

# Basics of International Transfer Pricing

An aerial photograph of a river winding through a mountainous landscape. The river is a light brown color, contrasting with the dark green and brown tones of the surrounding terrain. The river flows from the top right towards the bottom left, making several sharp turns. The mountains are rugged and densely forested, with some areas appearing more barren. The overall scene is captured from a high angle, providing a clear view of the river's path and the surrounding topography.

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# Agenda:

- What is Transfer Pricing?
- Applicability of Transfer Pricing Regulations
- Methods of Transfer Pricing
- Documentation
- Key TP Controversies / Issues
- Recent Transfer Pricing updates in India
- Alignment of TP Regulations with BEPS measures

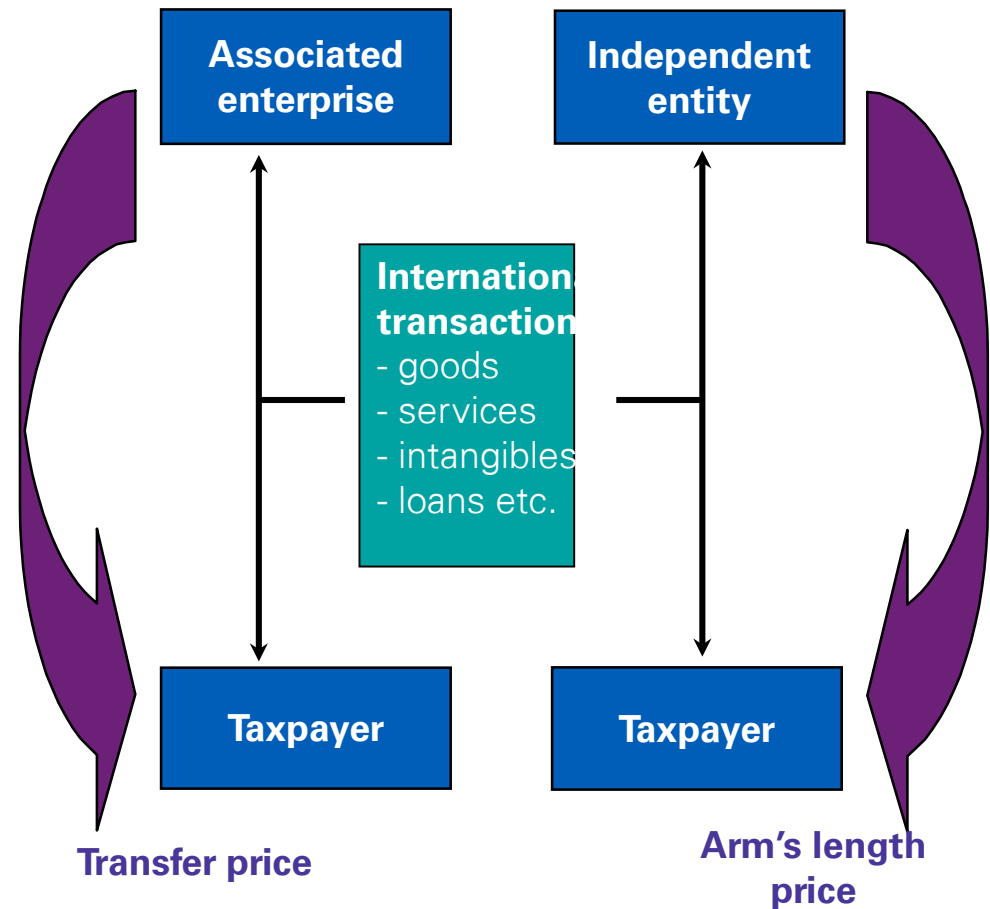


What is Transfer Pricing?



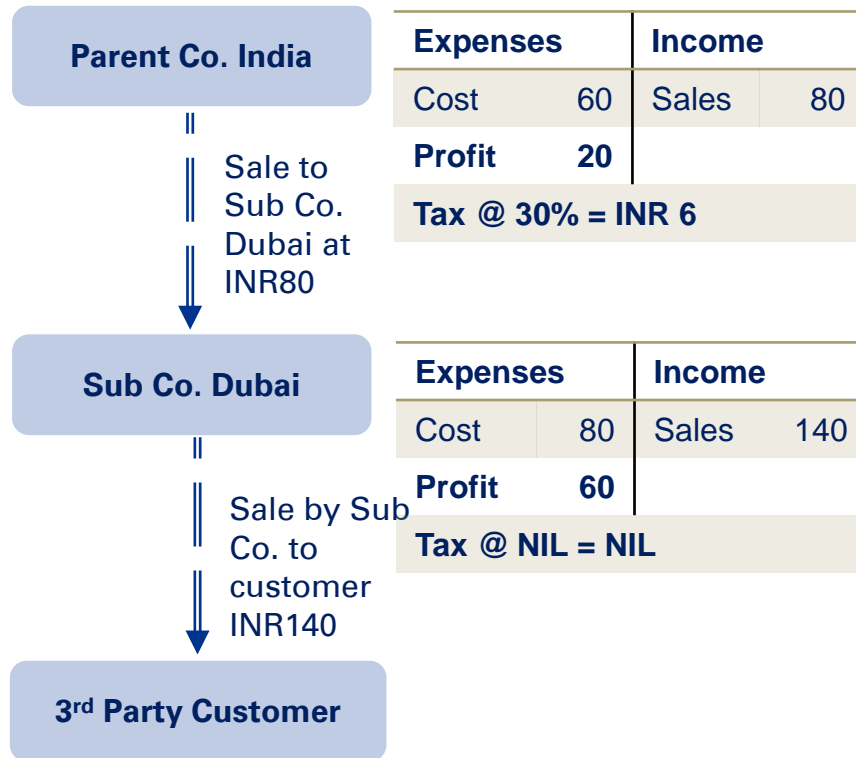
# What is Transfer Pricing?

- A mechanism for pricing the transfer of goods and services between the related entities – Associated Enterprises (AEs)
- When two related entities, i.e. AEs, enter into a transaction, price at which they undertake transaction is transfer price
- Due to the special relationship between the AEs, transfer price may be different than price that would have been agreed between two unrelated companies – Arm's Length Price (ALP)
- May or may not involve shifting of profits to optimize taxes



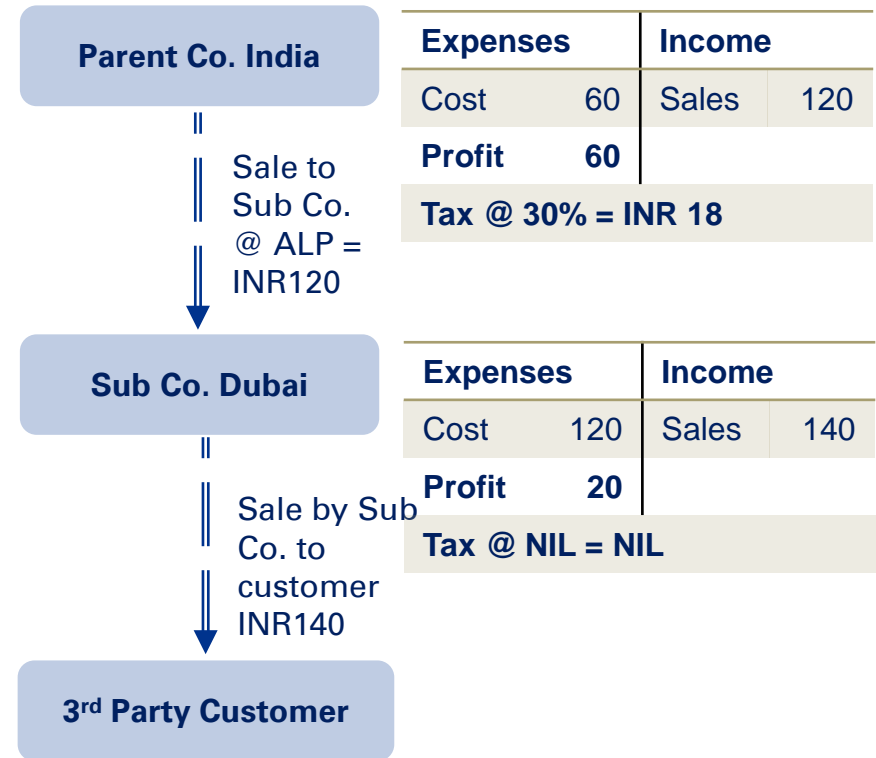
# Why Transfer Pricing?

## Situation I - Price



Overall tax burden of Group is INR 6

## Situation II - Arm's Length Price ('ALP')

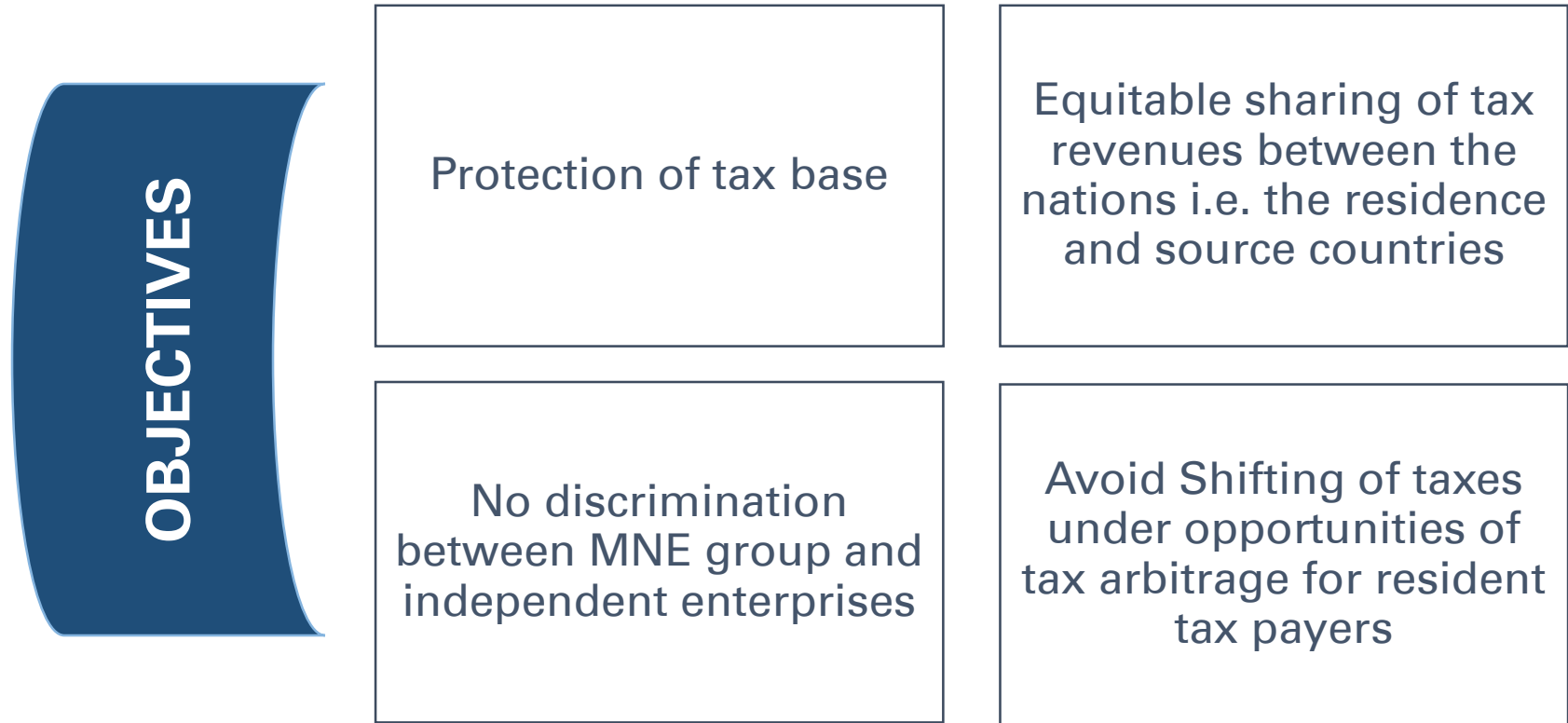


Overall tax burden of Group is INR 18

To Prevent Shifting of profits through Transfer Pricing

# Objectives of Transfer Pricing

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**Every government wants to prevent erosion of their tax base and plug potential tax leakages**

# Challenges faced by MNCs while setting transfer price

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**Shareholders expectations**

**Competitive pressures to structure the business operations efficiently**

**Entry to new geographic markets and penetrative pricing for new product launch**

**Constant regulatory changes and stringent revenue audit environment**

**New, varied and complex intra-group transactions**

**Optimization of effective tax rate for the Group**

**Targeting a particular transfer price – always a challenge**

# Transfer Pricing in India

THE ECONOMIC TIMES

Finance

## Many MNCs use profit shifting strategy to evade tax: Report

NEW DELHI: Many multinational companies operating in India and having links to tax havens use profit shifting strategies to "evade" taxes, according to a research report by Christian Aid.

The conclusions from the research report by UK-based international development group Christian Aid comes at a time when the Indian government is making efforts to crackdown on tax evasion and increase the tax base.

THE FINANCIAL EXPRESS

## Cleaning up the transfer pricing mess

It is increasingly getting clear that transfer pricing regime in India needs quick, corrective steps. CBDT must revise safe harbour norms fast and expedite APAs

Two important developments last week in the transfer pricing domain have the potential of completely transforming the way this critical and controversial tax area has been handled by the income-tax department.

## Business Standard

### Ad expenses of Indian arm of MNCs fall under transfer pricing:

Press Trust of India | New Delhi March 17, 2015 Last Updated at 20:02 IST

The Delhi High Court has held that money spent by Indian subsidiaries of foreign companies on advertising, marketing and promotion (AMP) of their global brand here are international transactions and fall under the purview of transfer pricing rules.





