

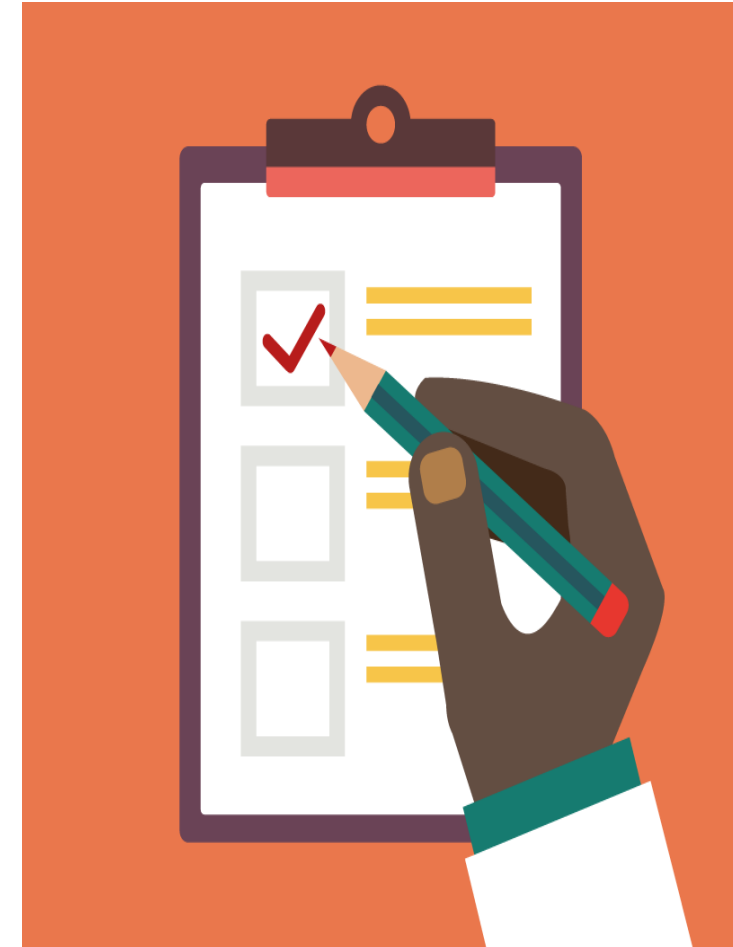
Basics of Transfer Pricing principles in India

**Presented by:
CA Rushabh Vora**

Agenda

AGENDA

- ✓ Concept of Transfer Pricing
- ✓ TP Overview – Global & India
- ✓ Important Definitions
- ✓ Most Appropriate Method
- ✓ 3-Tier Documentation
- ✓ FAR Analysis
- ✓ Economic Analysis
- ✓ Transfer Pricing Audit process
- ✓ Dispute/ Litigation Mechanism
- ✓ Penalties
- ✓ Recent amendment/ introduction in TP
- ✓ Complex issues/ Litigation
- ✓ Opportunities for CAs
- ✓ Way Forward/ Q & A





Concept of Transfer Pricing

“WH” Questions?

What is Transfer Pricing?

Why is there a need?

When do provisions originate?

How does it work?

Transfer Pricing | What

What is Transfer Pricing??

- The process of fixation of Pricing of any Transaction between Associated Enterprises of MNC's is Known as "Transfer Pricing".
- *The OECD defines "transfer Pricing" as prices at which an enterprise transfers physical goods and intangible property or provides services to associated enterprise.*



Transfer Pricing:
*Keeping it at Arm's
Length*



Transfer Pricing | Why

THE FINANCIAL EXPRESS

www.financialexpress.com

Read to Lead

Apple, Starbucks and Fiat's tax affairs examined by European commission

Brussels is looking into the tax affairs of Apple, Starbucks and Fiat. "It is particularly important that large multinationals pay their fair share of taxes," said the European commission's top competition regulator, Joaquín Almunia.

