delhi vs ABB Lummus Heat Transfer BV [2015] 64 taxmann.com 210 (Delhi-Trib)

23. The Ld.AR accordingly submits that the Ld. CIT(A) was justified in taking the average brokerage rate charged by assessee to its overseas and Indian clients irrespective of geographical location of service recipients. The Ld.AR further submits that volume discount / adjustment should be allowed in computing arm's length price. It was explained that volume traded / executed by assessee on behalf of Mauritius entity was Rs.1.316 crores for CH trade, which constitute approximately 34% of total CH trade executed by assessee of its clients. And on the other the highest third party client had executed volume of CH trade of Rs. 396.84 Crore which constitute 10% of the total CH trades executed by assessee to all its clients. In support of his submissions the ld AR for the assessee relied on the following case laws;

- Clariant Chemical (India) Ltd Vs JCIT[2014] 44 taxmann.com 421 (Mumbai-Trib),
- Dresser-Rand India (P) Ltd Vs ACIT [2011] 13 taxmann.com 82 (Mumbai Trib),
- Livingstones Vs DCIT [2014] 41 taxmann.com 499(Mumbai-Trib)

24. It was further explained that adjustment of research cost should be allowed for computing the arm's length price.

25. On the other hand the ld. DR for the revenue supported the order of TPO/ AO.

26. We have considered the submissions of both the parties, perused the record. While filing the return of income, the assessee reported transactions with its AE as reported in Form 3CEB. Consequent to that, the AO made reference to the TPO vide reference dated 24-09-2003 for computation of arm's length price. The TPO vide his order dated 22-02-2005 suggested adjustment of Rs.1,18,559,779/-. The TPO rejected the TNMM method applied by assessee for bench marking its transaction with its AE. The TPO computed the arm's length price by applying CUP method. And suggested adjustment of Rs.18,59,779/- in arms length price. On receipt of report of TPO, the AO made addition of Rs.1,18,59,779/- in respect of arm's length price while passing the assessment order. The assessee filed appeal before CIT(A). Before CIT(A), the assessee besides other contentions, stated that CUP method cannot be used as it is for determination of ALP of assessee's transactions with its AE as it is difficult to make accurate adjustments for itself as compared to other trades / transactions and TNMM on the overall basis should have been considered, being more reliable and accurate method in assessee's case.

The Ld.CIT(A), after considering the submissions of assessee concluded that CUP is the most appropriate method which should be applied to the proper adjustment instead of using TNMM which is an indirect method.

27. On the grounds of comparability of comparables, concluded that domestic independent client should be considered for comparability purpose. The assessee further stated that if CUP is to be applied, then appropriate adjustment need to be made for lesser function performed / asset utilised and risk assumed. It was further stated that assessee did not perform any marketing and sales activities while executing trade for AE in Mauritius. Even the levels of other activities like research, trade relationship, etc. are lower as compared to independent client. In addition, Mauritius AE is the trusted client of assessee and provided substantial volume of business. Mauritius AE is dedicated client of the assessee. While fixing the brokerage rate of Mauritius AE, the assessee has to consider all the above factors. Accordingly, the assessee urged that if CUP has to be applied, then discounting factor of 50% should be applied as an adjustment to the brokerage rate charged to all Indian clients.

28. The contention of assessee was accepted by Ld. CIT(A) by taking view that if CUP method has to be applied, then appropriate adjustment need to be made for all differences. The Ld. CIT(A) further noted that TPO has carried out adjustment for marketing function by making adjustment

considering part of marketing cost and has not made any adjustment to research activities on the premise that Mauritius AE would be getting research related services from assessee. Thus, the Ld. CIT(A) not agreed with the view of TPO that no adjustments are required to be made for research activities based on assumption and possibility and not on actual facts. The Ld.CIT(A), after considering the high volume of business profit of Mauritius AE to assessee which is 15% of the total business volume of assessee and the other highest client account is only 3.7% of total business volume, the Ld.CIT(A) took his view that it is settled commercial principle that "volume increases, the price decrees". The Ld.CIT(A), after considering the facts, passed the following order:-