# Indian Transfer Pricing Litigation Environment

## TP Adjustment scenario in past

| Transfer pricing audit year | Assessment year | Amount of adjustment in income (₹ crore) |
|-----------------------------|-----------------|--|
| 2005-06                     | 2002-03         | 1,220                                    |
| 2006-07                     | 2003-04         | 2,287                                    |
| 2007-08                     | 2004-05         | 3,432                                    |
| 2008-09                     | 2005-06         | 7,754                                    |
| 2009-10                     | 2006-07         | 10,908                                   |
| 2010-11                     | 2007-08         | 24,111                                   |
| 2011-12                     | 2008-09         | 44,532                                   |
| 2012-13                     | 2009-10         | 70,000                                   |
| 2013-14                     | 2010-11         | 60,000                                   |
| 2014-15                     | 2011-12         | 47,000                                   |

TP disputes in India accounted for 70% of the world's total by volume

*Financial Express 1 September 2012*

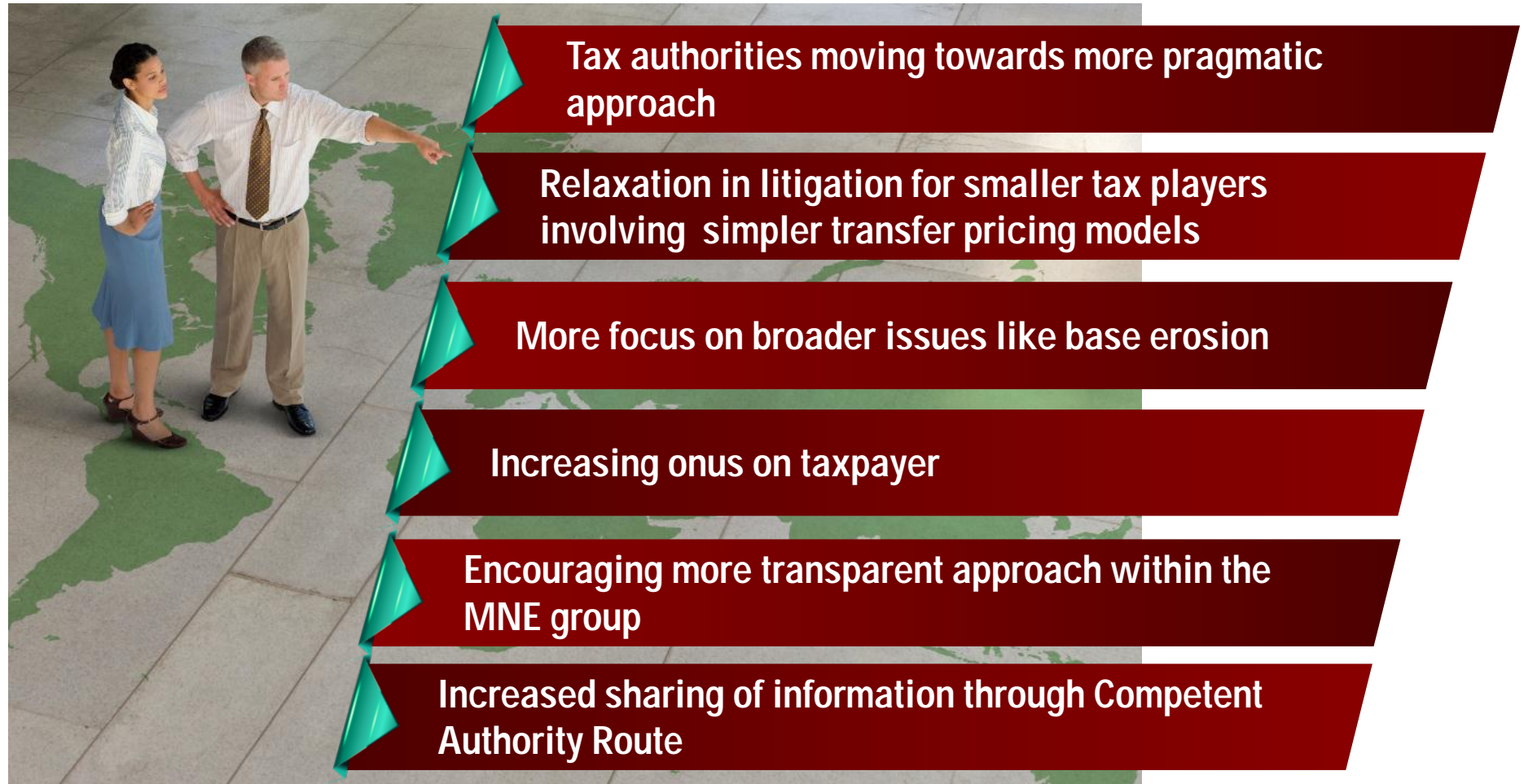
The issue of TP has generated much heat in India involving MNCs operating here such as Vodafone, Shell, WNS and Nokia

*Economic Times , 8 April, 2014*

TP adjustments data from Financial Express Newspaper dated 25 March 2015

# India today on Transfer Pricing Litigation

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# Applicability of Transfer Pricing Regulations



# Scheme of Transfer Pricing Provisions in India

Relevant Provisions under **Section 92**

Computation of Income from **International Transaction** having regard to **Arm's Length Price**

## Applicability sections

**Applicability**

Section 92

**Associated Enterprises**

Section 92A

**International Transaction**

Section 92B

**Specified Domestic Transaction**

Section 92BA

## ALP and Documentation sections

**Arm's Length Price**

Section 92C + Rule 10A/10B/ 10C/10CA

**Documentation and Certificate**

Section 92D and Section 92E + Rule 10D /10E

# Scheme of Transfer Pricing Provisions in India

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## Other relevant sections

### **Advance Pricing Agreements**

Section 92CC and CD+ Rules 10F to 10T

### **Safe Harbour**

Section 92CB + Rules 10TA to 10THD

## Scrutiny sections

### **Power of AO and TPO**

Section 92CA

### **Dispute Resolution Panel**

Section 144C

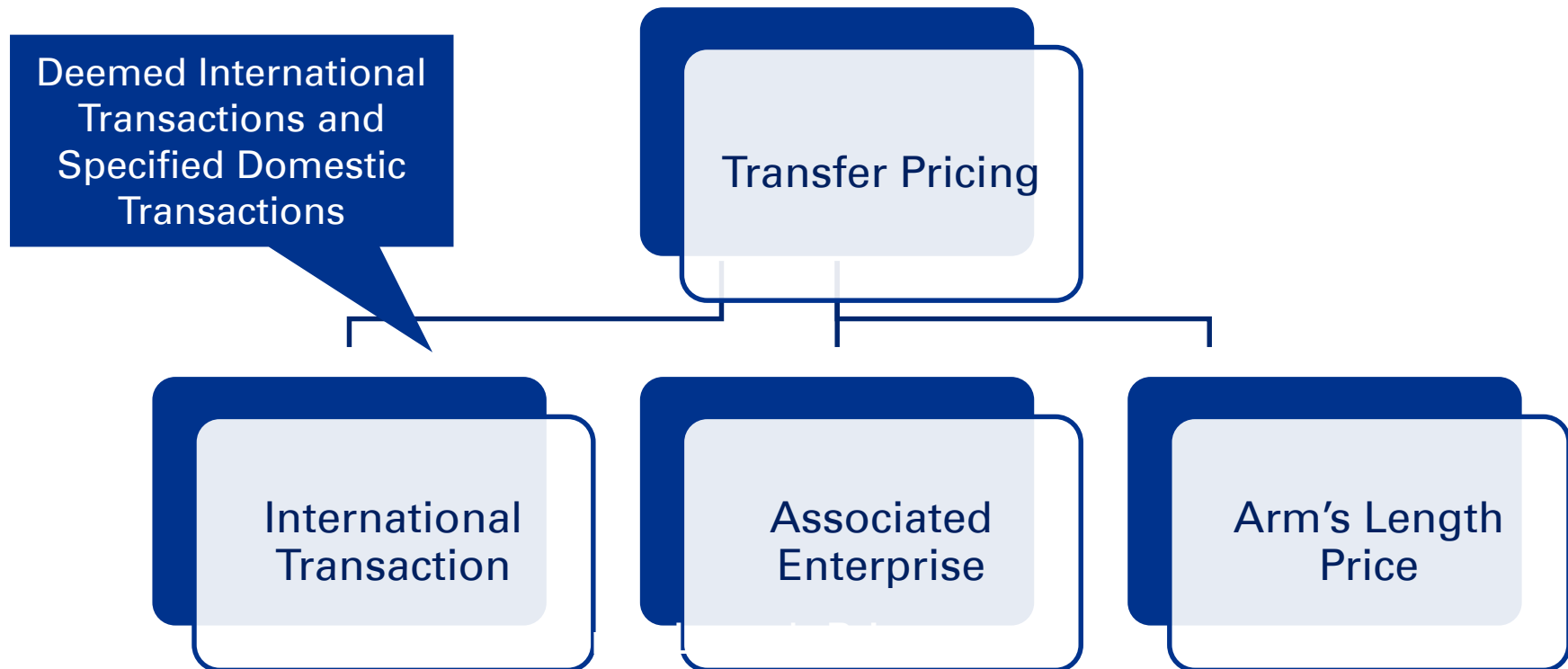
### **Penalties**

Section 271 (1) (c), 271AA, 271BA, 271G

# Important Concepts

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**Section 92** - Any income arising from an international transaction with to associated enterprises, shall be computed having regard to the Arm's Length Price



# "Income" - Judicial guidance

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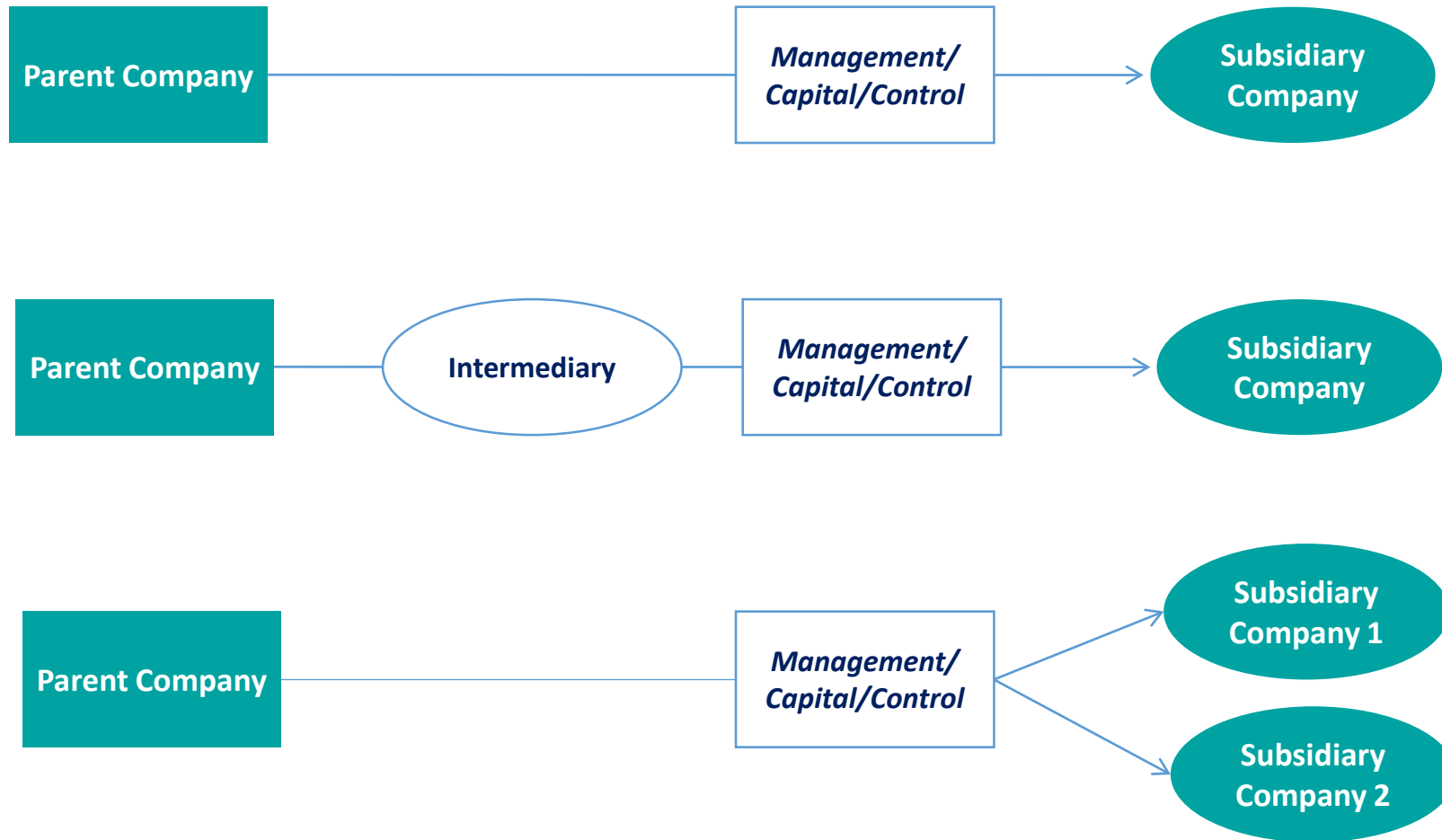
## **Vodafone India Services Pvt. Ltd. [TS-308-HC-2014(BOM)-TP]**

- **Bombay High Court rules in favour of taxpayer in share valuation case:**
  - Chapter X (Transfer Pricing), not a complete code, but a machinery provision to arrive at arm's length price (ALP)
  - Share issue at premium does not give rise to 'income' (taxable in India), to trigger TP provisions
  - Rejects Revenue's contention that income must be given a broader meaning to include notional income
- **Union Cabinet accepts the Bombay High Court order**
  - The Union Cabinet, decided to accept the order of the Bombay High Court and not to challenge it before the Supreme Court

**Ruling: The High Court quashed the order of tax authorities by ruling that no jurisdiction of Chapter X applies for issue of shares at a premium as it does not give rise to any income from an admitted international transaction**

# Associated Enterprises - Section 92A(1) (Primary Association)

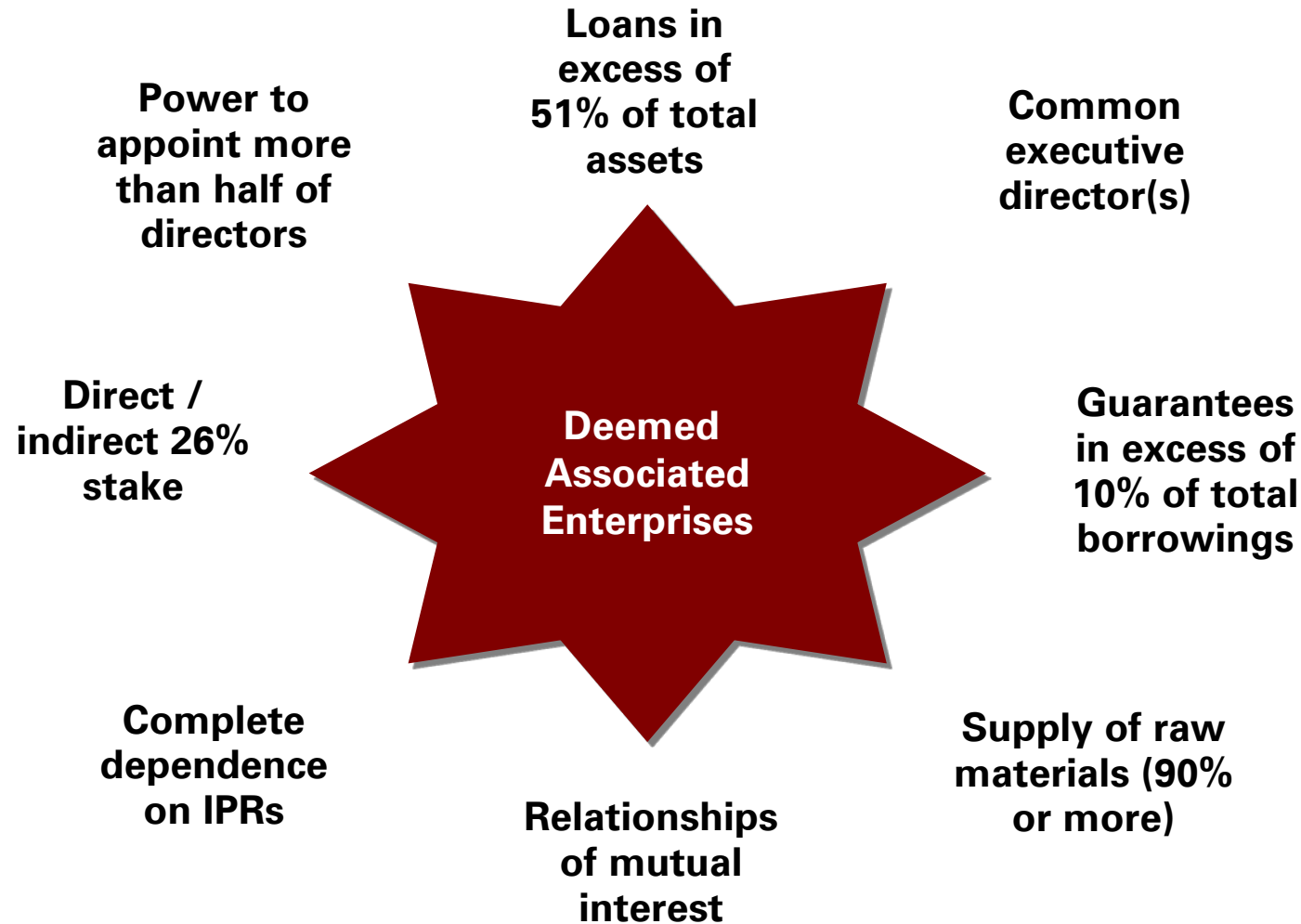
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# Associated Enterprise - Section 92A(2) (Deemed Association)