THE FINANCIAL EXPRESS

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Read to Lead

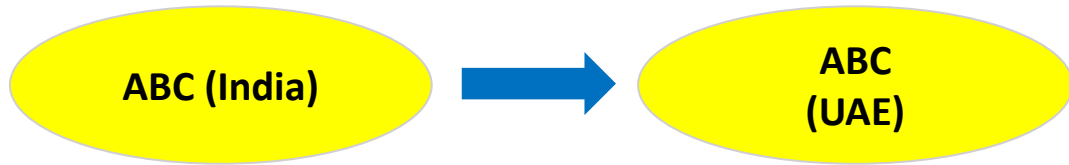
Anger as Starbucks boss says: We may not pay UK tax for up to three years

- Chief Executive Mark Fox said chain aimed to be profitable by 2017
- Mr. Fox insisted there was 'nothing abnormal' about the way firm was run
- Starbucks slated in 2012 after paying just £8.6m in tax on £3bn of sales
- Coffee chain remains under investigation by the European Commission
- It volunteered to pay £20 million tax payment in 2012 after complaints

Do taxpayers have a "moral duty" to pay their "fair share" of taxes?

Transfer Pricing | How

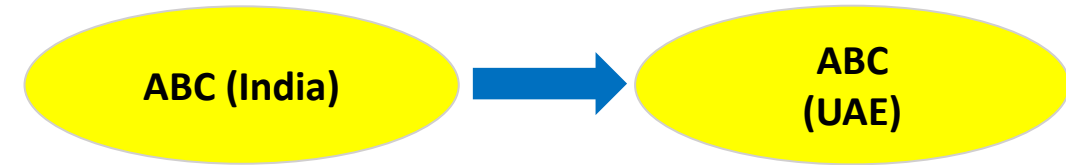
Situation 1



Particulars	India	UAE
Revenue	1000	1350
COGS	700	1000
Other costs	200	300
Profit	100	50
CIT Rate	10%	0%
Tax	10	0

