



Sales to two customers which constitutes more than 20 per cent of total sales of the taxpayer shall constitute 'dominant influence'; AE relationship upheld

Background

Recently, the Chennai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Hospira Healthcare India Private Limited¹ (the taxpayer) held that as per Section 92A(2)(i) of the Income-tax Act, 1961 (the Act) influence implies dominant influence where “a person who purchased more than 1/5th of the total sales of the taxpayer would have a distinctly dominant influence on the pricing and can exercise a de facto control”.

Facts of the case

- The taxpayer incorporated as a subsidiary of Hospira Pte, Singapore, engaged in manufacturing and selling of generic injectable drugs to its group entities and certain other concerns.
- The Company is incorporated by acquiring the generic injectable pharmaceuticals business of Orchid Chemicals & Pharmaceuticals Ltd (Orchid India) as a going concern on slump sale basis.
- The agreements entered into by Orchid India, and various distribution partners (DPs) were inherited by the taxpayer termed as legacy agreements. The business model of the taxpayer with its DPs is on profit sharing basis.
- Transfer Pricing Officer (TPO) proposed adjustment on the following aspects:
 - Deficiency in pricing of supplies to Hospira Group

- Profit shared on sale on the pharma products with its Associated Enterprises (AEs)
- The rate of interest paid by the AE on the Inter Corporate Convertible Debentures (ICCD) issued by the taxpayer to its AE.
- While proposing the above adjustments, the TPO concluded that Apotex Corp and Apotex Inc. Signet (DPs) also as AEs, by relying on the settlement commission order of Orchid India for Assessment Years (AY) 2006-07 to 2010-11.
- The above conclusions of the TPO were upheld by the Dispute Resolution Panel. Aggrieved by the order, the taxpayer was in appeal before the Tribunal.

Taxpayer's contentions

- The taxpayer contended that Section 92A(2) of the Income-tax Act, 1961 (the Act) could not be brought into play unless the conditions of 92A(1) are satisfied. Also, the taxpayer stated that participation in management or control or capital of one enterprise in another enterprise is required to establish AE relationship.
- The taxpayer highlighted that Section 92A(2)(i) of the Act mentions about dominant influence and not passive influence in the ordinary course of business.
- The taxpayer placed reliance on the ruling of Page Industries Limited² which emphasises that Section 92A(1) and 92A(2) of the Act to be read together to establish AE relationship.

¹ Hospira Healthcare India Private Limited v. DCIT (ITA No. 821/Mds/2016 - AY 2011-12)

² Page Industries Limited v. DCIT [2016] 159 ITD 680 (Bang)

- The taxpayer also stated that the taxpayer was not a party to the settlement commission order and hence the same is not binding on the taxpayer.
- Therefore, the taxpayer contended that the lower authorities erred in concluding Apotex entities as AEs and erroneously applied the profit share ratio stated in the settlement commission order of Orchid India. Also, the lower authorities ignored the agreements entered into with the DPs and an artificial profit sharing ratio thrust on the taxpayer.

Tax department's contentions

- The department placed the following arguments against the taxpayer:
 - Section 92A(2)(i) of the Act does not talk about dominant influence, what is required is 'influence'
 - The taxpayer has not submitted any material evidence justifying the profit share with DPs in the ratio of 50:50
 - Predominant risks borne by the taxpayer and hence settlement commission recommended profit share in the ratio of 60:40.

Tribunal's ruling

After hearing both the parties, the Chennai Tribunal held the following:

- The Tribunal relied on the ruling of Orchid Pharma Limited³ for interpreting Section 92A(2)(i) of the Act, from which it is understood that Section 92A(2)(i) of the Act creates a dominant influence, which automatically leads to a de facto control over the enterprise.
- More than 20 per cent of the taxpayer's sales are to Apotex entities, which creates a dominant influence on the taxpayer by Apotex entities. Considering the above, the Tribunal held that Apotex entities are considered as AEs of the taxpayer.
- Further on the profit share of 60:40 determined by the lower authorities relying on the settlement commission order of Orchid India, the Tribunal held as follows:
 - The lower authorities erred in the determination of the profit share by merely relying on the settlement commission order without analysing the facts and circumstances of the taxpayer.

- Further, Rule 10B(d) of the Income-tax Rules, 1962 is not properly applied by the lower authorities while determining the profit share between the taxpayer and DPs.

- Considering the above, the Tribunal set aside the orders of lower authorities in relation to the determination of profit share and remanded the same back to the Assessing Officer (AO)/TPO for fresh consideration.

Deficiency in pricing of supplies to Hospira Group

The TPO proposed an adjustment due to price differences at which certain products were sold to Hospira Group by the taxpayer.

The taxpayer contended that the TPO did a cherry picking of the items supplied. There were a large number of items which were sold at a higher price than the price agreed by Orchid India and Hospira Group. The TPO cherry picked the negative differences ignoring the positive difference, which is erroneous and skewed.

The department supported the approach adopted by the TPO.

Considering the contentions of both the parties, the Tribunal set aside the orders of the lower authorities and remanded the case back for fresh adjudication.

Interest paid on ICCDs

The taxpayer paid interest at the rate of 10.5 per cent on the ICCDs. The TPO determined two comparables namely Parsvnath Estate Developers Pvt Ltd and TPG Wholesale Private Limited (TPG) at the interest rate of 15.5 per cent and 0.5 per cent respectively.

The taxpayer contended that the benchmarking performed by the TPO is erroneous, and TPG is not a comparable to the taxpayer as their interest rate on debentures is based on corporate restructuring and the debenture rate of the said company based on the annual report is 50 per cent and not 0.5 per cent.

Considering the above, the Tribunal set aside the order of the lower authorities and remanded the case back to the AO/TPO for fresh adjudication.

Our comments

This ruling pronounced by the Chennai Tribunal on interpretation of section 92A(2)(i) clarifies that the relevant section creates a de facto control,

³ Orchid Pharma Limited v. DCIT (ITA No. 771/Mds/2016 - AY 2011-12)

which implies that conditions of Section 92A(1) are satisfied though there is no explicit influence by one enterprise on the control, management and capital of other enterprise.

In this context, it is imperative to note the Chennai Tribunal's ruling in the case of Orchid Pharma Limited (supra) wherein the Tribunal has held that in respect of the determination of AE relationship, mere 5-6 per cent of the sales by the assessee to two major customers shall not constitute AE relationship.

It is interesting to note that the Tribunal in the abovementioned ruling has clearly laid down certain observations/suggestions as under:

- Prima facie there is an inadvertent omission with respect to the threshold for application of Section 92A(2)(i) whether in terms of a percentage of such sales or otherwise, in the statute.
- Apparent omission which is resulting in wholly avoidable litigation on the applicability of Section 92A(2)(i). However, once this omission is supplied, Section 92A(2)(i) may indeed be successfully put into service to check and neutralise the impact of control of one enterprise over the other enterprise in the form of dominant influence as a buyer.



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