TransPrice Times

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Sun Pharmaceutical Industries Ltd – ITAT – Ahmedabad

Outcome: In favour of taxpayer
Category: Transfer pricing methods

Transaction: Sale and supply of tablets by taxpayer to its Associated Enterprise (AE).

AE is IPR rights owner after acquiring certain intellectual property rights from a demerged division of taxpayer's company. Following this event, AE being parent company from USA engaged the taxpayer as a contract manufacturer for manufacturing the chemicals for the said tablets.

Case Summary: Tax Court deletes transfer pricing adjustment in respect of sale of tablets to AE and upholds transfer pricing method of TNMM (Transactional Net Margin Method) benchmarking based on net profit margins of taxpayer, for contract manufacturing of tablets for its AE.

The taxpayer contended that it performs only one function i.e. manufacturing while the AE is owner of IP rights (after receiving it from the demerged division of the taxpayer's company). The intermediary appellate authorities opined that since the R&D was done by taxpayer before any transfer of IPR to AE, and the entire settlement of transfer was borne by taxpayer, it was a case of 'brutal tax evasion'.

Tax Court rejects Revenue's claim of tax evasion and recognized the economic reality behind MNCs having a holding-subsidiary company structure. Further, as the AE faced an infringement claim in the US market in respect of supplying the tablets in its region, it suffered a huge loss to the extent of $506 million. The Tax Court opined that no group company would alter its group structure in such a manner that would lead to such huge losses.

The main reason of intermediary authorities rejecting taxpayer's views were that it did not view taxpayer as a contract manufacturer. The authorities contended that taxpayer did not simply provide contract manufacturing services, but also performed substantial functions and shared an equal risk with its AE. Thereby, rejected the method of benchmarking used by taxpayer based on net profit margins, and instead stated that since functions of taxpayer and its AE were not very clearly distinguishable on entity basis, total profits should be split between the 2 entities. Further, the AE earned profit from further sale to third parties in USA at a margin of 95% as compared to taxpayer's margin on sale to its AE at 21.57%, after which the intermediary authorities made a tax adjustment in the hands of taxpayer.

Taxpayer contended that it did not bear any risk and since the IPRs were owned by AE, the AE bore all the risk. Tax Court accepted this contention and held that substantial risks lied with AE in the form of litigation risk, chargebacks, self-stock adjustments, product returns & allowances and infringement issues.

Tax Court accepts taxpayer's contention and holds taxpayer as a mere contract manufacturer where a splitting of profits would not be appropriate in justifying an arm's length price. Further, Tax Court also observes that taxpayer earned higher margins from a sale to a third party, than a sale to its AE, and hence proceeded to delete any transfer pricing adjustment.

Bechtel India Private Limited – HC – Delhi

Outcome: In favour of taxpayer
Category: Remanding matter for adjudication

High Court rejects Tax Court's order in respect of transfer pricing matters being remanded back to AO/ TPO (assessing officer/ transfer pricing officer) without a proper ruling on facts.

Accordingly, Tax Court had remanded the transfer pricing matter back for a fresh adjudication with a direction to undertake a fresh benchmarking by AO/ TPO, which the Hon'ble High Court observed was not proper and not based on complete reliance of documentation provided by taxpayer on record.

It is observed that taxpayer provided a chart detailing all its business segments showing the transfer pricing approach including comparables adopted by various lower authorities, even after which the Tax Court failed to provide any findings. Hon'ble High Court then directed Tax Court to

examine each issue without remanding back matter to AO/ TPO for a fresh adjudication.

Latest from OECD

India notifies MCAA for Country-by-country-reporting

India, being a party to the Convention on Mutual Administrative Assistance in Tax Matters, has notified the Multilateral Competent Authority Agreement on exchange of CbC Reports. Through this Convention, each jurisdiction's Competent Authority will annually exchange CbC Report received from each entity that is a tax resident, with all other Competent Authorities of jurisdictions (only if both jurisdictions have MCAA in effect).

Updated guidance on implementation of Country-by-country Reporting

The OECD has been continuously updating the master guidance on implementation of the now colloquially used term: CbCR.

In our past editions, we have strived to cover every update OECD update stemming from CbCR. The latest update to the guidance covers the nitty-gritties of CbCR such as reporting of aggregated or consolidated data for each jurisdiction and intra-jurisdiction transactions. Secondly, the updated guidance also covers the treatment of an entity owned and/or operated by more than 1 unrelated MNE Groups (for example, joint venture entity).

The first issue regarding reporting of data pertains to whether the aggregated or consolidated financial data is to be reported for each jurisdiction in the CbC Report. The guidance states that data should be reported on aggregated basis for any cross-border or intra-jurisdiction or related party or unrelated parties.

OECD further clarifies that where Ultimate Parent entity's jurisdiction has consolidated reporting system of taxation for corporate groups, the intra-group transactions shall not be required to be reported separately. Thereby, the Ultimate Parent Entity can use consolidated data at its own jurisdiction provided it is applied consistently across the years.

Regarding second part of updated guidance, when an entity is owner and/or operated by more than 1 unrelated MNE group, the entity in question should report the data under CbCR as per the accounting rules applicable to each of the unrelated MNE groups respectively. This means that if unrelated MNE group follows consolidation of accounts, the financial data of entity (which is owned/ operated) should be reported fully in CbC report of the unrelated MNE group. Where the consolidation is not followed as an accounting practise by MNE group, the entity is required to report its financial data in CbC report on pro-rata share of financial data. However, an entity included in the consolidated data of an MNE group but following 'equity accounting rules' would not be required to report its data in the CbC report.

Opt for revised Safe Harbour Rules through Form 3CEFA

CBDT has recently notified Form 3CEFA for revised safe harbour rules in respect of the eligible international transactions w.e.f. 1st April 2017. Regarding the new inclusion of low value added intra-group services in the revised safe harbour rules, the amended form now also asks for the particulars, description of services, jurisdiction of AE being low tax or no tax jurisdiction, amount paid/ payable, mark-up charged, and price charged in accordance with Income-tax rules under Rule 10TD.

The amended form also lists the requirements for KPO services and intra-group loans as per the revised rules.

New safe harbour rules has been exclusively covered in our June special edition article before: https://transprice.in/pdf/article/New-Safe-Harbour.pdf