Concluded APA has a considerable bearing on characterisation of prior years’ international transactions

Background
Recently, the Chennai Bench of the Income-tax Appellate Tribunal (the Tribunal), in the case of Lotus Footwear Enterprises Limited1 (India Branch) (the taxpayer), admitted taxpayer’s Advance Pricing Agreement (APA) as an additional evidence and held that such APA has considerable bearing on the characterisation of the international transactions.

Facts of the case
- The taxpayer is engaged in the manufacturing of footwear for its Associated Enterprise (AE), Lotus Footwear Ltd., British Virgin Islands. Prior to Financial Year (FY) 2011-12, the taxpayer did not characterise itself as a contract manufacturer.
- However, the Transfer Pricing Officer (TPO) re-characterised the taxpayer as a contract manufacturer and proposed an adjustment for Assessment Year (AY) 2009-10 to AY 2011-12 which was upheld by the Dispute Resolution Panel. Aggrieved by the order, the taxpayer was in appeal before the Tribunal.

Taxpayer’s contentions
- The taxpayer pleaded for admission of concluded APA as an additional evidence. The taxpayer emphasised that the same has the fundamental bearing on the issues raised in the years under appeal.
- The taxpayer stated that it had become a contract manufacturer only after multiple labour strikes which took place during FY 2010-11.
- In order to substantiate the aforesaid statement, the taxpayer highlighted that in the APA (applicable from FY 2014-15 onwards) concluded on 24 May 2016, the rollback period had been curtailed from four years to three years as an exception to the norm, i.e. the rollback period commenced from FY 2011-12 instead of FY 2010-11.
- The taxpayer referred to Section 92CC(9A) of the Income Tax Act, 1961 read with Rule 10MA(2)(i) of the Income Tax Rules, 1962 which emphasises to have a mandatory period of four years for the purpose of rollback. Further, the taxpayer placed reliance on Circular No.10/20152 which covers the circumstances wherein exemptions from applying rollback for the entire block of four years could be granted.
- In light of the above, the taxpayer contended that it is considered as a contract manufacturer by the CBDT only from FY 2011-12 onwards. Therefore, FY 2010-11 has been excluded from the APA rollback period.

Tax department’s contention
The tax department agreed that APA is required to be considered while benchmarking the international transactions of the taxpayer.

---

1 Lotus Footwear Enterprises Ltd (India Branch) v. DCIT (ITA Nos.779/Mds/2014, 801/Mds/2015 & 810/Mds/2016)
Tribunal’s ruling

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

- The APA allowed for curtailment of rollback years considering the submissions of the taxpayer substantiating that it had become a contract manufacturer only from FY 2011-12 onwards.

- The APA being signed on 24 May 2016, the taxpayer had no occasion to submit the same before the lower authorities. Therefore, the additional evidence was admitted.

- Upon admission of the additional evidence, the orders of lower authorities were set aside and remitted back to the Assessing Officer/TPO for fresh adjudication.

Our comments

This ruling pronounced by the Chennai Tribunal brings to light the impact of APA on the characterisation of prior years’ international transactions.