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# Associated Enterprises - Indian Judicial Precedents

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## **Kaybee Private Limited [TS-233-ITAT-2015(Mum)-TP]**

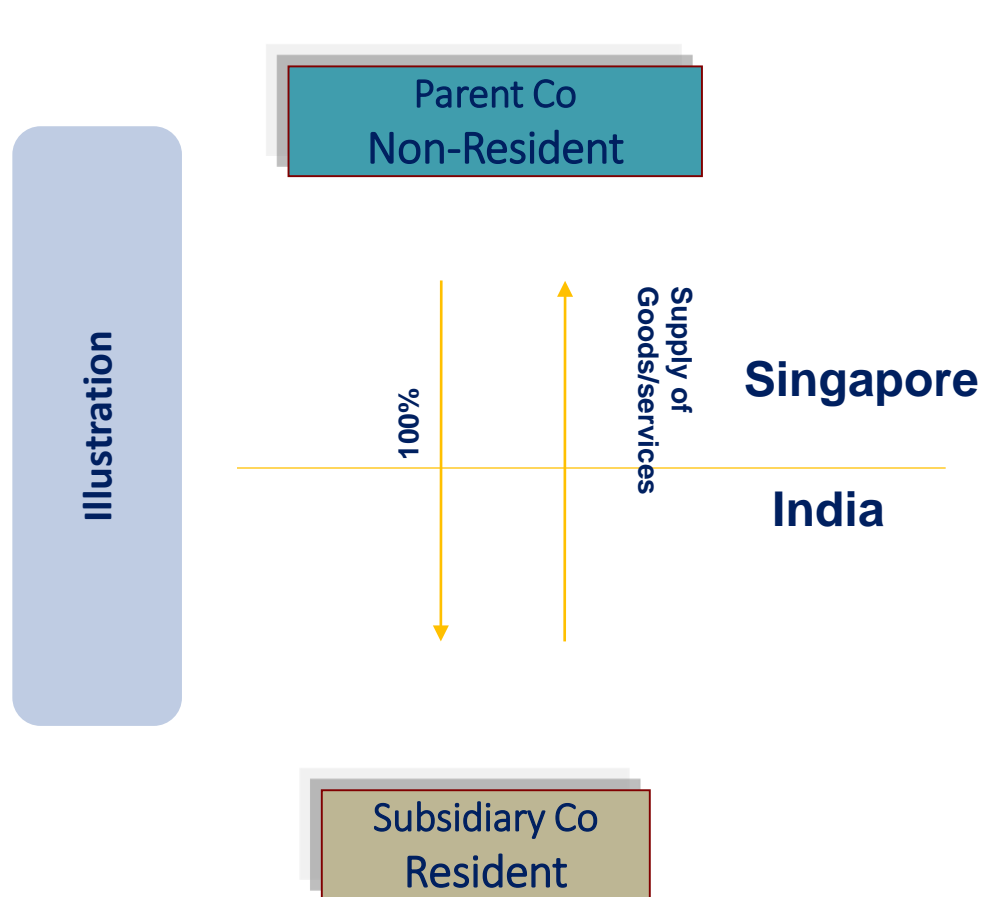
- ITAT rules that Sec 92A(1) not subject to clauses of Sec 92A(2)
- Holds if conditions prescribed in Sec 92A(1) are 'independently satisfied', then 2 enterprises will be treated as AE's
- Opines that Sec 92A(2) is a deeming fiction which expands / enlarges the scope and meaning of expression "AE" provided under Sec 92A(1), and has specific application only where any of the conditions stipulated therein are fulfilled

## **Diageo India Private Limited [TS-507-ITAT-2011(Mum)-TP]**

- Participation in control and management' as per Sec 92A to mean 'de facto or effective control' in decision making
- Assessee and AEs exercised 'de facto control' in decision making over contractors' manufacturing

# International Transaction -Section 92B

- Transaction between two or more associated enterprises, **either** or **both** of whom are **non-residents**
- In the nature of -
  - Purchase, sale or lease of tangible or intangible property, or
  - Provision of services, or
  - Lending or borrowing money, or
  - Any other transaction having a bearing on the profits, income, losses or assets of such enterprises,
  - Any mutual agreement or arrangement on allocation or apportionment or any contribution of cost or expenses



# International Transaction -Section 92B(1)

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## Transactions covered under the definition of international transactions

- **tangible property**
  - purchase, sale, transfer, lease  
/use of property/article/  
product/ thing
  - includes Building, Vehicle,  
machinery etc.
- **intangible property**
  - purchase, sale, transfer,  
lease/use of IP
  - includes transfer of  
ownership/use of rights/other  
commercial right



### Intangible Property

- Marketing related
- Technology related –  
Royalty
- Artistic related
- Data processing related
- Engineering related
- Customer related
- Contract related
- Human capital related
- Location related
- Goodwill related
- methods, programs,  
systems, procedures  
etc.

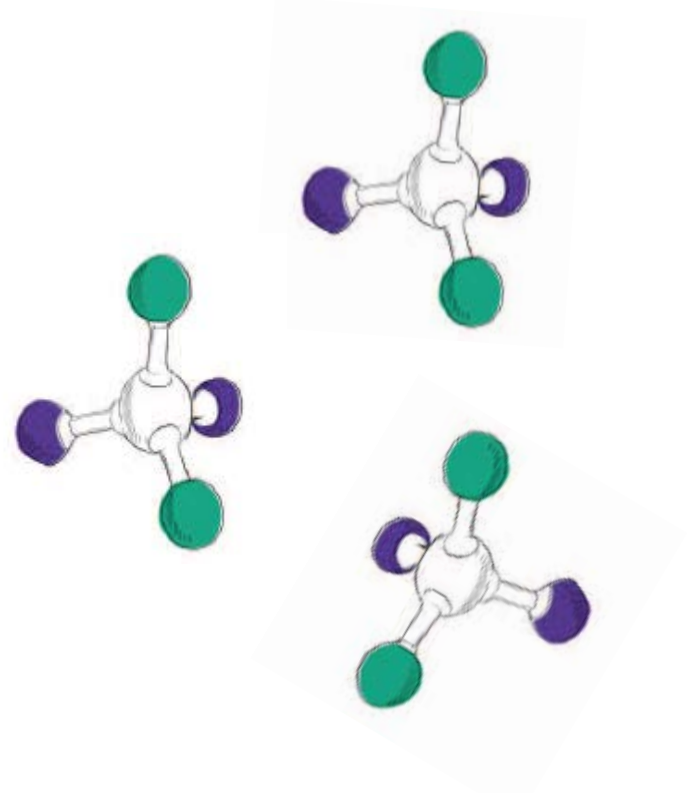
# International Transaction -Section 92B(1)

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## Transactions covered under the definition of international transactions

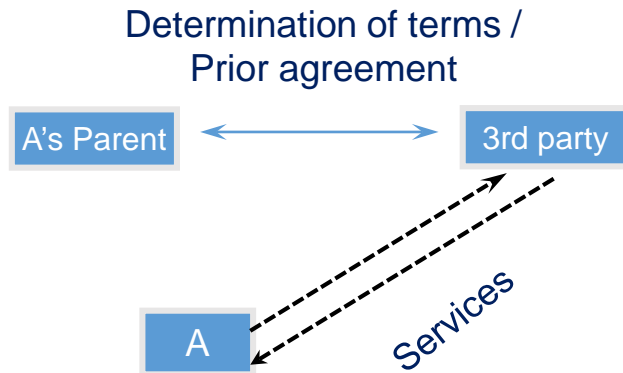
- **capital financing**
  - long/short term borrowing/lending
  - **guarantee**
  - purchase/sale securities
  - **advances/ receivables, payments/any debt etc.**
- **provision of services**
  - Market Research/ Development
  - Technical Service
  - Scientific Research
  - Legal/ Accounting Service etc.
- **business restructuring**
  - Transaction of Business restructuring/ reorganization with AE irrespective of bearing profit/ income/ loss or assets – at the time of transaction/ future date

....Contd.



# Deemed International Transaction - Section 92B(2)

## Earlier Provisions – Before Finance Act 2014-15

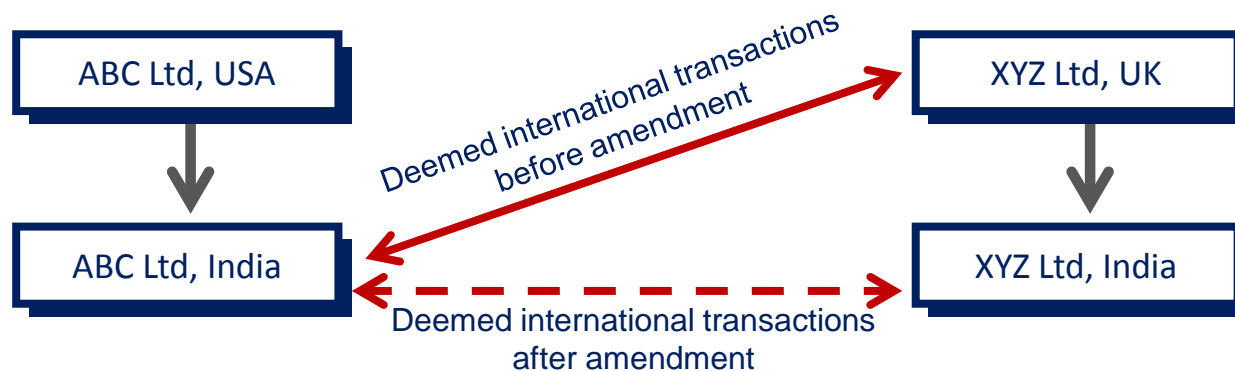


Transaction between A and Third party also subject to transfer pricing norms, if:

- a prior agreement exists between A's parent and Third party; or
- terms of transaction are determined in substance between A's parent and Third party

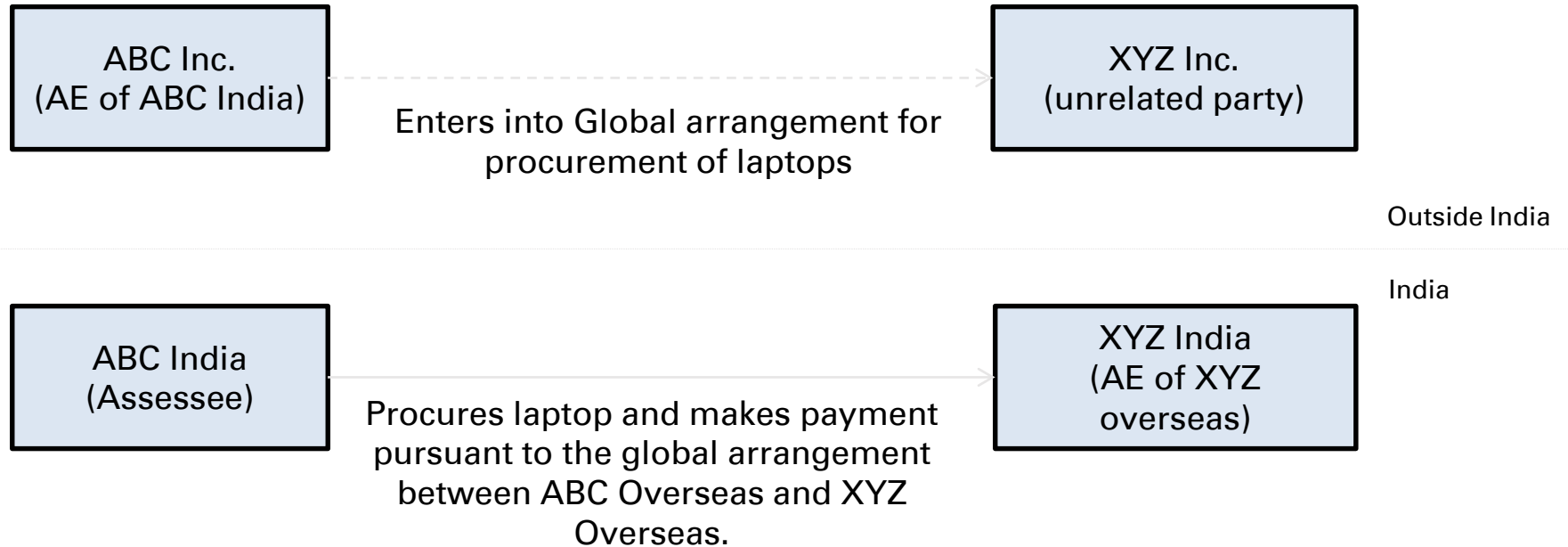
Earlier provisions could be interpreted to exist only if the independent person was a non-resident

## Current Provisions after Finance Act 2014-15



Applies to transactions between an enterprise & an independent person irrespective of whether such independent person is non-resident or not

# Section 92B(2) - Deemed International Transactions - Case Study



**View 1** – Yes, as ABC India’s transaction with XYZ India is the outcome/result of the global arrangement between ABC Inc. and XYZ Inc.

**View 2** – No, since XYZ India is not a party to the agreement between ABC Inc. and XYZ Inc.

# Specified Domestic Transactions ("SDT") - Section 92BA

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## **Tax holiday undertakings covering:**

- Inter unit transfer of goods and services – **Section 80-IA(8)**
- More than ordinary profits from transactions with closely connected persons – **Section 80-IA(10)**
- Inter unit or intra group transaction for taxpayer enjoying benefit of **Chapter VI-A or section 10AA (SEZ units)**
- Profits and gains of undertaking/s units/ eligible businesses to be computed having regard to arm's length price in case of inter unit transfer of goods or services by the taxpayer - **Section 80A**

Any other transaction that may be specified

Applicable where **aggregate SDT value exceeds INR 20 crore** in a year - from FY 2015-16 onwards

Section 40A(2)(b) payments to specified persons removed from the scope of SDT w.e.f FY 2016-17



# Arm's Length Price

Price applied or proposed to be applied in a transaction between persons other than AEs, in uncontrolled conditions

Determination of arm's length prices using one of the [Prescribed methods](#)

Whether you arrive at a single price?

