

IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCHES : I-2 : NEW DELHI

BEFORE SHRI R.S. SYAL, VICE PRESIDENT
AND
SHRI K. NARASIMHA CHARY, JUDICIAL MEMBER

ITA No.6706/Del/2016
Assessment Year: 2012-13

Stay Appln. No.601/Del/2016
(ITA No.6706/Del/2016)
Assessment Year : 2012-13

Teva API India Pvt. Ltd.
(Formerly known as Teva API
India Ltd.),
M-34, Saket,
New Delhi.

Vs. Addl. CIT,
Special Range-9,
New Delhi.

PAN: AACCR0679R

(Appellant)

(Respondent)

Assessee By : Shri Himanshu Sinha &
Ms Vrinda Tulshan, Advocates
Department By : Mrs Y.S. Kakkar, CIT, DR

Date of Hearing : 01.11.2017
Date of Pronouncement : 03.11.2017

ORDER

PER R.S. SYAL, VP:

Since the appeal has also been taken up for hearing today along with the Stay Application and the same is being disposed of, the stay application is dismissed as having become infructuous.

2. This appeal filed by the assessee is directed against the final assessment order passed by the Assessing Officer (AO) on 30.11.2016 u/s 143(3) read with section 144C of the Income-tax Act, 1961 (hereinafter also called 'the Act') in relation to the assessment year 2012-13.

3. The only issue assailed in this appeal is against the addition on account of transfer pricing adjustment made by the Assessing Officer amounting to Rs.40,91,86,032/-.

4. Briefly stated, the facts of the case are that the assessee is engaged in manufacturing of APIs, other intermediaries and bulk drugs and is also providing Contract R&D services for in-house use and for group companies. It is undisputed that manufacturing was done on contract

basis with cost plus mark up of 8.7% and contract R&D activities were carried out with cost plus mark up of 19.95%. The assessee reported nine international transactions in its report in Form no. 3CEB, which have been reproduced on page 5 of the Transfer Pricing Officer (TPO)'s order. The AO referred the matter of determination of the arm's length price of the international transactions to the TPO. The TPO observed that the assessee used Transactional Net Margin Method (TNMM) to benchmark its international transactions pertaining to sale of bulk drugs/bulk drug intermediates; purchase of raw material; sale of raw material; and provision of contract R&D services with Profit level indicator (PLI) of Operating Profit to Operating Cost (OP/OC). On analysis of the transfer pricing approach of the assessee, the TPO observed that there were two segments, namely, manufacturing segment and service segment. The TPO did not approve separate benchmarking of these two major international transactions of Manufacturing and R&D. For the reasons given in the order, the TPO combined these two segments and then proceeded to determine the ALP on an aggregate basis. Here, it is pertinent to mention that albeit a ground has been taken

in the appeal before the Tribunal against the combining of manufacturing segment with service segment by the TPO, but the Id. AR did not press the same. As such, we are not referring to the reasons and justification given by the TPO for aggregating these two segments. The TPO determined the assessee's combined OP/OC at 7.10%. In determining such PLI, the TPO reduced Exchange loss of Rs.112.40 million from total expenses for calculating 'Operating costs'. The assessee had selected 22 companies as comparables, which have been listed on pages 9 to 11 of the TPO's order. The TPO carried out a fresh search and, eventually, shortlisted nine companies as comparable, which include two companies from the assessee's lists, namely, Shilpa Medicare Ltd. and Sri Krishna Pharmaceuticals Ltd. Average OP/OC of such nine companies was computed at 13.02%. By applying this PLI as a benchmark, the TPO worked out transfer pricing adjustment of Rs.42,87,51,255/-. The assessee approached the Dispute Resolution Panel (DRP) which gave certain directions. The TPO, while giving effect to such directions, computed the fresh amount of transfer pricing adjustment at Rs.40,91,86,032/-, which amount stood added by the

Assessing Officer in the final assessment order. The assessee is aggrieved against such transfer pricing addition.

5. The first issue challenged before the tribunal is the exclusion of Exchange loss of Rs.112.40 million from total expenses. The TPO treated such amount as of non-operating nature and, hence, excluded it from the ambit of total expenses for working out operating costs. The DRP directed the TPO to verify: “if there is foreign exchange gain on account of sale of the assessee (not on account of capital expenditure) it should be treated as operating gains.” The TPO recorded in his order dated 22.11.2016 giving effect to the directions of the DRP that: “the TPO has been directed to take foreign exchange fluctuation as operating while computing margins of the company.”