> "I agree with the appellant that if CUP method has to be applied then appropriate adjustments need to be made for all differences. The TPO has carried out adjustments for marketing functions by making an adjustment considering part of the marketing cost. The TPO has not made any adjustments for research activities on the premise that MSDW Mauritius would be getting research related services from the appellant. I an unable to agree with the TPO who has formed a view that no adjustments are required to be made for research activities based on certain assumptions and possibilities and not on actual facts.
>
> Further, the TPO has not considered any adjustment for the high volume of business given by MSDW Mauritius to the appellant. The total volume of trades (for purchases and sale) generated by MSDW Mauritius is Rs.1316 crores. As noted by the TPO on page 8 of his order, the business provided by MSDW Mauritius is approximately 15% of the total business volume of total trades. The next highest client accounts for only 3.77% of the total business volume. It is well settled commercial principle that 'as volume increases, the price decreases'. The TPO has dealt with this issue on para 2 of page 8 in his

order. The TPO has picked out certain instances where even though the volume has increased there is no decrease in the brokerage rate and accordingly has not considered any adjustment for volume differences. I am unable to agree with the TPO to the extent that one cannot disregard well-settled commercial principle based on certain stray instances. The fact that 'as volume increases, the price decreases' is a well-established commercial principle and accordingly due weightage /adjustment should be given for the huge volume of business given by MSDW Mauritius.

As per the appellant, MSDW Mauritius is a dedicated client i.e. it bought and sold securities only through the appellant for the entire previous year. Accordingly, while fixing the brokerage rate for MSDW Mauritius, the appellant has to consider the fact that MSDW Mauritius has no transactions through any of its competitors. The TPO has not considered any adjustments for the same. I am unable to agree with the TPO as certain amount of adjustment is required to loyalty factor of MSDW Mauritius.

The appellant carries out 'Clearing House' and 'DVP' trades for MSDW Clearing House' trades. As stated above, the average brokerage charged to all independent clients for 'Clearing House' trades is 0.3511%. The TPO, in his order, has already considered an adjustment of 0.1076% on account of marketing cost. Thus, adjustment granted by the TPO amounts to approx. 30% of average brokerage charged to all independent clients.

As stated above, the appellant has contended that the discounting factor of atleast 50% should be applied as an adjustment to the brokerage rate charged to all independent clients.

Keeping the entire factual matrix in mind, I feel that the ends of justice would be met to both sides by considering a discounting factor of 40%. This discounting factor of 40% would cover the marketing cost adjustment already considered by the TPO.

Conclusion

Based on the above, this sub-ground is partly allowed. For comparability purposes, all the independent entities i.e. domestic as well as overseas should be considered, and a discounting factor of 40% as adjustment should be applied.

The calculation of the arm's length price is enclosed as Annexure 1.

ANNEXURE-1

Particulars	Clearing House Trades	DVP Trades
Overseas Trades	13,513,701,695	62,321,033,641
Domestic Trades	9,741,948,998	2,248,476.175
Total Uncontrolled Trades	23,255,650,692	64,569,509,816
Total Commission for Uncontrolled Trades	81,660,811	298,410,339
Weighted Average Rate	0.3511%	0.4622%
Discount @40%	0.1405%	0.2080%
Arm's length price (i.e. adjusted average rate for uncontrolled trades)	0.2107%	0.2542%
Trades for MSDW Mauritius	131,622,693	4,735,557
Commission Amount	31,343,868	11,379
Rate charged To MSDW Mauritius	0.2381%	0.2403%
Diff in ALP and rate charged to MSDW		0.0139%
Addition		658

Considering the arm's length price determined on the above factors, the brokerage rate charged by the appellant to MSDW Mauritius for 'Clearing House' trades meets with the arm's length principle. However, the brokerage rate charged by the appellant to MSDW Mauritius for 'DVP' trades does not meet with the arm's length principle and consequently, the addition of Rs.658 is therefore confirmed.

The appellant gets a relief of Rs. 1,18,59,121 for this sub-ground."

29. Before us, the Ld. DR for the revenue could not bring out any fact to enable us to take a different view. No contrary law is brought to our notice. Therefore, we do not find any reason to interfere with the finding of Ld. CIT(A). In the result, this ground of appeal also fails.

30. In the result, appeal of the revenue is dismissed.

CO & Appeal of the assessee.

