



## **Ruling by Delhi Income Tax Appellate Tribunal on Transfer Pricing**

### **RANBAXY LAB. LTD. V. ADDL. CIT (DELHI) RECENT DECISION OF ITAT (ASSESSMENT YEAR 2004-.05)**

#### **EXECUTIVE SUMMARY**

The ruling relates to an Indian multinational pharmaceutical company, Ranbaxy Laboratory Limited (the assessee). In this ruling, the ITAT held that an order passed by Assessing Officer can be revised by the Commissioner of Income tax. If Assessing officer had passed the order without considering relevant facts while determining the arms length price. The ITAT also ruled that a better way to determine the Arm's length price (ALP) was to rely on prices charged for similar transactions by domestic pharmaceuticals companies than applying the TNMM.

In this case, the firm has taken overseas entities as 'tested parties' and calculated its earnings after determining ALP accordingly, which the tax department does not think to be in consonance with the Income Tax rules.

The ITAT also rejected the choice of foreign associated enterprises (AE's) as tested party for determination of ALP as the tax payer had not given due consideration to factors such as geographic location, economic background and analysis of functions performed, risk assumed and assets employed while selecting the comparables and tested party.

#### **FACTS OF CASE**

Assessee is a multinational company carrying on the business of manufacture and sale of pharmaceuticals. It had entered into international transactions with its overseas Associated Enterprises (AE's) and charged goods & rendered services to and from its AE's at arm's length price.

The bone of contention between Ranbaxy and the income tax department was the method adopted by the company for valuing the goods sold and services rendered to 17 overseas AEs, including joint venture companies and wholly-owned subsidiaries in more than a dozen countries including the US, the UK, Germany and China.

While determining ALP, the assessee had applied the Transaction Net Margin Method and had taken the overseas party as tested party. Moreover, the assessee compared the net

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margins of 17 associated enterprises with the average margins of comparable companies in different parts of world. The assessing officer (AO) accepted Arm's length price given by assessee and completed assessment without considering it necessary to refer the matter to the transfer pricing officer (TPO).

***Commissioner of Income tax (CIT's) order***

CIT is of the view that assessment made was erroneous as it was prejudicial to interest of revenue and initiated action under section 263 to redo the assessment. Thus the findings of CIT can be summarized as follows:

- AO had not referred the transfer pricing assessment to the TPO as required under CBDT instruction No. 3 dated 20.05.03 which is mandatory in nature. It would be expedient for the TPO to efficiently deal with the arms length price.
- No detail of overseas comparable companies taken into account was given in audit report and the various factors such as geographic location, economic background and analysis of functions performed, assets employed and risk assumed was not taken into account while selecting the tested party.
- Instead of the taxpayer, 17 foreign AE's were selected as the tested party. If assessee wishes to take the foreign AEs as the tested party, it must ensure that it is such an entity for which the relevant data for comparison is available in the public domain or is furnished to tax administration.
- The AO accepted the assessee's view without making proper enquiry.
- On the claim of the assessee that it was making more profit than similar concerns in India, the CIT was of the view that it needed more verification and detailed investigation. Thus, he passed an order directing the TPO to make a transfer pricing assessment of the Taxpayer's claim.

Aggrieved by the said order of CIT, the assessee filed an appeal before ITAT on following issues:

- The CIT should not have revised the order passed by the AO. The AO was not duty bound to refer to the TPO in regard to ALP as he had ample power to do the assessment. Even if, it was necessary, it was only a procedural error on the part of the AO.
- The CIT had wrongly rejected the use of the foreign AE's as the tested party for the purpose of determining ALP.

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***Order of the Income Tax Appellate Tribunal-Delhi (ITAT)***

ITAT held that the Commissioner is justified in revising the order of the AO on the following grounds listed below as the has passed the order without proper application of mind.

- The AO fails to examine the question relating to application of the Transfer Pricing(TP) regulations i.e. characteristics of transactions.
- No calculation of margin of profit of comparable companies was available in the TP study report.
- Determination of ALP was not referred to the TPO as required under the CBDT instructions, which are mandatory in nature.
- It was not even stated that all transactions with the 17AE's were closely linked transactions. Separate transactions with different entities were taken as closely linked transactions. This assertion was wrong as there is no justification for clubbing separate transactions of different parties in different continents.

The ITAT made the following observations for the choice of tested party:

- It should be the least complex controlled taxpayer in respect of which reliable data is available. However, where comparable controlled and uncontrolled entities are available, it may not be right to eliminate them because they look to be complex.
- If assessee wishes to take 17 foreign AE's as the tested party, it must ensure that it is such an entity for which relevant data for comparison is available in public domain or is furnished to tax administration.

ITAT held that

- Foreign AE's operating under different market conditions were taken as one party and the justification given for taking all 17 AE's as one tested party is not convincing.
- No justification given for clubbing separate transactions of separate entities in separate countries.

The assessee's view to select the combined foreign associated enterprises as a single tested party was rejected and it was held that it was reasonable to compare the assessee's performance with comparable Indian companies. Further, the ITAT upheld the CIT's order remanding the matter to the TPO.

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### **Observations**

This ruling highlights important points to be taken care of while doing documentation for international transactions:

- Discussing the key issues such as analysis of data considered for determining the most appropriate method.
- Factors considered in choice of tested party
- Justification for aggregation of international transactions,
- Emphasis on proper examination of internal 'uncontrolled transaction' and documentation for reason in case such transactions are not considered as comparable transactions.
- Separate transactions should not be aggregated if they are of different companies in different countries.

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