Yes

No

The price thus determined is the arm's length price

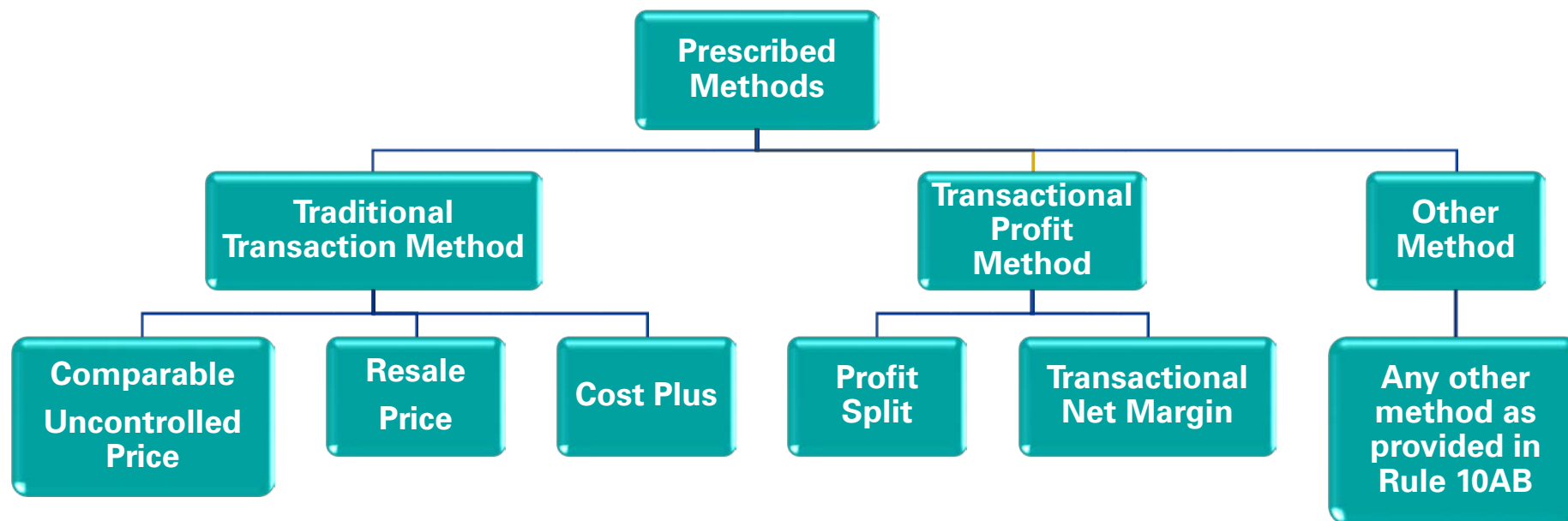
**Replaced by the Finance Act 2015** with percentile range (applicable if prescribed conditions are satisfied) and mean to apply in all other cases

# Methods of Transfer Pricing



# Methods

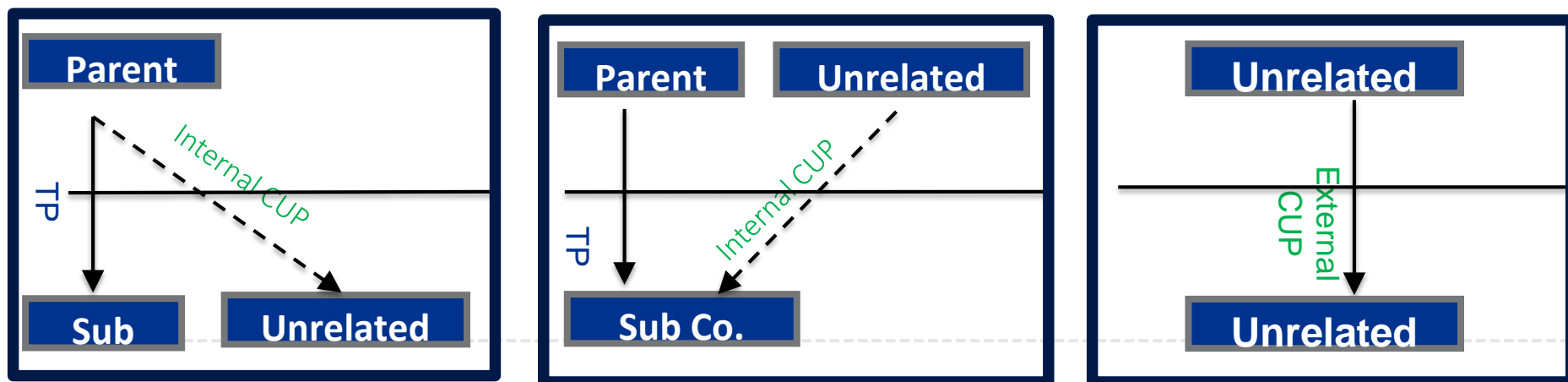
- Determination of ALP using one of the Prescribed methods -
  - Best suited to the facts and circumstances of each particular international transaction and
  - Provides the most reliable measure of an arm's length price in relation to the international transaction ~ termed as the **"Most Appropriate Method"**



**No hierarchy or preference of methods prescribed under the Act**

# Comparable Uncontrolled Price Method

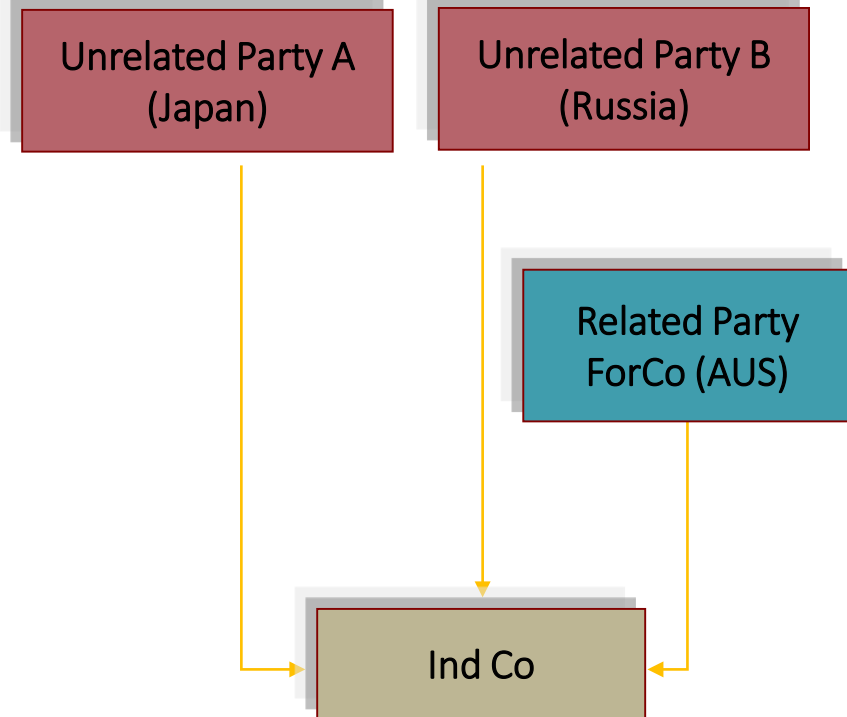
- Most Direct Method
- Prices are benchmarked without any reference to the profits
- Requires strict comparability in products, contractual terms, economic terms, etc.
  - Volume/ quantity of product
  - Credit terms
  - Geographic market
  - Other terms of contract
- Two types of CUPs available - Internal CUP & External CUP
- Typically Internal CUP is preferred over External CUP due to higher degree of comparability



# Case Study : Application of CUP Method...



- Ind Co, an Indian Company is engaged in the refining and sale of copper metal.
- Ind Co purchases crude metal from both related and unrelated parties
- Volume of supplies made by Ind Co ~ 2800 MT
- Critical factors that affect the crude copper price are:
  - Volume,
  - Tenure of supply contract (long terms, short term)
  - Product mix (with or without small quantities of other metal alloys like gold and silver)
  - Other terms of contracts (FOB vs CIF, port of shipment etc)



**Relevant facts**

# ...Case Study : Application of CUP Method...



| Criteria                               | Related Party ForCo<br>(Australia)<br>Controlled | Unrelated Party<br>A (Japan)<br>Uncontrolled  | Unrelated Party<br>B (Russia)<br>Uncontrolled |
|--|--|---|---|
| Tenure of Contract                     | Long Term (10 yrs)                               | Long Term (8 yrs)                             | Short Term (2 yrs)                            |
| Volume during year under consideration | 2200 MT  | 3000 MT                                       | 9000 MT                                       |
| Alloy Mix                              | 0.5% Gold, 1% silver                             | 1% Gold, 1% silver                            | None  |
| Port of shipment                       | Australia  | Japan   | Russia  |
| Price (per MT)                         | INR 29,500 (applicable<br>for entire year)       | INR 32,000<br>(applicable for<br>entire year) | INR 28,500<br>(applicable for entire<br>year) |
| Other Terms                            | FOB basis  | CIF basis                                     | FOB basis                                     |

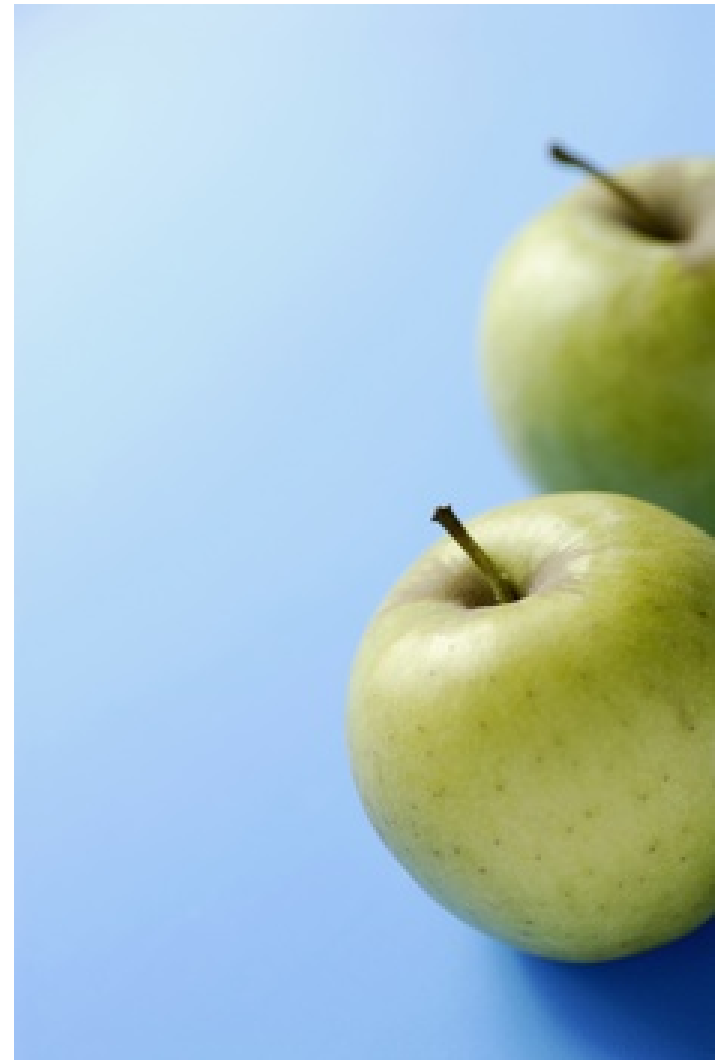
# ...Case Study : Application of CUP Method



- **Best Method:** given the availability of required data, CUP is the most appropriate method
- **Rejection of CUP related to Supplier B:** the significant difference in volume render the Supplier B transactions unreliable as suitable adjustments cannot be made to account for the difference
- **Acceptance of CUP related to Supplier A:** the uncontrolled transaction with Supplier A is comparable with the controlled transactions with ForCo. Although, certain adjustments need to be made

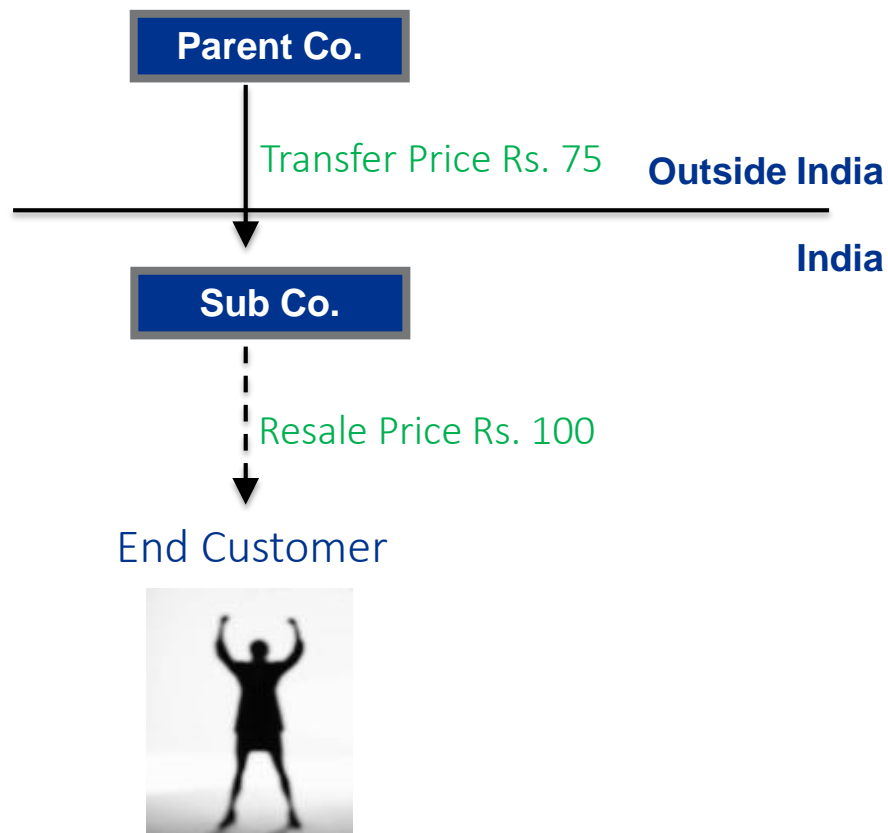
## Adjustments

- **Difference in pricing basis (FOB vs CIF)** – add freight and insurance cost
- **Difference in alloy mix** – adjust Supplier A's price to exclude price for higher content of gold



# Resale Price Method

- Compares resale Gross Margin
- Preferred method for a distributor - buying purely finished goods from a group company
- Comparability is relatively less dependent on strict product comparability and additional emphasis is on similarity of functions performed & risks assumed
- Used when reseller does not add substantial value to the goods and does not apply intangible assets to add value
- Difficult to apply where goods are further processed before resale