Consolidated Tax $10 + 0 = 10$

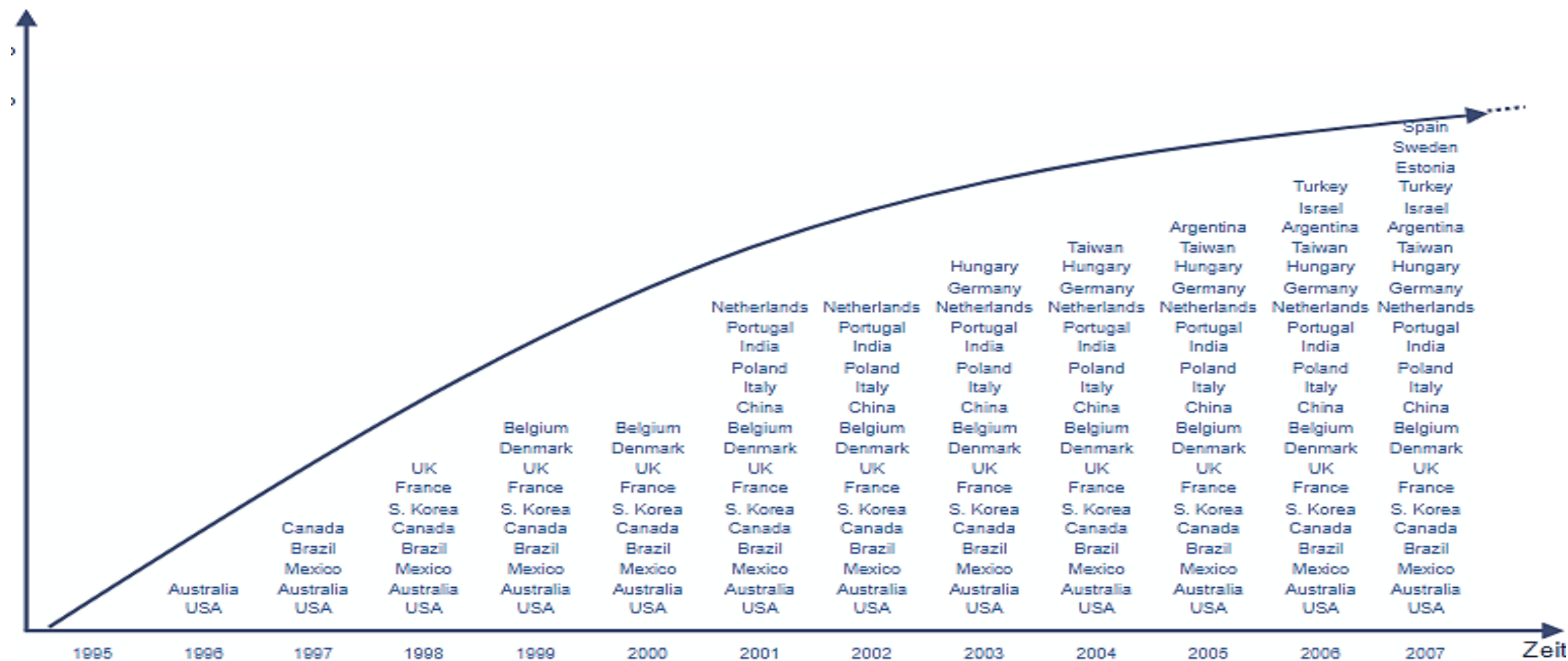
Situation 2



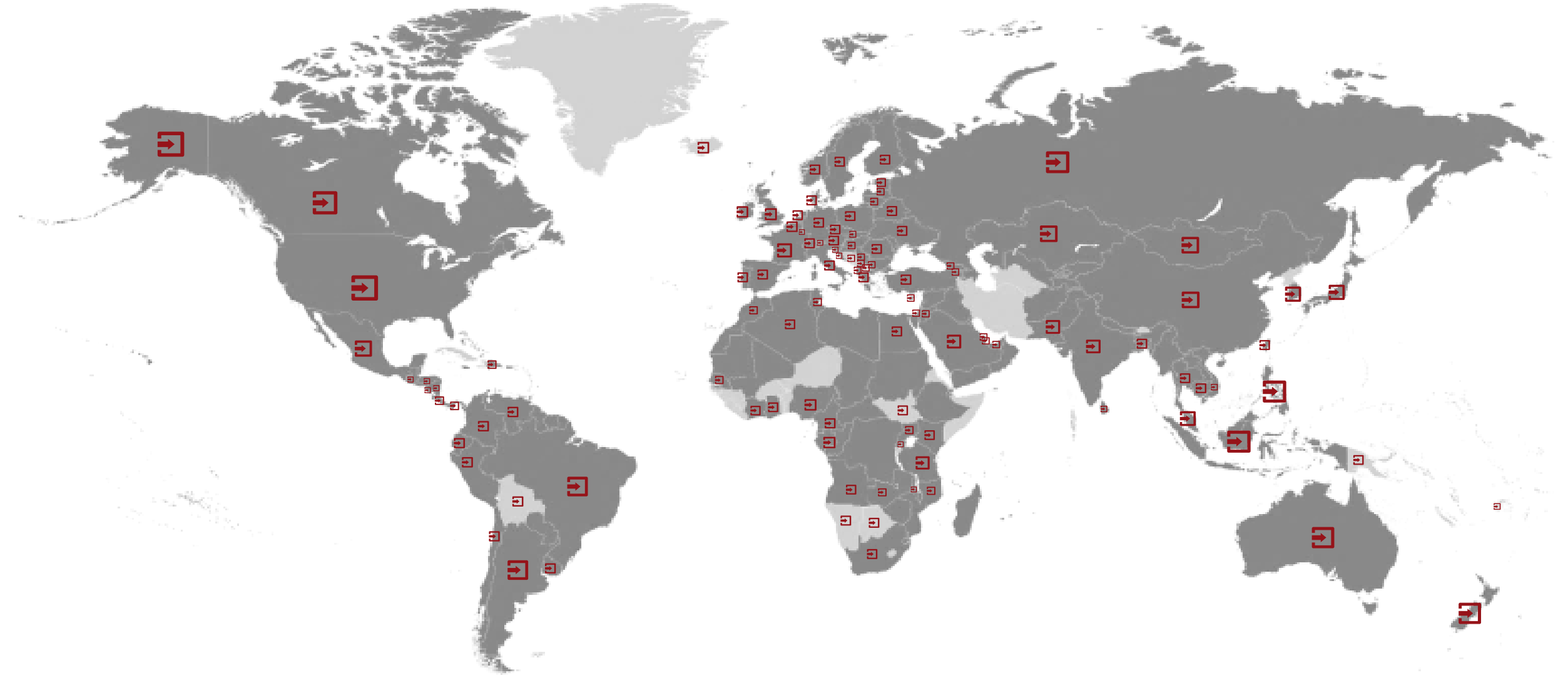
Particulars	India	UAE
Revenue	910	1350
COGS	700	910
Other costs	200	300
Profit	10	140
CIT Rate	10%	0%
Tax	1	0