6. Having heard both the sides on the point and perused the relevant material on record, it is seen that the DRP directed the TPO to examine if foreign exchange gain was on account of sales, and if yes, then that should be treated as operating gain. Impliedly, the direction of the DRP was that foreign exchange gain/loss from trading transactions should be

taken as an item of operating nature and in other cases it should be considered as non-operating. This view of the DRP accords with the *ratio* of the judgment of the Hon'ble Supreme Court in *CIT VS. Woodward Governor India P. Ltd. (2009) 312 ITR 254 (SC)*. The ld. counsel for the assessee submitted that the exchange loss of Rs.112.40 million pertains to loan taken by the assessee from Teva Pharmaceuticals Finance, Netherlands B.V., its holding company. Referring to the balance sheet of the assessee for the year under consideration, the ld. AR submitted that the assessee effected long-term borrowings amounting to Rs.992.1 million from its holding company and the exchange loss pertained to such borrowing alone. We have gone through the assessee's balance sheet, a copy of which is available on page 242 of the paper book. It can be seen from such balance sheet that there are certain trade receivables as well as trade payables. Admittedly, some of the trade receivables and trade payables are on account of import and export transactions of the trading nature. The ld. counsel for the assessee could not link exchange loss of Rs.112.40 million with the borrowings effected by the assessee from its holding company. It is

patent that foreign exchange loss on account of trade receivables and payables has to be taken as an item of operating expenditure and exchange loss on account of financing transactions will be considered as non-operating. Since the Id. AR could not link the amount of foreign exchange loss of Rs.112.40 million with the transaction of borrowing from the assessee's AE, we cannot uphold the argument put forth before us without verification. Under these circumstances, we set aside the impugned order and remit the matter to the file of Assessing Officer/TPO for ascertaining if exchange loss of Rs.112.40 million pertains to loan transactions from the assessee's AE or trading transactions as well. A part of such exchange loss which pertains to borrowing made by the assessee from Teva Pharmaceuticals Finance Netherlands B.V., should be considered as non-operating and the remaining amount, if any, pertaining to trading transactions should be taken as operating expense. Needless to say, the assessee will be allowed a reasonable opportunity of hearing before taking any decision for the purposes of computing the assessee's 'Operating costs' to find out its OP/OC.

7. The next issue raised before the tribunal is about certain comparables. Before proceeding to deal with the comparables, it is significant to note that the assessee is engaged in the manufacturing of APIs, other intermediaries and bulk drugs. The first international transaction is sale of bulk drugs/bulk drug intermediates. The TPO aggregated provision of contract R&D services with the manufacturing segment and we have noted above that the Id. AR did not agitate such combining of two segments. In a nutshell, the assessee's aggregated international transaction under consideration is manufacturing and contract R&D. With this background, now we take up the companies challenged before us.

(i) Auro Laboratories Ltd.

8. The assessee treated this company as comparable. The TPO excluded it by noticing that it failed the sales filter and, hence, could not be considered as comparable. The DRP observed on page 6 of its direction that this company is functionally similar. However, the TPO was: "directed to include this if it passes all the filters." The TPO, in his

order giving effect to the direction given by the DRP excluded this company by noticing that it: “fails the sales filter.” The assessee moved an application u/s 154 of the Act. The TPO vide order dated 20.06.2017, observed that this company was passing the sales filter. However, it was noticed that: “the net assets of the company is Rs.6,38,14,663/- and the sales in the same year is Rs.26,39,77,179/-. Thus, net fixed assets to sales ratio of the company is 24.17%. Hence, this company fails net fixed assets to sales filter applied by this office.”

9. Having heard the rival submissions and perused the relevant material on record, it is noticed that the DRP treated this company as functionally similar. However, direction was given to the TPO to include this company if it was passing other filters. The TPO in his order u/s 154 of the Act has held that the company was not passing the filter of net asset to sales, which was adopted by him at 25% and in the case of Auro Laboratories, it was only 24.17%. We have gone through the Annual accounts of this company for the year under consideration, whose copy is available on page 769 of third paper book filed by the