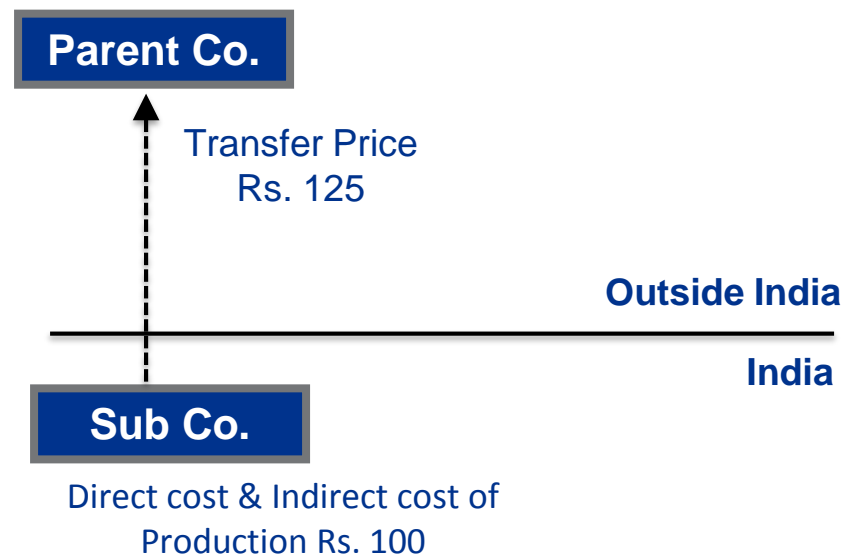


**Price paid by Sub Co. to AE is at arm's length if the 25% resale margin earned by Sub Co. is more than margins earned by similar Indian distributors**



# Cost Plus Method

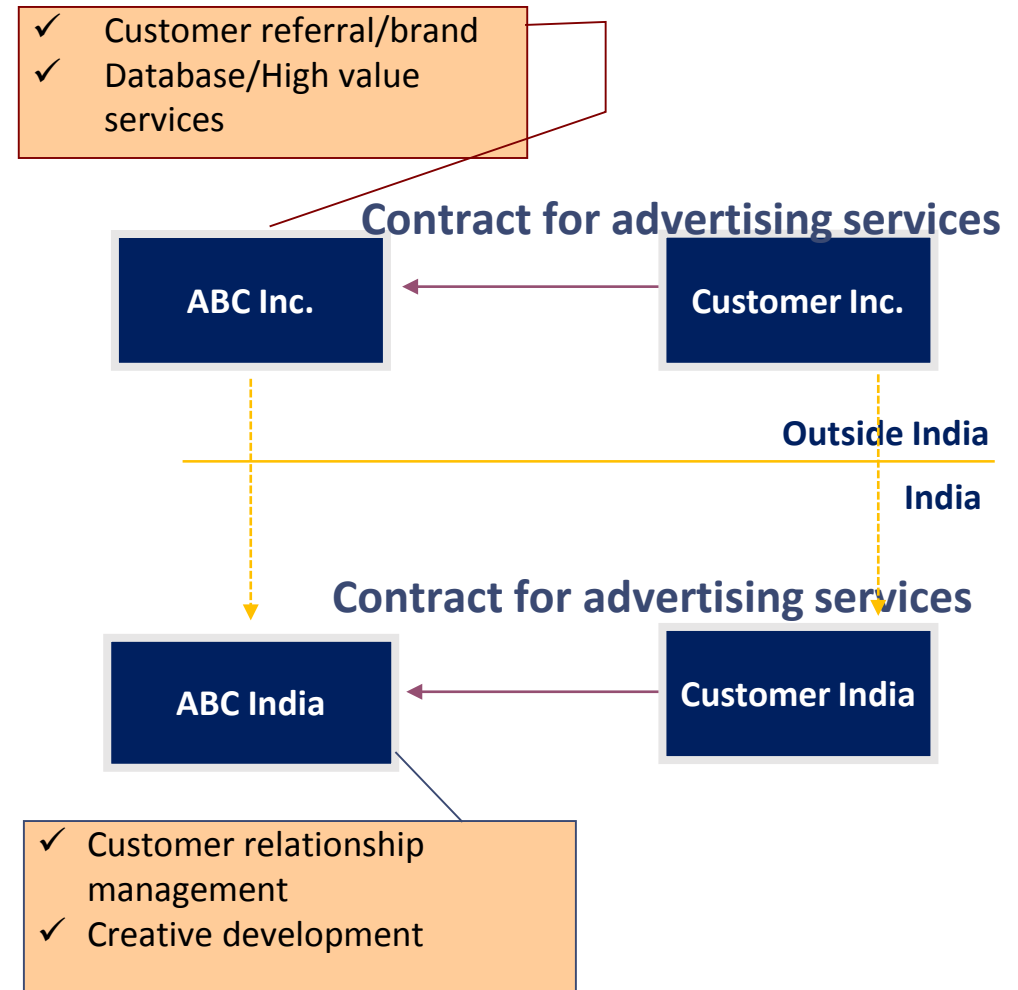
- Compares and identifies mark-up earned on direct and indirect costs of production incurred with that of comparable independent companies
- Preferred method in case-
  - Semi-finished goods sold between related parties
  - Contract manufacturing agreement
- To be applied in cases involving manufacture, assembly or production of tangible products or services that are sold/ provided to AEs
- Comparability under this method is relatively not as much dependent on close physical similarity between the products.
- Larger emphasis on functional comparability



**Price charged by Sub Co. to AE is at arm's length if the 25% mark-up on cost is more than that of similar Indian assemblers**

# Profit Split Method

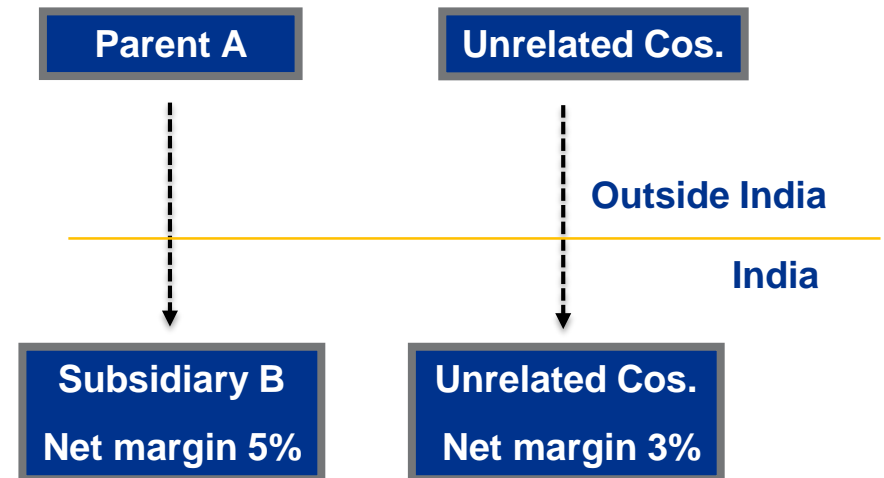
- To be applied in cases involving-
  - transfer of unique intangibles; or
  - in multiple international transactions that cannot be evaluated separately
- Calculates the combined operating profit resulting from an inter-company transaction based on the relative value of each AEs contribution to the operating profit
- Evaluates allocation of combined profit/loss in controlled integrated transactions
- The contribution made by each party is based upon a functional analysis and valued, if possible, using external comparable data



# Transactional Net Margin Method 1/2

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- Most frequently used method, due to lack of availability of data for application of other methods
- Examines net operating profit from transactions as a percentage of a certain base (can use different bases i.e. costs, turnover, etc)
- Both internal TNMM and external TNMM are possible
- Broad level of product comparability and high level of functional comparability
- Applicable for most categories of transaction and often used to supplement analysis under other methods



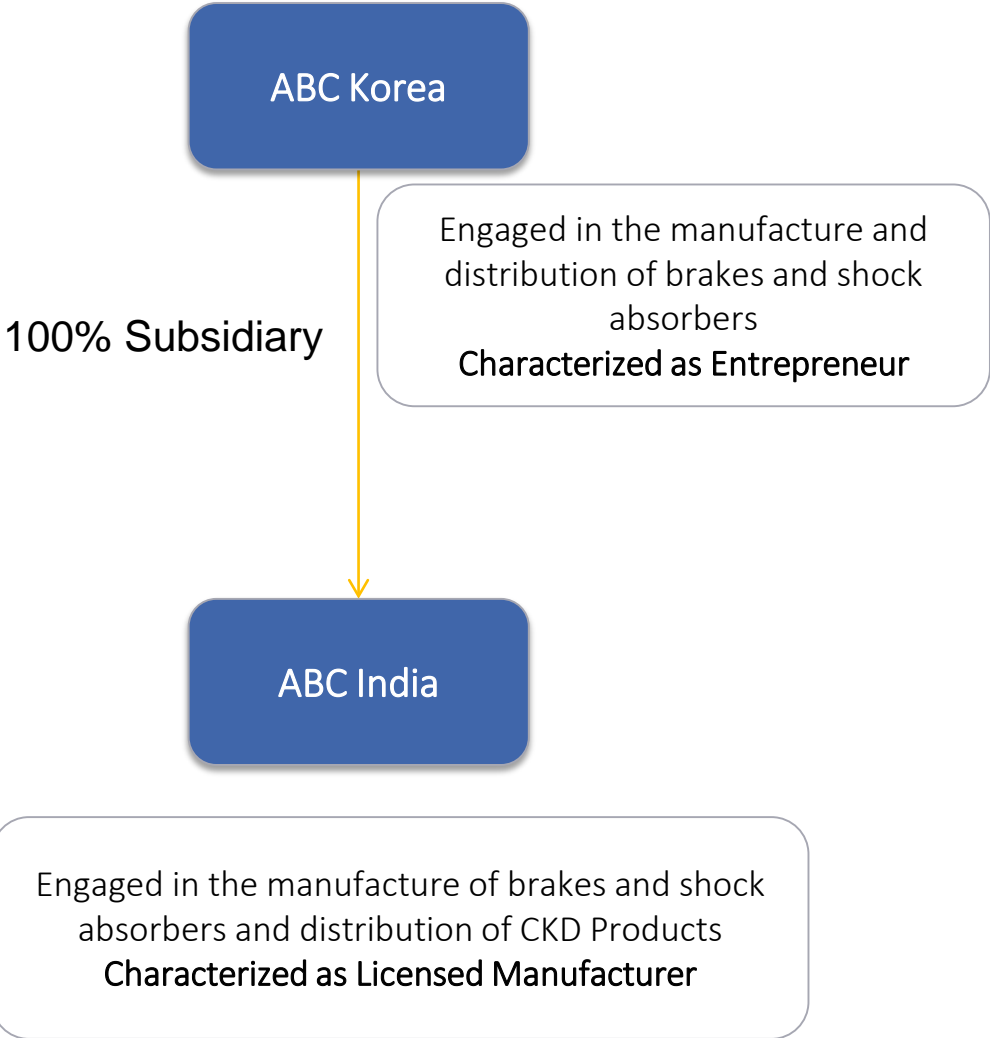
# Transactional Net Margin Method 2/2

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- Grouping of transaction - Relevant controlled transactions require to be aggregated to test whether the controlled transaction earn a reasonable margin as compared to uncontrolled transaction
- **Selection of tested party - Least complex entity**
- Selection of Profit Level Indicator such as Operating Margin, Return on Value added expenses, Return on assets – Unaffected by transfer price
- Benchmarking exercise (**on Databases**)
  - Entity with similar industry classification to the tested party – through search in Prowess and Capitaline plus databases
  - Screen entities by applying appropriate quantitative filters, such as mfg sales <75%, R&D exp >5%, Advertisement exp >5%.
  - Review financial and textual information available in the public database of the selected entities – for qualitative filters
  - Computation of ALP

**Usually regarded as an indirect and one-sided method, but is most widely adopted**

# Case Study : Application of TNMM...



| Inputs Received from  | Output Delivered to  |
|---|--|
| <u>Domestic Parties</u> <ul style="list-style-type: none"> <li>• Purchase of CKD products</li> </ul>  | <u>Domestic Parties</u> <ul style="list-style-type: none"> <li>• Sale of Brakes and Shock Absorbers</li> </ul> |
| <u>Related Parties</u> <ul style="list-style-type: none"> <li>• Import of components</li> <li>• Provision of drawings, technical knowledge, and manufacturing information<br/><b>(R&amp; D Center)</b></li> </ul> | <u>Related Parties</u> <ul style="list-style-type: none"> <li>• Sale of CKD Products</li> </ul>                |

# ...Case Study : Application of TNMM...



| Particulars                    | Amount  |
|--------------------------------|---------|
| Import of Components           | 15,000  |
| Payment towards Royalty        | 5,000   |
| Payment towards Technical fees | 5,000   |
| Sale of CKD Products           | 150,000 |
| Reimbursement                  | 15,000  |

The following international transactions are inextricably linked with the manufacturing function of ABC India and hence have been aggregated:

- Import of components; and
- Payment towards royalty and technical fees

# ...Case Study : Application of TNMM...



| Particulars                                | Manufacturing | Trading   | Total   |
|--|---------------|-----------|---------|
| Sales                                      | 200,000       | 300,000   | 500,000 |
| Manufacturing expenses / cost of purchases | 90,000        | 210,000   | 300,000 |
| Royalty and technical fees                 | 10,000        | -         | 10,000  |
| Employee cost                              | 30,000        | 24,000    | 54,000  |
| Administrative expenses                    | 24,000        | 15,000    | 39,000  |
| Selling and distribution cost              | 16,000        | 24,000    | 40,000  |
| Depreciation                               | 16,000        | 12,000    | 28,000  |
| Total Expenses                             | 186,000       | 285,000   | 471,000 |
| Total Profit                               | 14,000        | 15,000    | 29,000  |
| <b>Net cost plus Margins (NCP)</b>         |               | <b>5%</b> |         |
| <b>Net Profit Margins (NPM)</b>            | <b>7%</b>     |           |         |

**Results :** The NPM earned by the company in the manufacturing segment is 7% and the NPM range of broadly comparable companies operating in the similar segment is between 4.86 % and 8.36 % with a median of 6.76%. The NCP earned by the company in the trading segment is 5% and the arithmetic mean of the comparable companies is 4.4%

# ...Case Study : Application of TNMM



| Name of comparable companies     | Weighted Avg NPM |
|----------------------------------|------------------|
| A N G Industries Ltd             | 16.21            |
| Bosch Chassis Systems India Ltd. | 6.95             |
| Brakes India Ltd                 | 9.52             |
| C M Smith & Sons Ltd             | 3.46             |
| Hindustan Composites Ltd         | 1.59             |
| Rambal Ltd                       | 12.83            |
| Rane Brake Lining Ltd            | 6.57             |
| Renowned Auto Products Mfrs. Ltd | -7.54            |
| <b>Median</b>                    | <b>6.76</b>      |
| <b>35th Percentile</b>           | <b>4.86</b>      |
| <b>65th Percentile</b>           | <b>8.36</b>      |

← Companies engaged in similar manufacturing or assembly activities

→ Companies engaged in similar trading activities

| Name of comparable companies       | Weighted Avg NCP |
|------------------------------------|------------------|
| George Oakes Ltd                   | 4.02             |
| Jullundur Motor Agency (Delhi) Ltd | 4.78             |
| Speed – A – Way Pvt Ltd            | 6.22             |
| Sri Aruna Auto Service Ltd         | 1.73             |
| PAE Ltd                            | 5.44             |
| <b>Arithmetical Mean</b>           | <b>4.44</b>      |



# Other Method

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➤ CBDT has notified the “Other method” vide a Notification

➤ Applicable from FY 2011-12

**Rule 10AB - “any method which takes into account the price which has been charged or paid, or would have been charged or paid, for the same or similar uncontrolled transaction, with or between non-associated enterprises, under similar circumstances, considering all the relevant facts.”**