Consolidated Tax $1 + 0 = 1$

Transfer Pricing | When

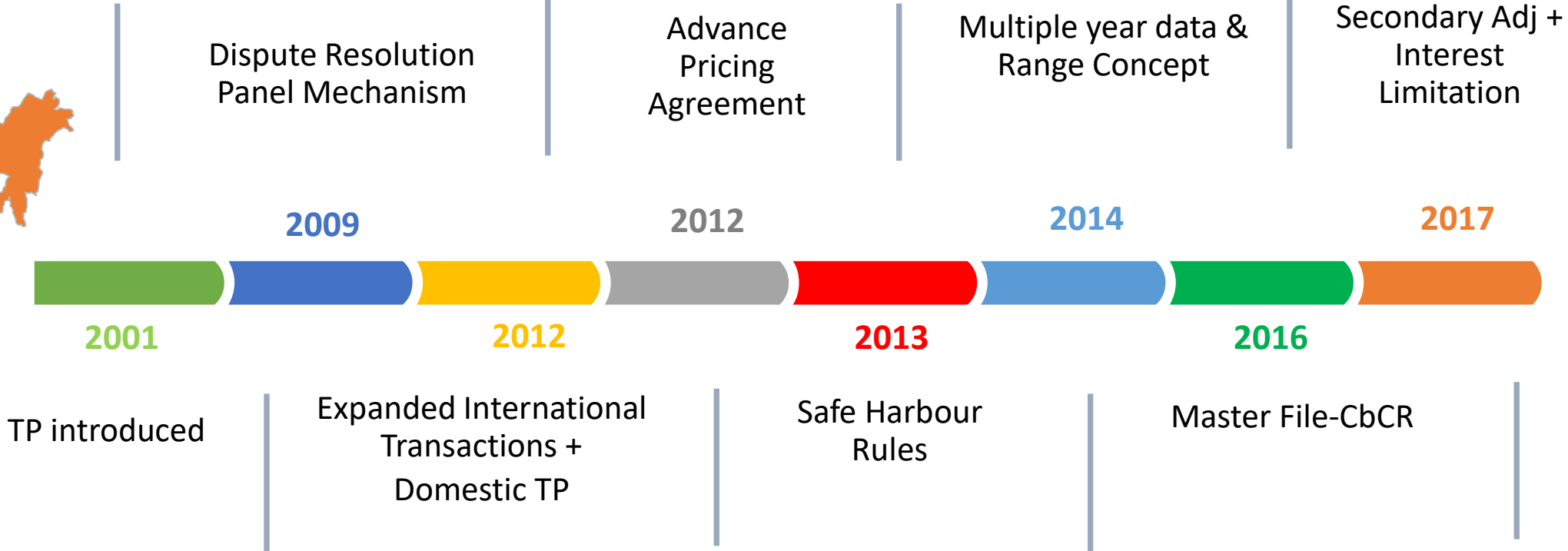
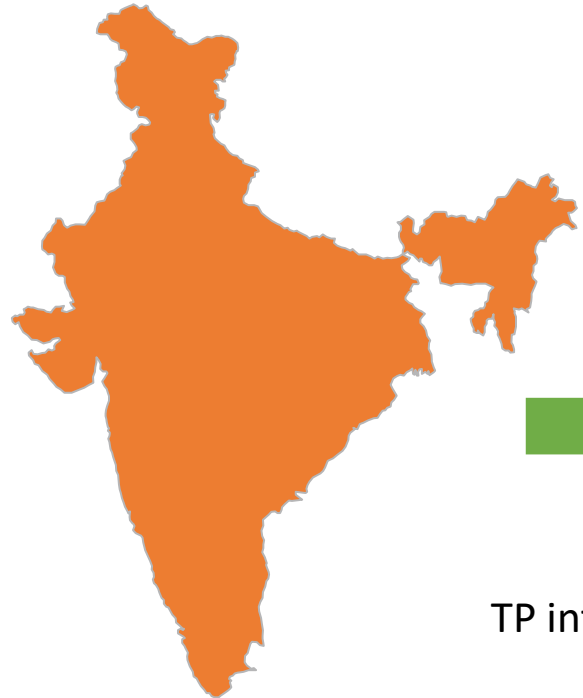