31. Brief facts of the case are that in AY 2000-01, the assessee claimed revenue expenditure of Rs.6.22 crores on computer software. The assessment for AY 2000-01 was completed on 28-03-2005 and the AO considered the said expenses as capital against the revenue expenses claimed by assessee and allowed depreciation @ 25%. The assessee accepted the treatment. Accordingly, subsequent to the assessment year 2000-01, the assessee filed a letter dated 08-07-2003 requesting the AO to allow the depreciation on computer software in AY 2001-02. Accordingly, vide order passed u/s 154 for AY 2001-02, the assessee was allowed depreciation on computer software. While passing the assessment for AY 2002-03 i.e. assessment year under consideration u/s 143(3), due depreciation on computer software of Rs.87,46,875/- was not allowed. After receipt of the order, the assessee filed application for rectification dated 28-03-2005 before AO for allowing consequential depreciation on computer software. The AO in his rectification order on 29-06-2005

allowed the claim of depreciation to the assessee. However, subsequently, a notice u/s 154 dated 07-04-2006 was issued to the assessee seeking to withdraw the depreciation already allowed. The assessee filed detailed submission dated 28-04-2006 in response to notice dated 07-04-2006. However, vide order dated 26-06-2006 passed u/s 154 withdrew the claim of depreciation on the ground that assessee's income assessed was lower than the returned income. The assessee filed its submission before AO dated 06-06-2006 and contended that there was neither any omission nor wrong statement in the return of income originally filed and as such revised return of income can be filed. Aggrieved by the action of AO, the assessee filed appeal before the CIT(A). The CIT(A) vide order dated 11-11-2008 upheld the action of AO. Thus, aggrieved by the action of CIT(A), assessee has filed appeal before the Tribunal as well as cross objection in the revenue's appeal by raising the common grounds of appeal in appeal as well as in cross objections.

32. We have heard the submission of Ld.AR of the assessee and Ld. DR for the revenue and perused the material available on record. The Ld.AR of the assessee submits that the circular No.549 dated 31-10-1989 relied upon by the AO ultra virus. The AO /CIT(A) or Tribunal is not bound by the said circular. The Ld.AR of the assessee submits that the Hon'ble Gujarat High Court in Gujarat Gas Co Ltd vs JCIT (2000) 111 taxmann.144 (Guj) held that AO exercised quasi judicial function and has a duty cast upon

him to act in a quasi judicial and independent manner and authorities cannot be controlled or affected his judgement in the matter of assessment. The High Court concluded that the order of AO to his extent stated that total income should be returned income was to be set aside. The High Court directed the AO to ignore even the circular of CBDT which directs the AO not to let the assessed income below the returned income. The Ld.AR also relied upon the following decisions;

- Kalindi Rail Nirman (Engineers) Ltd Vs CIT 88 txmann.com533 (RAJ),
- Sajjan India Ltd Vs ACIT [2018] 89 taxmann.com 21(Mumbai Trib),
- Tata Industries Ltd Vs ITO [2016] 70 taxman.com 227 (Mumbai Trib),
- Dhampur Sugar Mills Limited vs CIT (90 ITR 236),

33. On the other hand, the Ld. DR for the revenue supported the orders of authorities below.

34. We have considered the submission of parties and perused the orders of authorities below. We have noted that initially in A.Y. 2000-2001, the assessee claimed revenue expenditure on computer software. However, the Assessing Officer treated the expenditure as capital expenditure and allowed the deprecation. Initially the Assessing Officer rectified the assessment order for the Assessment Year under consideration on 29.06.2005. The Assessing Officer thereafter, while giving effect to the order of ld. CIT(A) passed on 08.12.2005 took his view that the order passed under section 154 dated 29.06.2005 resulted in assessing income at

below the return income. The Assessing Officer sought the approval for issue of refund from the office of CIT-4, Mumbai. The CIT-4, Mumbai vide his letter dated 17.03.2006 conveyed to the Assessing Officer that assessed income has become less than the returned income and Assessing Officer accordingly directed to verify how the assessed income is less than the returned income. Accordingly, the Assessing Officer issued show-cause notice to the assessee and by making reference of Circular No. 549 dated 31.10.1989, withdrew the depreciation on computer software allowed to the assessee. The ld. CIT(A) affirmed the action of Assessing Officer by taking view that no depreciation on computer software was claimed by assessee in the return of income, nor the same was claimed by filing revised return. The assessee claimed depreciation vide letter dated 08.07.2003 on which cognizance was taken by Assessing Officer. Subsequently, the assessee filed rectification application before the Assessing Officer, who rectified the assessment order under section 143(3) on 18.03.2005 by allowing claim of depreciation. However, on receipt of CIT(A) order, order giving effect was passed on 08.12.2005 which resulted in assessing the income at Rs. 17,24,79,590/-. The Assessing Officer sought the approval of CIT. The office of CIT directed to take remedial action with reference to Circular No. 549 of CBDT dated 31.10.1989. The ld. CIT(A) also held that in view of the decision of Hon'ble Supreme Court in Goetz India Ltd., the Assessing Officer is not entitled to allow claim

