



Transfer Pricing Insight with information

APA has a persuasive value
for resolving disputes even
beyond the rollback years

Issue no: TP/3/2016

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Executive Summary

The Hon'ble Income Tax Appellate Tribunal (the Tribunal), Delhi bench has pronounced an important ruling on April 25, 2016 in the case of Ranbaxy Laboratories Limited (Ranbaxy India, company, taxpayer) stating that the Advance Pricing Agreement (APA) can have a strong persuasive value for resolving disputes of the years even prior to the roll back years if the nature of international transactions and FAR (Functions, assets and risk) of the taxpayer and the Associated enterprises (AEs) remains the same.

Specifically, the Tribunal held that:

“the concept and the methodology laid down in the APA can have the guidance value for the revenue authorities for the purpose of comparability analysis. The main intent of the APA is to protect the fair share of the revenue of the states in simple and efficient manner and to protect the tax base.Therefore, the agreement entered into by the CBDT with the assessee, which has considered all the aspects of the manner of termination of the ALP which are also similar for this year, should be given highest sanctity and therefore the mechanism suggested in that agreement should be necessarily followed in determining ALP of the transactions for this year.”

Facts

- The taxpayer is a manufacturer of pharmaceuticals for many decades, having manufacturing at several locations. It is engaged in other activities such as R&D, quality control processes, etc. For the multi-country operations, the taxpayer has set up a number of wholly-owned subsidiaries, joint ventures and representative offices in different parts of the world.
- The AEs of the company are mainly engaged in the distribution of pharmaceuticals to customers in overseas markets. Some of the AEs are also engaged in the conversion and sale of active pharmaceutical ingredients (APIs) into dosage forms, repacking and finishing activities. For the Transfer Pricing (TP) purposes, the taxpayer characterized

itself as normal risk bearing entity, bearing the risk of success or failure of the business. It also stated that the AEs were engaged only in the business of selling and distribution or secondary manufacturing activity, bearing minimum risk with least complex operations without owning any intangible or unique asset. Accordingly, it considered AEs as tested parties for determining the arm's length price.

- During assessment proceedings, the Transfer Pricing Officer (TPO) rejected the selection of foreign AE as tested party on the ground that there is a geographical difference between the AE and the comparables, and selected taxpayer as the tested party. TPO determined the arm's length nature of the international transactions of the taxpayer on the basis of a set of comparables selected by him, and made TP adjustment for the difference. The Dispute Resolution Panel (DRP) confirmed the TP adjustment made by the TPO.
- Consequently, the taxpayer filed an appeal before the Tribunal.

Issues before the Tribunal

- Whether overseas AEs can be considered as “tested party” if they are least complex entities?
- Though APA was signed for AY 2014-15, can it have any impact on the international transactions for the year under appeal?

Observations & Ruling of the Tribunal

- The taxpayer submitted that it entered into an APA on August 7, 2015 with the CBDT, Government of India for AY 2014-15. For the purpose of arriving at the advance pricing, the CBDT conducted detailed FAR analysis of the taxpayer and concluded that the taxpayer was an entrepreneur manufacturer and the AEs were functioning as distributors or secondary manufacturers.

- The taxpayer also contended that there was no change in the FAR of the AEs in the year under appeal vis-à-vis the year of APA. The mechanism for TP analysis as accepted in the APA may, therefore, be applied in the years under appeal also.
- The Departmental Representative (DR) contested that an APA was merely a negotiated agreement and was applicable only for the year for which it was entered into, and so it should not be applied retrospectively to the year under appeal which was not covered year even under the rollback period.
- The Tribunal observed that the CBDT agreed to accept AEs as the tested party in the APA with the taxpayer, and adopted TNMM as the most appropriate method. The CBDT also approved the concept of regional benchmarking for the purpose of determining arm's length price – this basically meant that to select the appropriate comparables, regional benchmarking can be applied in case country-by-country benchmarking is not feasible though the same shall be preferred over regional benchmarking. In fact, the CBDT agreed to benchmark South African, Ireland and Romania AEs as of Europe, and Nigeria, Malaysia and Morocco as of Asia. Further, European benchmark was accepted for the AEs in South Africa and Peru, and similarly Asian benchmark was accepted for the AEs in Egypt, Brazil and Thailand.
- Based on the above, the Tribunal held that even though the APA would be applicable for the year for which it has been entered into but the principles laid down in the APA for the comparability analysis would have a greater persuasive value for past years also if the nature of international transactions and the FAR of the AE and the taxpayer remained the same.
- The Tribunal also observed that if the CBDT agrees to apply the same terms and conditions to the roll back years, the methodology accepted in the APA can be applied in the year under appeal also, provided the international transactions and the FAR are the same for the year under appeal.

Conclusion

This is the first ruling of the Tribunal, after the introduction of APA regime in India, expounding on the persuasive value of the APA to the past years even beyond the rollback years, provided the international transactions and the FAR are the same for the year.

This verdict extends the benefit of rollback to the taxpayers to other past years under litigation, beyond the 4 rollback years.

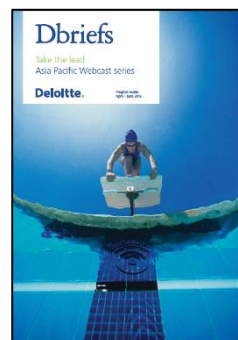
The verdict can go a long way in reducing the protracted past litigations, and would give a fillip to the emergence of the APAs as an effective dispute resolution mechanism, tax certainty to large number of taxpayers in India.

Source: M/s Ranbaxy Laboratories Limited, (ITA No. 196/Del/2013, AY 2008- 2009)

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