assessee. It can be seen that the balance sheet of the company gives figure of Fixed assets at Rs.10,81,52,547/-, which is total of 'Tangible assets' at Rs.6,36,14,663/- and 'Capital work in progress' at Rs.4,43,37,884/-. The TPO did not include the amount of 'Capital work in progress' and considered only 'Tangible assets' for computing the ratio of Fixed assets to turnover. We are unable to appreciate the reasons for not including amount of 'Capital work in progress' in the total amount of Fixed assets for working out the relevant filter. Capital work in progress represents the amount spent by the company on fixed assets, but, was pending apportionment to various fixed assets at the end of the year. If we go with the logic of the Id. DR justifying the exclusion of 'Capital work in progress' that only the fixed assets resulting in sales should be considered and the fixed assets which do not contribute to sales should be excluded, then, it would require independent evaluation of each and every item of fixed assets as to whether the same was being used for the business purpose or not. Obviously, this is not a correct proposition. Since the filter taken by the TPO himself is sales to fixed assets, not only the apportioned, but, non-apportioned cost of fixed asset

should also be included. If we include the amount of `Capital work in progress` along with `Tangible assets` given under the head `Fixed assets`, the filter will pass. We, therefore, overturn the view point of the TPO and, order for the inclusion of this company in the list of comparables.

(ii) Neuland Laboratories Limited

10. The TPO excluded this company from the assessee's list of comparables by noticing that it was functionally different. The DRP noticed that it was also engaged in API manufacturing. The TPO was directed to include its API segment if the assessee was able to provide segmental data and the segment passed all the filters.

11. Here, it is important to mention that the assessee moved application u/s 154 of the Act before the DRP contending that M/s Neuland Laboratories Ltd. was engaged in sales of bulk drugs as was the assessee and, hence, no segmental data was required as originally directed by the DRP. It was submitted that the company as a whole should be accepted as a good comparable. The DRP rejected this

contention. We find from the assessee's Annual accounts as well as report of international transactions that it was engaged not only in APIs. As noticed above, the assessee was engaged in sale of bulk drugs/bulk drug intermediates. Thus, to say that the assessee was engaged only in the business of APIs, is not correct. Once it is clear from the report of the assessee as well as the order of the TPO that the assessee was engaged in the manufacturing of bulk drugs as well, it was unreasonable to restrict the comparability with the companies dealing in APIs alone. At this juncture, it is relevant to mention that the assessee included M/s Shilpa Medicare Ltd. in its list of 22 comparables and the TPO was pleased to include it in the final list of comparables. M/s Shilpa Medicare Ltd. is a company engaged in manufacturing of 'bulk drugs' as is evident from the assessee's transfer pricing study report which mentions that this company is engaged in manufacturing of bulk drugs, intermediates and generation of power. We have gone through the Annual accounts of Neuland Laboratories Ltd., whose copy is available at page 789 onwards of the paper book. It is seen that the same is engaged in bulk drug manufacturing. Once it is found that Neuland

Laboratories Ltd. is also engaged in manufacturing of bulk drugs, the same matches with the assessee's functional profile. Thus the reasoning given by the authorities for exclusion of this company that it is engaged in manufacturing of bulk drugs and not APIs, as is the assessee, falls to the ground. We, therefore, order to include this company in the list of comparables.

(iii) Suven Life Sciences Ltd.

12. There is no dispute on the functional comparability or the inclusion of this company in the final tally of comparables. The Id. AR submitted that the TPO went wrong in computing OP/OC of this company. Referring to the order dated 20.6.2017 passed by the TPO u/s 154 of the Act, the Id. AR submitted that the TPO treated 'Loss of forward contracts' and 'MTM of forward contracts' as non-operating items, which ought to have been considered as operating.

13. Having regard to the facts of the instant case, we find that the assessee did not raise any objection before the DRP on this issue. Since the issue of 'Loss of forward contracts' and 'MTM of forward

contracts' has not received consideration at the hands of any of the authorities below, we are of the considered opinion that the ends of justice would meet adequately if the Assessing Officer/TPO is directed to examine this contention of the assessee and then decide it as per law.

14. No other issue except the points discussed above were argued by the Id. AR. The grounds agitating other issues, not argued before us, are, therefore, dismissed as not pressed.

15. To sum up, we set aside the impugned order on the issue of addition towards transfer pricing adjustment and remit the matter to the file of AO/TPO for fresh determination of the ALP of the combined international transaction of Manufacturing and Service segments in consonance with our above directions. Needless to say, the assessee will be allowed a reasonable opportunity of being heard in such fresh proceedings

16. In the result, the appeal is allowed for statistical purposes.

The order pronounced in the open court on 03.11.2017.

Sd/-

[K. NARASIMHA CHARY]
JUDICIAL MEMBER

Sd/-

[R.S. SYAL]
VICE PRESIDENT

Dated, 03rd November, 2017.

dk

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT (A)
5. DR, ITAT

AR, ITAT, NEW DELHI.