unless revised return is filed. There was mistake by Assessing Officer while passing the order under section 154 dated 26.09.2005 which was rectified vide order dated 26.06.2006.

35. We have noted that there was no dispute that in A.Y. 2000-01, the assessee claimed revenue expenditure on computer software, the Assessing Officer treated the same as capital expenditure and allowed the depreciation. The similar treatment was followed in A.Y. 2001-02 allowing depreciation @ 25% again in A.Y. 2002-03, the assessee was allowed depreciation @ 25% though allowed on filing application/letter dated 08.07.2003. Subsequently, the depreciation was allowed on the pretext that assessed income was below the returned income. The Assessing Officer also relied upon the Circular No. 549 dated 31.10.1989. The Hon'ble Gujarat High Court in Gujarat Gas Co. Ltd. vs. JCIT (supra) held that Assessing Officer exercised quasi judicial function and a duty cast upon him to act in a judicial and independent manner and other authorities cannot control or affect this judgement in the matter of assessment. The Hon'ble High Court further held and directed the Assessing Officer to ignore even the Circular of CBDT, which directed the Assessing Officer not to let the assessed income below the returned income. Further, the Hon'ble Gujarat High Court in CIT vs. Milton Laminates Ltd. [2013] 37 taxmann.com 249 (Guj.) held that while giving effect to the order of ld. CIT(A), the Assessing Officer can compute income lower than the retuned income. The Hon'ble

Rajasthan High Court in Kalindee Rail Nirman (Engineers) Ltd. vs. CIT held that after proceeding if it is found that the assessee is entitled to refund, the same should be refunded as State cannot recover tax more than what is due. Considering the aforesaid legal discussion, we are of the view that the Assessing Officer cannot withdrew the depreciation already allowed by taking plea that assessed income became less than the returned income. So far as objection of ld. CIT(A) that Assessing Officer is not entitled to entertain fresh claim in absence of revised return of income as held by Hon'ble Apex Court in Goetz India Ltd. (supra).

36. The Hon'ble Bombay High Court in a landmark decision in Pruthvi Brokers & Shareholders Pvt. Ltd. [2012] 349 ITR 366 (Bom.) held that an assessee is entitled to raise a fresh claim before the Appellate Authorities, even if the same was not raised before the Assessing Officer at the time of filing return of income or by filing a revised return of income. Thus, in view of the decision of Pruthvi Brokers & Shareholders Pvt. Ltd. (supra), the Assessing Officer may not have entertain the revised claim of depreciation, though it was allowed, and subsequently withdrawn, however, the ld. CIT(A) having co-terminus power was fully competent to allow the depreciation as it was the revenue, which treated the expenditure incurred on computer software as capital expenditure in place of revenue expenditure in earlier assessment year. In our view once the particular treatment is accepted consistently by revenue, it cannot be treated

indifferently in subsequent A.Y. unless the facts are totally different. Therefore, in view of the aforesaid factual and legal discussion, the rectification order dated 26.06.2006 in withdrawing the depreciation is unjustified, which we set-aside.

37. In the result, appeal of the assessee is allowed.

38. Considering the fact that we have allowed the appeal of assessee in setting-aside the order dated 26.06.2006 passed under section 154 by Assessing Officer. Therefore, the Cross Objections filed by assessee have become infructuous and dismissed.

Order pronounced in the open court on 25th February, 2020

Sd/-	Sd/-
(R.C. Sharma) ACCOUNTANT MEMBER	(Pawan Singh) JUDICIAL MEMBER

Mumbai, Dated 25th February, 2020
Pk/-

Copy to :
1. Appellant
2. Respondent
3. CIT(A)9
4. CIT
5. DR

/True copy/

By order

Asstt. Registrar, ITAT, Mumbai