TP Regulations | Global Snapshot



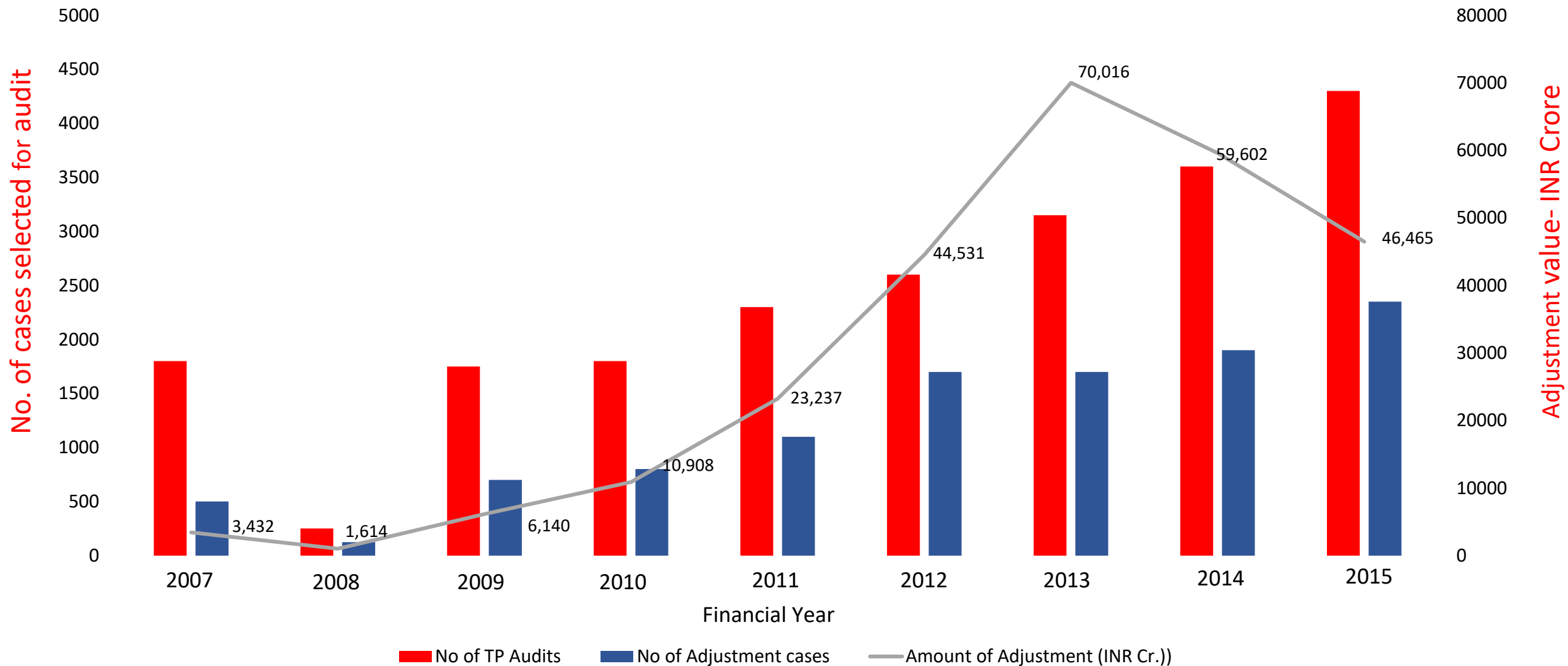
India Transfer Pricing

India | TP Landscape

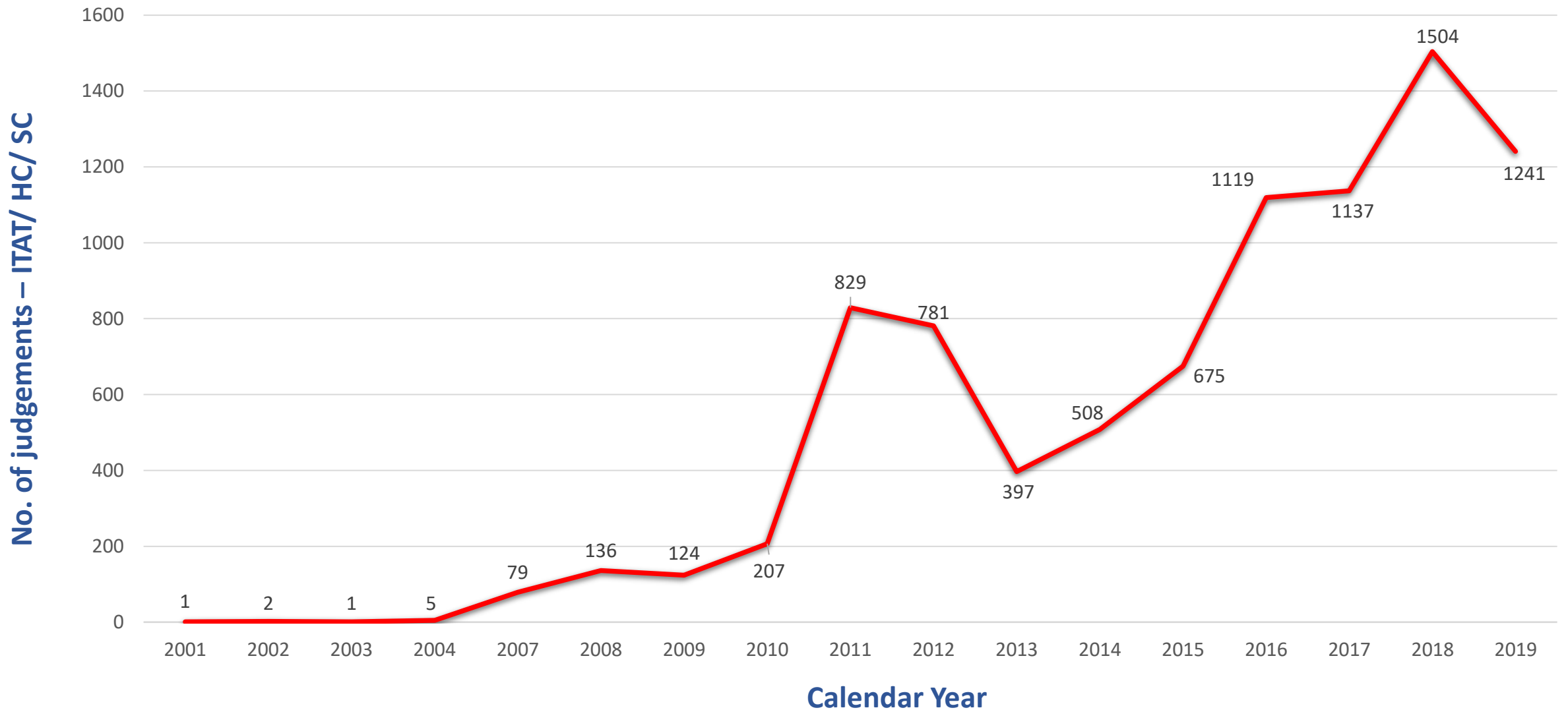


2+ Decades of Transfer Pricing in India

Statistics on TP Adjustments in India

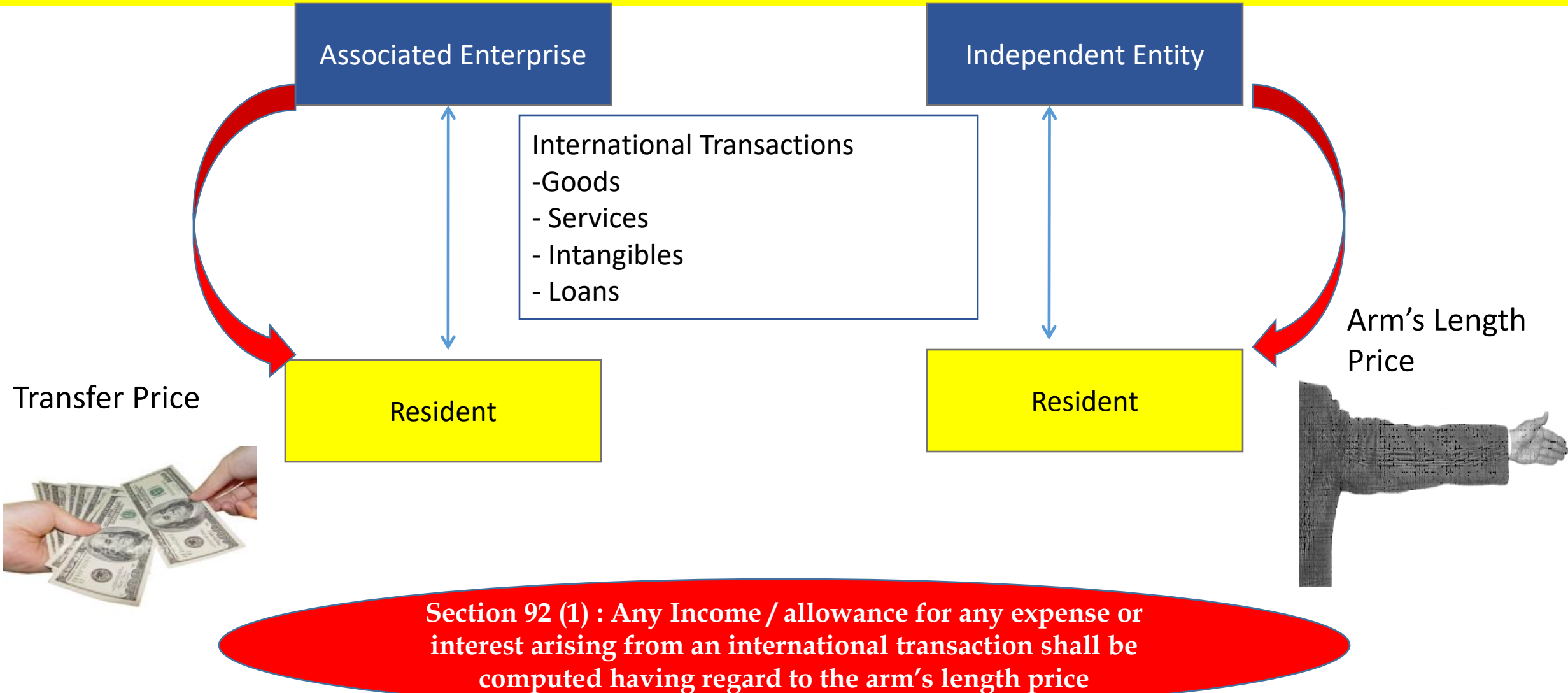


Snapshot of Transfer Pricing Rulings in India



Note: These are broad numbers based on our analysis of public domain data

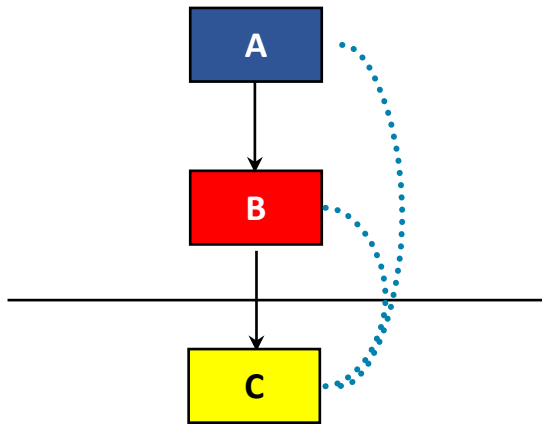
Applicability



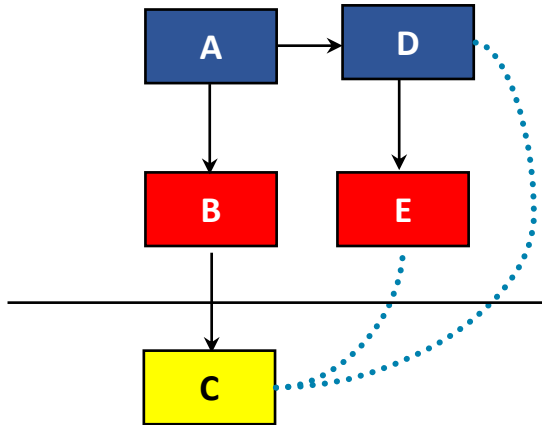


Associated
Enterprises

Section 92A(1): Meaning of Associated Enterprises



Both A and B are associated enterprises of C



D and E are also associated enterprises of C since they have a common ultimate parent (A)

- ✓ **Direct or indirect** participation (through one or more intermediaries) in **management, control or capital**
