

Recent Delhi High Court Ruling on Non-Binding Research/ Financial Advisory Services¹

In a recent landmark ruling (Avenue Asia Advisors Pvt Ltd), Delhi High Court has laid down important principles on comparability for non-binding research/ financial advisory services.

Facts

During the relevant financial year, assessee provided investment advisory and support services to its associated enterprise ('AE') at a cost plus mark-up. Assessee provided research reports and other material to assist AE in carrying out assessment of potential investment opportunities in India. The research undertaken by assessee assisted the AE in taking right financial/ investment decisions.

Issues

The key issues revolved around inclusion of three comparables namely (i) Sumedha Fiscal Services Limited (ii) Brescon Advisors Limited and (iii) Ladderup Corporation Limited which were contested by assessee on grounds of functional dissimilarity.

Decision

- (i) Sumedha Fiscal Services Limited - ITAT clearly acknowledged the Company earned substantial revenue from management of rights issues. Despite this fact, ITAT restored the matter to TPO to examine whether Sumedha was comparable to assessee. High Court held that such an approach of ITAT was not correct. Starting the entire exercise of comparability analysis from the stage of 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. High Court held that ITAT itself should have determined whether Sumedha was to be retained.
- (ii) Brescon Advisors Limited – ITAT analysed the annual reports and noticed that income of Brescon was from fee based financial services, from debt resolution and debt syndication. Brescon also earned revenue from sale of investments. High Court ruled that ITAT equated 'Advisory services related to debt financing' with 'financial services from debt resolution and debt syndication'.

¹ Avenue Asia Advisors Pvt. Limited v/s Deputy Commissioner of Income Tax

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These two were 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 required deeper analysis and examination.

- (iii) Ladderup Corporation Limited – 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 deserved to be retained.

High Court Ruled that ITAT had 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 comparable performed similar functions. The analysis at such a broad level, based upon the appearance of similar terminologies, does not by itself make the functions similar in nature. The High Court has ruled that though Transactional Net Margin Method (‘TNMM’) allows flexibility in choice of comparables, the Method did not permit comparison of non-binding research/ financial advisory service providers with full-fledged financial service companies undertaking activities such as merchant broking, debt syndication, debt financing etc.

Comments

The High Court has laid down a key principle on comparability for financial advisory service providers. Merely advising on financial issues and providing research/ advisory services is different from providing full-fledged services relating to debt restructuring, debt financing, issuance of IPOs, mergers and de-mergers, etc. In other words there is a difference between giving advice on these matters and actually undertaking the said services. Borrowing the analogy given by High Court, in the context of litigation, there is a 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.

The Ruling is a welcome decision that reaffirms similar rulings in the past that have held that mere advisory or research service providers cannot be equated with full-fledged financial service companies providing broking services, debt syndication, mergers & acquisition etc (refer Carlyle Ruling, Motilal Oswal and others).

Tax Team

The information contained in this newsletter is solely intended to provide general guidance on matters of interest. Nothing herein constitutes professional or legal advice, nor does any information herein constitute a comprehensive or complete statement of the issues discussed. It is recommended that you seek a professional advice to confirm your understanding on the issues dealt above.

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