➤ Effectively this implies that “quotations” rather than “actual prices” charged or paid can also be used

➤ Could also cover new instances of ALP computation which would now arise due to the various amendments introduced in the Finance Act 2012 – Expansion of definition of “international transaction” and introduction of domestic transfer pricing

➤ To maintain proper documentation specifying the rejection reasons for non-application of other five methods and appropriateness of the “other method”

# Choice of MAM - General Applicability

| Method | Transaction Type  |
|--------|---|
| CUP    | Loans, Royalties, Service fee, transfer of tangibles, etc.  |
| RPM    | Marketing operations of finished products, where distributor not performing significant value addition to product   |
| CPM    | Raw material or semi-finished goods are sold, long term buy-and-sell agreement                                      |
| PSM    | Transactions involving provision of integrated services by more than one enterprise or involving unique intangibles |
| TNMM   | Provision of services, distribution of finished goods where applicability of RPM is inappropriate, etc.             |

The regulations do not define any priority of methods

# Most Appropriate Method: Rule 10C

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## **Factors considered for selection of the most appropriate method:**

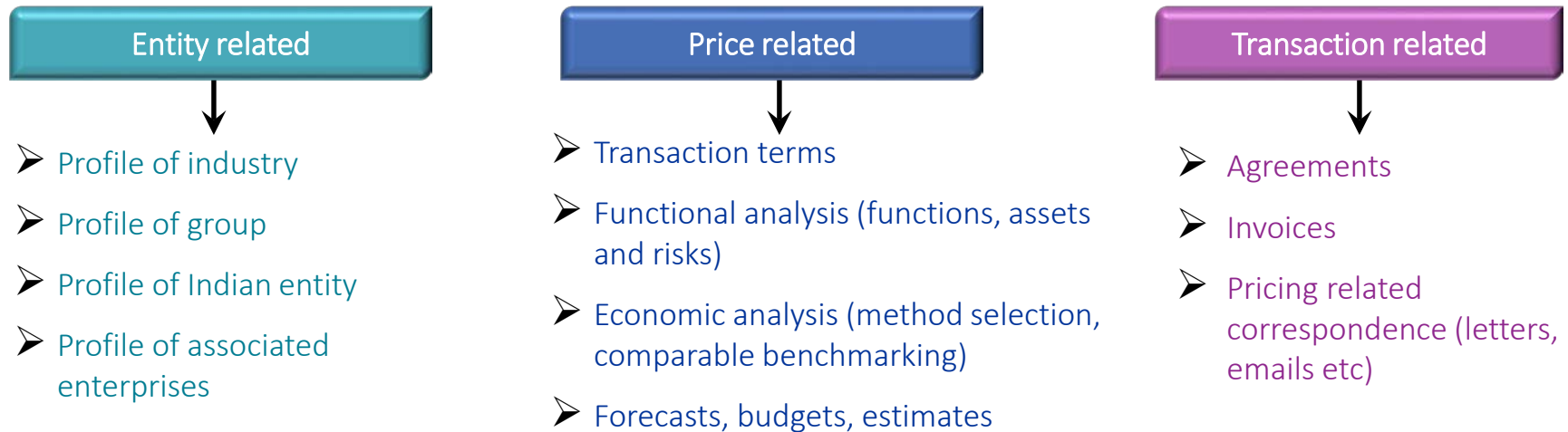
- Nature and class of international transaction
- Class of associated enterprise and functions performed
- Availability, coverage and reliability of data
- Degree of comparability between the International transaction
- Extent to which reliable and accurate adjustments can be made
- The nature, extent and reliability of assumptions for application of the method



# Documentation

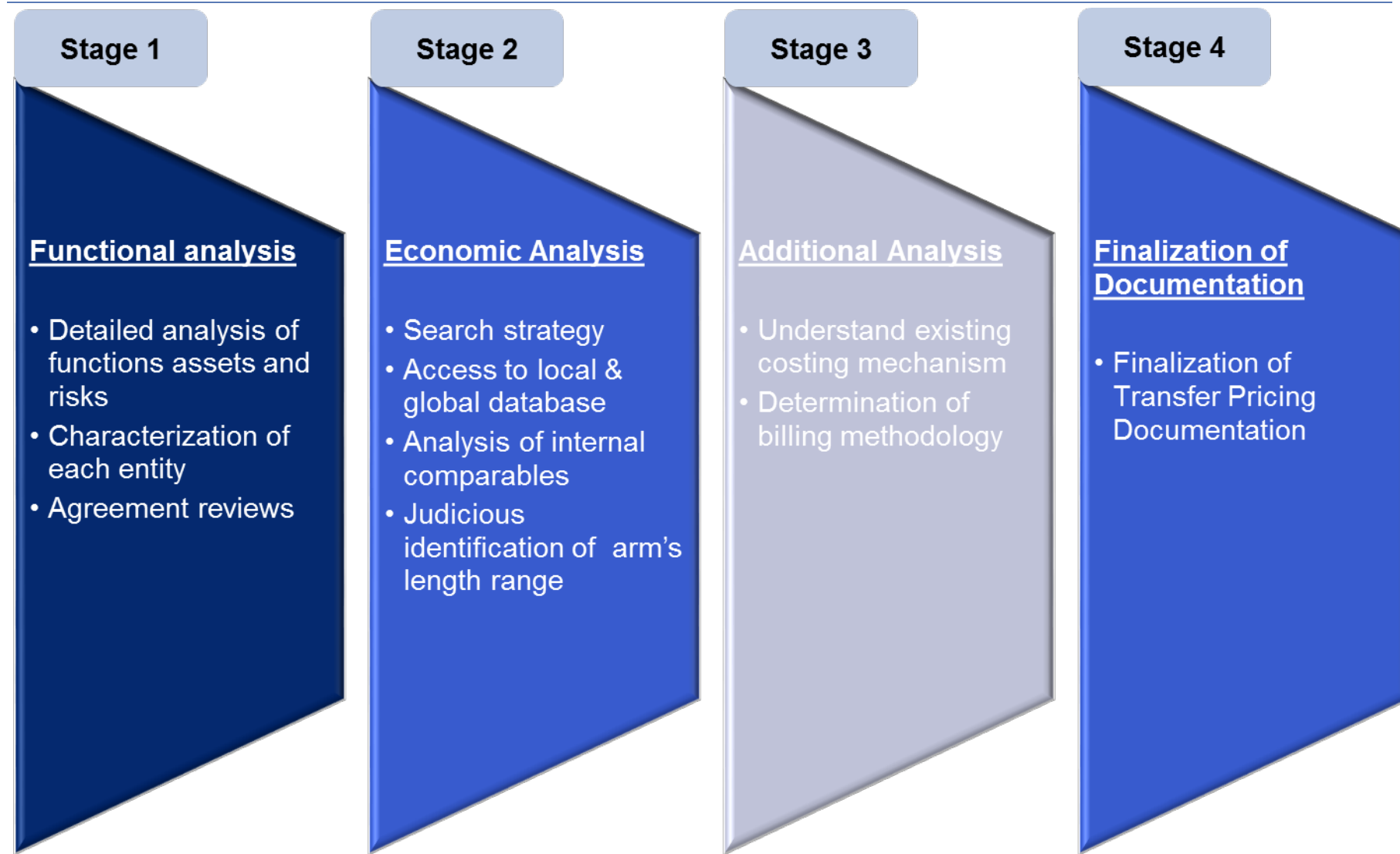


# Transfer Pricing Documentation: Section 92D / Rule 10D



- Contemporaneous documentation requirement – Rule 10D
- Documentation to be retained for 9 years
- No specific documentation requirement if the value of international transactions is less than one crore rupees.

# Process under Documentation



# Accountant's Report - Section 92E / Rule 10E

- Obtained by every person entering into an international transaction and specified domestic transactions
- To be filed by the due date for filing return of income (**e-filing mandatory**)
- Opinion whether prescribed documents have been maintained the particulars in the report are "true and correct"
- Inputs:
  - Related party ledgers extracts
  - Related party Schedule under AS-18
  - Sample Invoices/ Vouchers / DN / CN
  - Relevant intra-group agreements
  - CUP/ Internal comparison info

Form No. 3CEB

[See rule 10E]

Report from an accountant to be furnished under section 92E relating to international transaction(s)

1. We have examined the accounts and records of ENTITY NAME AND POSTAL ADDRESS - PAN No. that have been made available to us relating to the international transactions and specified domestic transactions entered into by the assessee during the previous year ending on 31st March 2014.
2. In our opinion proper information and documents as are prescribed have been kept by the assessee in respect of the international transaction (s) and specified domestic transaction (s) entered into so far as appears from our examination of the records of the assessee.
3. The particulars required to be furnished under section 92E are given in the Annexure to this Form. In our opinion and to the best of our information and according to the explanations given to us, the particulars given in the Annexure are **true and correct.**

Place :

Date :

For B S R & Co. LLP

Chartered Accountants

# Key TP Controversies / Issues





# Transfer Pricing - Key Issues/Controversies

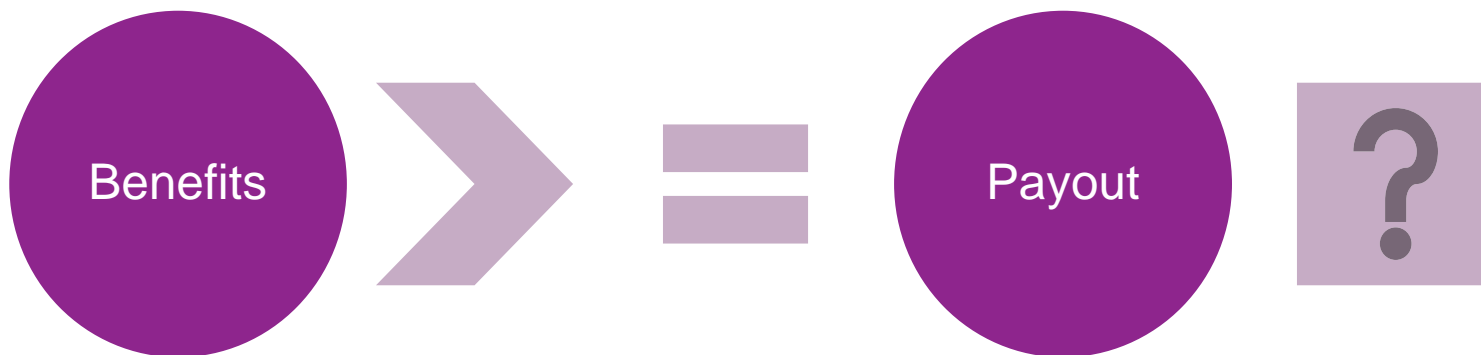
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# Payment for Management Fees, Royalty, etc.

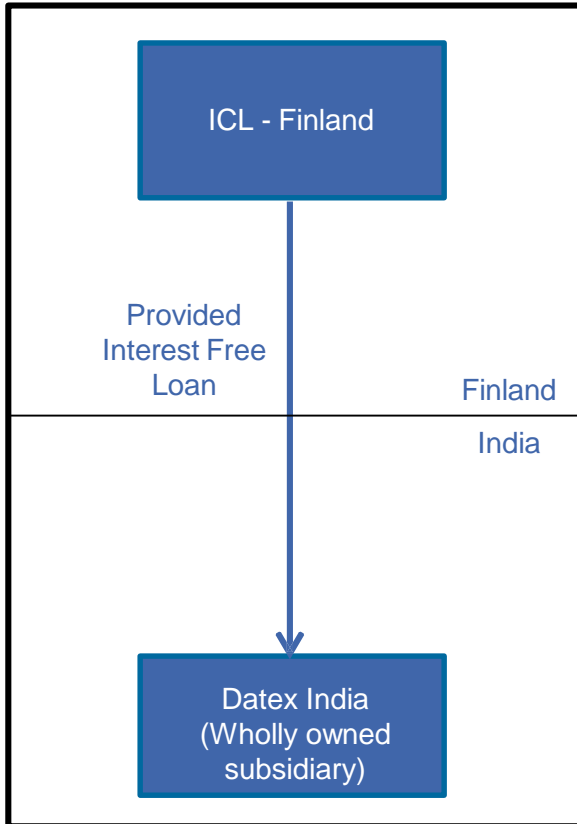
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- Management fee charge-outs by AEs are investigated in great detail by the Revenue department
- Robust / exhaustive documentation requirement demanded to evidence
  - appropriateness of fee charged
  - receipt of services
  - benefits received
- Complete / partial disallowance of fee charged , if all of the above is not provided
- Revenue also enquires into whether a similar charge is levied on other group entities and rates thereof are also called for and examined
- Typical mindset of the Revenue is that management charge are used for profit repatriation.



# Base Erosion and TP - Case Law

Instrumentarium Corporation - Kolkatta ITAT (Special Bench) - 2016



## **Special Bench ruling**

- Sec 92(3) requires independent computation in ALP in the hands of each taxpayer and not a holistic view considering the taxpayer and its AE
- Sec 92(3) considers each year on a standalone basis
- If an ALP adjustment is made in the hands of the foreign taxpayer – the Indian AE shall not be entitled to get a corresponding adjustment in respect of the same
- CBDT circular no. 14 of 2001 is not an ‘order, instruction or direction’ (as referred in section 119) which binds the field officers, but is in the nature of an explanatory note providing guidance during the introduction of TP provisions in India
- ‘Intent of legislature’ at best comes into play only when there is ambiguity in the words of the status sought to be interpreted – which was not so in the instant case – hence no need to resort to the above Circular

**Base Erosion theory’ – rejected in principle - could have repercussions not only on financial transactions (i.e. loans and guarantees), but also to wider classes of transactions!!!**

# BPO vs. KPO

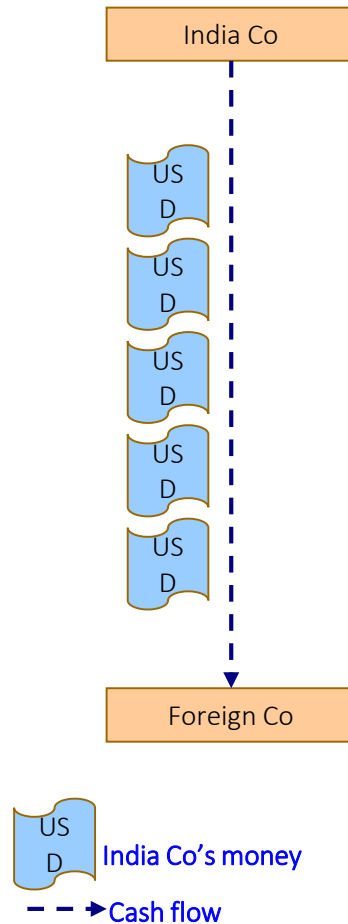
- Captive Service providers – a cost plus arrangement with mark-up between 10 to 20 percent, whereas, revenue authorities allege mark-up in the range of 25 to 35 percent
- In some case, low end back office support services ('BPO') characterized as High end Knowledge Process services ('KPO')
- High margin companies mainly providing KPO services are generally alleged as comparables (*companies such as Accentia Technologies Limited; eClerx Services Limited; etc.*)
- Loss making comparables usually rejected
- Revenue authorities allege Location Savings (low employee cost, etc.) and Location Specific Advantages (access to growing market, etc.) provided by India should be considered while carrying out comparability analysis



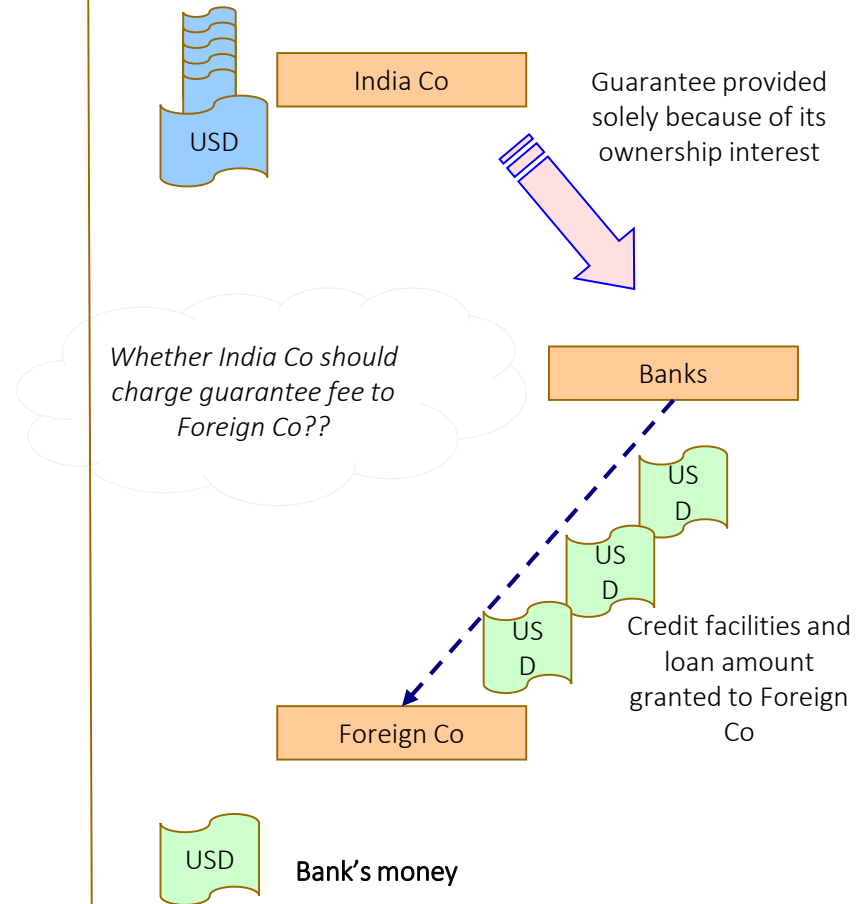
# Corporate guarantee and interest free loans

- Corporate Guarantee is a legally binding agreement under which the guarantor agrees to pay any or all of the amount due on a loan instrument in the event of non payment by the borrower
- Generally, no charge for guarantee fee on the ground that there is no cost of guarantee
- At times, Comfort Letters are also viewed as Guarantee
- Granting of interest free loans has historically led to tax controversies with the Revenue authorities.

Option I – To infuse capital



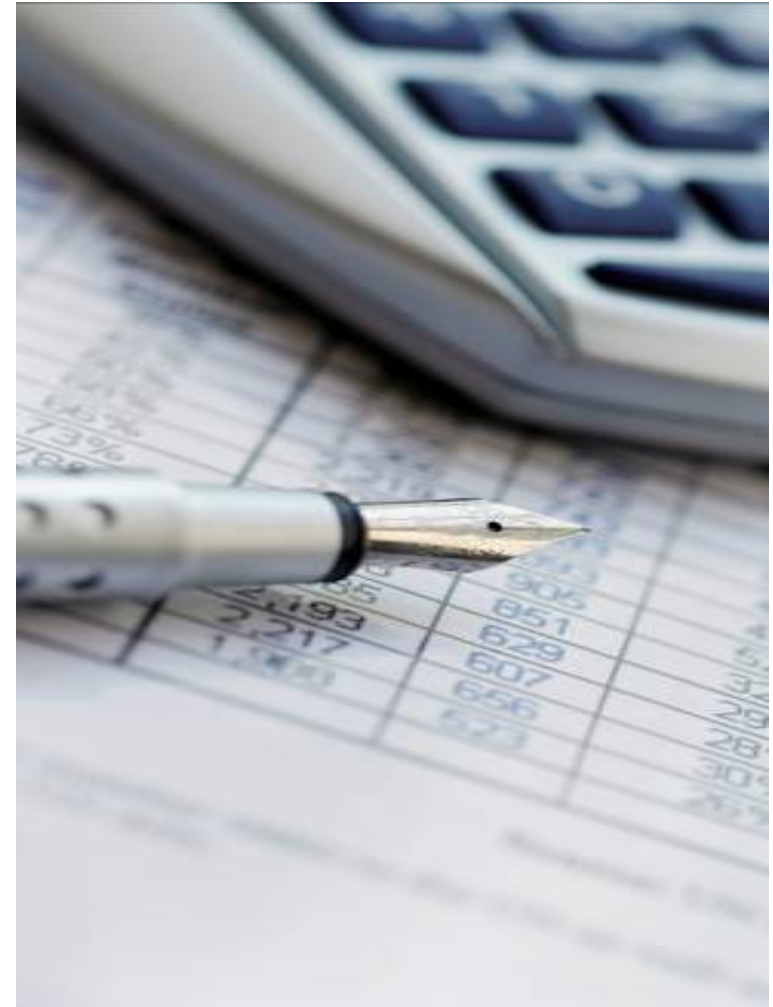
Option II – To maximize cash utilization



# Corporate Guarantees - Case Law

## **Bharti Airtel Limited (I.T.A. No.: 5816/Del/2012) - Tribunal Ruling**

- Corporate guarantee issued for AE's benefit, which does not involve any costs to the taxpayer, does not have any bearing on profits, income, losses or assets of enterprise, thus it will be outside ambit of expression 'international transaction'
- It is undisputed position that corporate guarantee issued by the taxpayer to the lender bank did not even have any impact on profits, income, losses or assets because no borrowings were resorted to by the AE from this bank
- Impact has to be on real basis, even if in present or in future, and not on contingent or hypothetical basis
- Tribunal rejected tax authorities reliance on GE Capital Canada as the domestic laws in Canada are quite at variance with the Indian TP regulations



# Key points for success in Transfer Pricing audits

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- Detailed Functions-Assets-Risks analysis
- Proactive Planning
- Price setting mechanisms to be documented
- Substantiate business, economic and commercial rationale
- Maintain detailed cost-benefit analysis with respect to cross charges (intra-group services)
- Strategizing and providing appropriate information during the audit
- Involve operational teams in tax and TP planning and documentation process
- Harmonize TP documentation with other regulatory requirements



A stack of colorful folders in shades of red, yellow, green, and pink is positioned on the right side of the image. In the bottom right corner, a silver and black pen with a perforated grip is visible. The background is a light, textured surface, possibly a desk or a wall.

# Recent Transfer Pricing updates in India



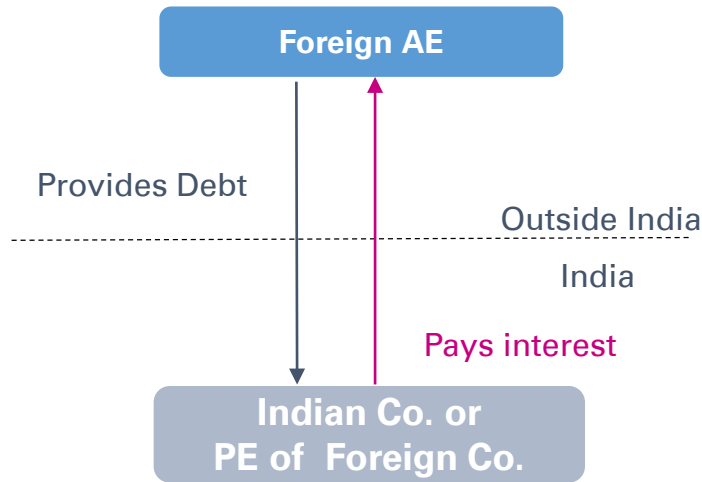
# Secondary Adjustment - Section 92CE

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- The Finance Act, 2017 has introduced provisions relating to **Secondary adjustment, w.e.f. 1 April 2018** in case of various situations wherein a primary adjustment is undertaken
- Primary adjustment results in excess money with the AE – If not repatriated to India within prescribed time, shall be **deemed to be an advance from taxpayer to the AE and liable to a charge for interest**, as may be prescribed
- The above provisions are not applicable if:
  - ✓ The primary adjustment is **less than INR 1 crore**; and
  - ✓ Such adjustment **relates to FY 2015-16 or prior years**
- Recently, CBDT has notified the following:
  - ✓ Time limit for repatriation of excess money
  - ✓ Rate for imputation of interest on excess money not repatriated within time limit

# Limitation on Interest Deduction - Section 94B

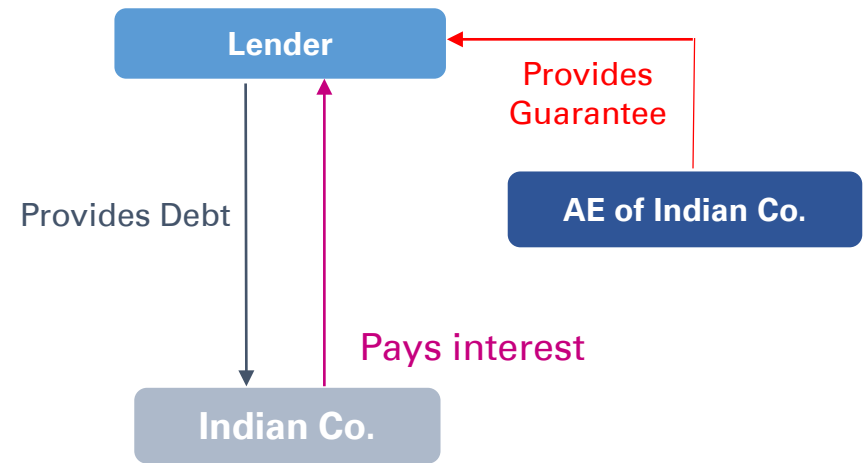
Situation 1



- Foreign AE provides debt to an Indian Co. or PE of a Foreign Co.
- Indian Co. or PE of Foreign Co. pays interest exceeding INR 10 mn in respect of such debt

OR

Situation 2



- Lender provides debt to an Indian Co.
- AE of Indian Co. provides guarantee or deposits sum of equivalent amount with lender
- Indian Co. pays interest exceeding INR 10 mn in respect of such debt or guarantee

- Interest paid above 30% of EBITDA not to be allowed as a tax deduction
  - Excess interest paid allowed to be carried forward for 8 years

# New Safe Harbour Rules (from FY 2016-17 to 2018-19)

| International Transaction   | Value of International Transaction (in INR) / Criteria   | Safe Harbour  |
|---|--|---|
| IT / ITES   | <ul style="list-style-type: none"> <li>Upto 100 crore</li> <li>Exceeds 100 crore upto 200 crore</li> </ul>                                 | <ul style="list-style-type: none"> <li>Not less than 17%</li> <li>Not less than 18%</li> </ul>                            |
| Knowledge processes outsourcing services  | Upto 200 crore & employee cost ratio of: <ul style="list-style-type: none"> <li>60% and above</li> <li>40-60%</li> <li>Upto 40%</li> </ul> | <ul style="list-style-type: none"> <li>Not less than 24%</li> <li>Not less than 21%</li> <li>Not less than 18%</li> </ul> |
| Contract research and development services wholly or partly relating to: <ul style="list-style-type: none"> <li>Software development</li> <li>Generic pharmaceutical drugs</li> </ul> | Upto 200 crore   | <ul style="list-style-type: none"> <li>Not less than 24%</li> </ul>   |
| Providing corporate guarantee   | None   | <ul style="list-style-type: none"> <li>Commission - not less than 1% p.a. on guaranteed amount</li> </ul>                 |
| Manufacture and export of: <ul style="list-style-type: none"> <li>core auto components</li> <li>non-core auto components</li> </ul>   | No monetary limit  | <ul style="list-style-type: none"> <li>Not less than 12%</li> <li>Not less than 8.5%</li> </ul>                           |
| Receipt of low value-adding intra-group services  | Upto 10 crore  | <ul style="list-style-type: none"> <li>Not exceeding 5%</li> </ul>  |

# New Safe Harbour Rules (from FY 2016-17 to 2018-19)

| International Transaction                                  | Value of International Transaction (in INR) / Criteria   | Safe Harbour  |
|--|--|---|
| Advancing of INR denominated intra-group loan              | CRISIL credit rating of AE: <ul style="list-style-type: none"> <li>• Between AAA to A or its equivalent</li> <li>• BBB-, BBB or BBB+ or its equivalent</li> <li>• Between BB to B or its equivalent</li> <li>• Between C to D or its equivalent</li> <li>• Not available and total amount of loan to AEs does not exceed 100 crores</li> </ul> | Not less than one-year marginal cost of funds lending rate of SBI, plus <ul style="list-style-type: none"> <li>• 175 bps</li> <li>• 325 bps</li> <li>• 475 bps</li> <li>• 625 bps</li> <li>• 425 bps</li> </ul> |
| Advancing of foreign currency denominated intra-group loan | CRISIL credit rating of AE: <ul style="list-style-type: none"> <li>• Between AAA to A or its equivalent</li> <li>• BBB-, BBB or BBB+ or its equivalent</li> <li>• Between BB to B or its equivalent</li> <li>• Between C to D or its equivalent</li> <li>• Not available and total amount of loan to AEs does not exceed 100 crores</li> </ul> | Not less than six month LIBOR, plus <ul style="list-style-type: none"> <li>• 150 bps</li> <li>• 300 bps</li> <li>• 450 bps</li> <li>• 600 bps</li> <li>• 400 bps</li> </ul>                                     |

\*SBI – State Bank of India

# Penalties

## Penalty provisions for cases involving under-reporting / misreporting of income (Section 270A):

| Nature of default / failure | Penalty prescribed                              | Sample instances related to Transfer Pricing   |
|-----------------------------|---|--|
| Under-reporting of income   | 50% of the tax payable on under-reported income | <ul style="list-style-type: none"> <li>• Non-maintenance of prescribed information and documents</li> <li>• Non-declaration of international transactions</li> <li>• Non-disclosure of all material facts relating to the transaction</li> </ul> |
| Misreporting of income      | 200% of the tax payable on misreported income   | <ul style="list-style-type: none"> <li>• Misrepresentation or suppression of facts</li> <li>• Failure to report any international transaction / deemed international transaction / specified domestic transaction</li> </ul>                     |

## Penalty provisions in relation to local transfer pricing compliances and documentation:

| Nature of default  | Penalty prescribed   |
|--|--|
| Failure to furnish Accountant's Report (i.e. a form prescribed for reporting of international transactions)  | INR 100,000  |
| <ul style="list-style-type: none"> <li>• Failure to report an international transaction</li> <li>• Failure to maintain prescribed information / documents</li> <li>• Maintenance or furnishing of incorrect information / documents</li> </ul> | 2% of value of international transactions as determined by the tax authorities |
| Failure to furnish information / documents during transfer pricing scrutiny assessment   | 2% of value of international transaction as determined by the tax authorities  |

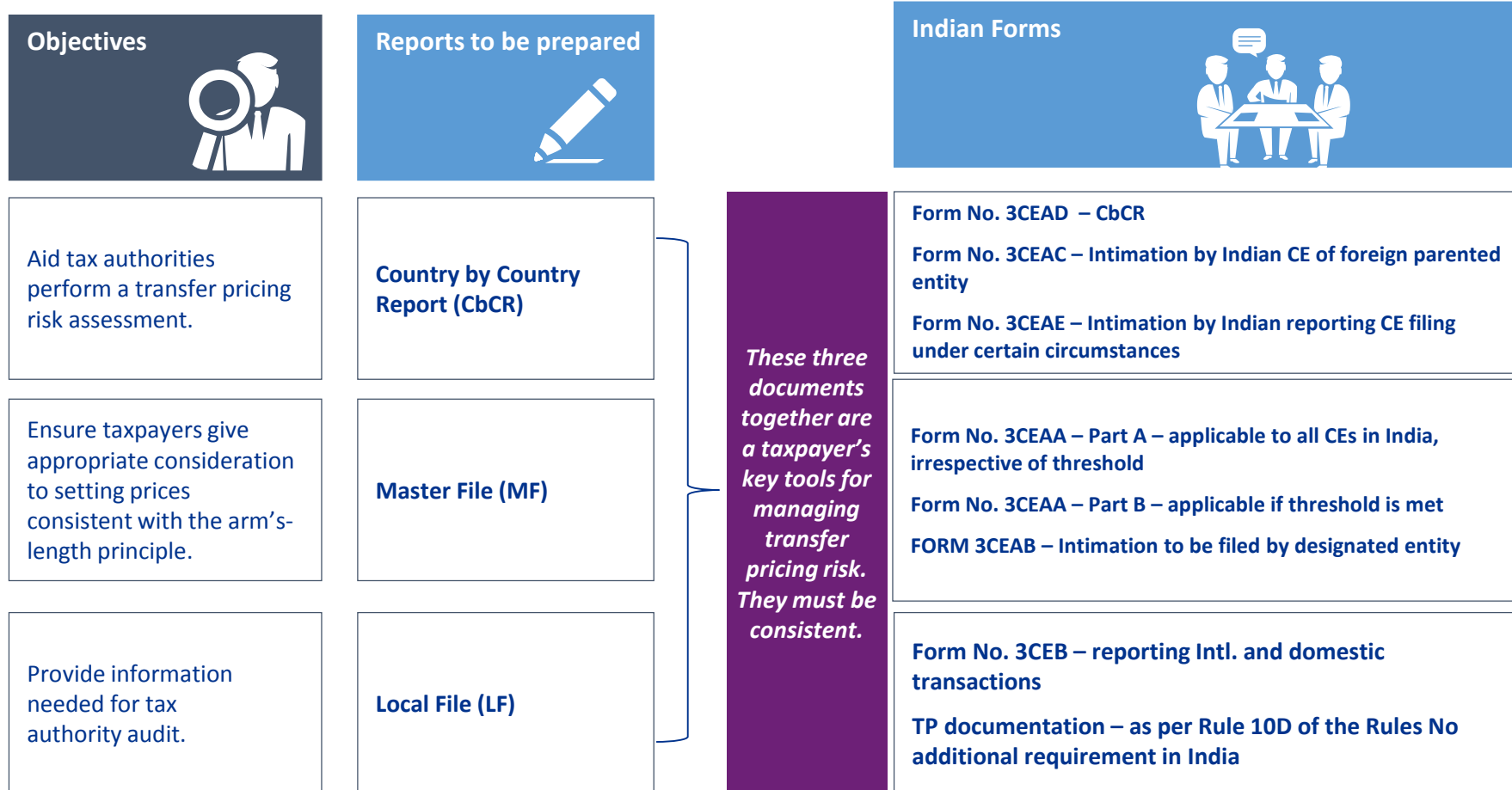
# Time limit for completion of assessment proceedings

| Assessment Year ('AY')                        | Time limit  | Due Date for Completion   |   |
|---|---|---------------------------|---|
|   |   | Cases not referred to TPO | Cases referred to TPO                                       |
| <b>Existing Time Limit</b>                    |   |                           |   |
| 2017-18                                       | 21 months from the end of relevant AY<br><b>Plus</b><br>12 months in case of reference to TPO | AO order - 31 Dec. 2019   | TPO order – 31 Oct. 2020;<br>Draft AO order – 31 Dec. 2020  |
| <b>Proposed Time Limit as per Budget 2017</b> |   |                           |   |
| 2018-19                                       | 18 months from the end of relevant AY<br><b>Plus</b><br>12 months in case of reference to TPO | AO order - 30 Sept. 2020  | TPO order – 31 July 2021;<br>Draft AO order - 30 Sept. 2021 |
| 2019-20 & subsequent AYs                      | 12 months from the end of relevant AY<br><b>Plus</b><br>12 months in case of reference to TPO | AO order - 31 Mar 2021    | TPO order – 31 Jan. 2022;<br>Draft AO order - 31 March 2022 |

# Alignment of TP Regulations with BEPS Measures



# Three Tiered Documentation – Objective & Approach



Indian Government introduced BEPS Action 13 related provisions through Finance Act 2016 to align with OECD Guidelines. Final Rules for Master File and CbCR were released in October 2017



# Master file - Applicability in India

## Applicability



| Particulars  | Value during the accounting year  |
|--|-----------------------------------|
| Consolidated group revenue for the reporting accounting year exceeds | INR 500 Crore<br>(USD 75 million) |
| And  |                                   |
| Aggregate value of international transactions:                       |                                   |
| a. overall as per books exceeds                                      | INR 50 Crore<br>(USD 7.5 million) |
| OR   |                                   |
| b. of intangible transactions as per books exceeds                   | INR10 Crore<br>(USD 1.5 million)  |

## Time Lines



| Financial Year (FY)    | Time Line                                 |
|------------------------|---|
| FY 2016-17             | 31 March 2018                             |
| FY 2017-18 and onwards | 30 Nov following fiscal year end in March |

**All documents to be filed with the Director General of Income-tax (Risk Assessment)  
E-filing procedures to be provided**

# Indian Regulations – Master File

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## ✓ Form 3CEAA: Master File – Consists of two parts

### **Part A** –

- required to be filed by every Constituent Entity (CE) of an international group whether or not it satisfies the cumulative thresholds mentioned in the table
- only requires disclosure of basic details such as name of the group, number of CEs in India, their names, addresses and PAN etc.

### **Part B** –

- Detailed Form - required to be filed only by those CEs which satisfy the cumulative thresholds mentioned in the table

## ✓ Form 3CEAB : Intimation for Master File where there are more than one CEs resident in India :

- The international group may opt to designate any one CE,
- Form 3CEAB to be filed only by the designated CE,
- 30 days prior to the due date of filing the Form 3CEAA.



# Master file requirements

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## The Master File should include a high level overview of the MNE, covering following:

- Organisation structure – legal and ownership along with geographic location of entities
- A general description of the business including:
  - Important drivers of business profit.
  - **Description of the supply chain (products / services - five largest by turnover plus those that represent more than 5% of turnover).**
  - Important intra-group services.
  - Description of the main geographies of products / services identified above.
  - Functional analysis describing principal contributions to value creation.
  - Important business restructurings.
- Intangibles including:
  - **MNE's overall strategy for the development of intangibles.**
  - A list of important intangibles.
  - Important agreements relating to intangibles, including CCAs,
  - R&D and License agt.'s.
  - Transfer pricing policies related to R& D and intangibles.
  - Important transfers of intangibles.
- Intra-group financial activity including:
  - How the MNE is financed.
  - **Identification of central financing companies.**
  - Transfer pricing policies relating to financing.
- Financial and tax positions including:
  - Consolidated financial statement.
  - Unilateral APAs; and other tax rulings relating to the allocation of income.

## Additional MF requirements as per Indian regulations

List of all entities of the group.

Description of FAR analysis of all the CEs that contribute at least 10 percent of the revenues or assets or profits of the group.

A list of all the entities of the international group engaged in development and management of intangible property along with their addresses

Detailed description of the financial arrangement of the group including the names and address of the top ten unrelated lenders.

# CbCR Filing – Applicability in India

| <b>Applicability</b><br> | <b>Particulars</b>  | <b>Value during the accounting year</b>                                   |
|---|---|---|
| <b>Time Lines</b><br>   | <b>Financial Year (FY)</b>  | <b>Time Line</b>  |
|   | Consolidated group revenue for the accounting year <u>preceding</u> the reporting year exceeds                    | INR 5,500 Crore<br>(in line with Action 13 threshold of EURO 750 million) |
|   | FY 2016-17  | 31 March 2018   |
|   | FY 2017-18 and onwards  | 30 Nov following fiscal year end in March                                 |
|   | Notification by Constituent entities (CE) of foreign inbound MNEs<br>(2 months prior to deadline for filing CbCR) | 30 Jan 2018 for FY 2016-17<br>30 Sep for each subsequent FYs              |

# Indian Regulations - CbCR

|   | Category   | Requirement  | Observations   |
|---|--|--|--|
| 1 | Parent entity or alternate reporting entity, resident in India*  | To file CbCR in Form 3CEAD (for every reporting accounting year).<br><br>The information included in the Form is similar to those recommended in Action Plan 13  | CEs in India other than the reporting Indian entity, need not file any intimation / notification with the Indian Revenue authorities (IRA)   |
| 2 | Constituent entity resident in India*, of foreign parented group   | To file CbCR intimation in Form 3CEAC.<br><br>Vide this Form the CE intimates <ul style="list-style-type: none"> <li>• Whether it is alternate reporting entity of the group; or</li> <li>• The <u>details of parent entity or the alternate reporting entity and the country/territory of which said entity is a resident</u></li> </ul>  | Intimation to be filed by <u>every constituent entity resident</u> in India at least two months prior to the due date of furnishing of CbCR.<br><br>The deadline for filing intimation in Form 3CEAC also stands extended to 31 January 2018 for FY 2016-17 as the deadline for filing CbCR is extended to 31 March 2018 |
| 3 | Constituent entity resident in India*, of foreign parented group , falling under – following circumstances <ul style="list-style-type: none"> <li>• no agreement for exchange of CbCR, or</li> <li>• systemic failure by parents jurisdiction</li> </ul> | To file CbCR in Form 3CEAD (for every reporting accounting year).<br><br>In case there are more than one CEs resident in India, <ul style="list-style-type: none"> <li>• the international group may opt to designate any one CE,</li> <li>• Form 3CEAD to be filed only by the designated CE,</li> <li>• The intimation in Form 3CEAE needs to be filed by the designated CE</li> </ul> | Due date for filing CbCR is the same, as above<br><br>Due date for filing of intimation by the designated has not been prescribed.   |

\* Use of term “resident in India” - CbCR filing and intimation for CbCR not applicable to non-resident entity operating in India only through a Permanent Establishment (PE)

# CbCR Requirements

## Part A - Overview of allocation of income, taxes and business activities by tax jurisdiction

| Tax jurisdiction | Unrelated party revenue | Related party revenue | Total revenue | Profit (loss) before income tax | Income tax paid (on a cash basis) | Income tax accrued – Reportable Accounting year | Stated capital | Accumulated earnings | Number of employees | Tangible assets other than cash and cash equivalents |
|------------------|-------------------------|-----------------------|---------------|---------------------------------|-----------------------------------|---|----------------|----------------------|---------------------|--|
| Country A        | x                       | x                     | x             | x                               | x                                 | x   | x              | x                    | x                   | x  |
| Country B        | x                       | x                     | x             | x                               | x                                 | x   | x              | x                    | x                   | x  |

## Part B - List of all the constituent entities of the multinational enterprises group included in each aggregation per tax jurisdiction

| Activities       |   |   |                          |   |                           |                             |                                  |  |  |                        |                              |           |  |         |       |
|------------------|---|---|--------------------------|---|---------------------------|-----------------------------|----------------------------------|--|--|------------------------|------------------------------|-----------|--|---------|-------|
| Tax jurisdiction | Constituent entities resident in the tax jurisdiction | Tax jurisdiction of organisation or incorporation if different from tax jurisdiction of residence | Research and development | Holding or managing intellectual property | Purchasing or procurement | Manufacturing or production | Sales, marketing or distribution | Administrative, management or support services | Provision of services to unrelated parties | Internal group finance | Regulated financial services | Insurance | Holding shares or other equity instruments | Dormant | Other |
| Country A        | Entity A  | Country B   |                          | ✓   |                           |                             |                                  |  |  |                        |                              |           |  |         |       |
|                  | Entity B  |   |                          |   | ✓                         | ✓                           |                                  |  | ✓  |                        |                              |           |  |         | ✓     |
| Country B        | Entity C  |   | ✓                        |   |                           |                             |                                  |  |  |                        |                              | ✓         |  |         |       |
|                  | PE 1  |   |                          |   |                           |                             | ✓                                |  |  |                        |                              |           |  |         |       |

# Stringent penalties prescribed

Failure to furnish master file by the due date will attract penalty of be INR 500,000 (approx. USD 7,500).

| Penalty for CbCR :   | Delay upto one month  | Delay beyond one month                   | Further delay - after receipt of penalty order |
|--|---|--|--|
| Failure to furnish CbCR by the due date of filing of return of income                                    | INR 5,000 (USD75) per day   | INR 150000 + INR 15,000 (USD230) per day | INR 50,000 (USD 750) per day                   |
| Failure to furnish additional information and documents sought by the Revenue authorities                | INR 5,000 (USD 75) per day from the day on which the period for furnishing the information and document expires |  | INR 50,000 (USD 750) per day                   |
| Inaccurate information filed under the CbCR<br><i>(Penalty to be levied based on certain conditions)</i> | INR 500,000 (USD 7500)  |  |  |

Quiz





# Quiz

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1. Which transfer pricing method is the used least in India ?

- a) CUP
- b) TNMM
- c) RPM
- d) PSM

2. Does transfer of shares between two non-residents of an Indian entity will be subjected to Indian transfer pricing regulations?

What if transaction is exempt as per DTAA?

3. What is the threshold for maintaining mandatory TP documentation and filing of Accountant's Report?

- a) 5 crores
- b) 20 crores
- c) 1 crore
- d) NIL

4. As per the Master File rules, recently released in India, a notification in Form 3CEAB is required to be filed within

- 
- a) 30 days prior to the due date of filing Master file
  - b) 60 days prior to the due date of filing Master file

# Quiz

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5. Finance Act 2017 introduced the concept of \_\_\_\_\_ in India
- a) Three tier documentation
  - b) Secondary adjustment
6. The penalty for under-reported income, as per Section 270A, is \_\_\_\_\_
- a) 100 to 300%
  - b) 200%
  - c) 50%
7. Does TP provisions apply to transaction between two unrelated parties ?
- a) Yes
  - b) No
  - c) On a case to case basis
8. As per the TP provisions, the only way to study the ALP, is to compare the "prices"?
- a) True
  - b) False
- What other ways of comparing you think of?

# Questions?



Thank you