- ✓ As per ICAI guidance notes:
 - **Capital:** Refers to the amount invested in an enterprise by its owners.
 - **Management/ Control:** Individual along with his relative has power to control to make crucial decisions regarding the enterprise - a proactive and not reactive power.
- ✓ If any condition is satisfied during the year, then it will be AE for the whole year.

Section 92A(2): Associated Enterprises

Holding/ Capital	Management	Activities	Control
<p>1. $\geq 26\%$ direct / indirect holding by enterprise</p> <p><u>OR</u></p> <p>2. By same person in each enterprise</p> <p>3. Loan $\geq 51\%$ of Total Assets</p> <p>4. Guarantees $\geq 10\%$ of debt</p> <p>5. $> 10\%$ interest in Firm/ AOP / BOI</p>	<p>6. Appointment $> 50\%$ of Directors / one or more Executive Director by an enterprise</p> <p><u>OR</u></p> <p>7. Appointment by same person in each enterprise</p>	<p>8. 100% dependence on use of intangibles for manufacture/ processing / business</p> <p>9. Direct / indirect supply of $\geq 90\%$ Raw Materials under influenced prices and conditions</p> <p>10. Sale under influenced prices and conditions</p>	<p>11. One enterprise controlled by an individual and the other by himself or his relative or jointly</p> <p>12. One enterprise controlled by HUF and the other by</p> <ul style="list-style-type: none"> - a member of HUF - his relative or - Jointly by member and relative



International Transactions

Section 92B : International Transactions

- ✓ Transaction between two or more Associated Enterprises
- ✓ Either or both of whom are non-residents
- ✓ Definition of transaction u/s 92f(v)
 - transaction” includes an arrangement, understanding or action in concert –
 - (A) formal or in writing or
 - (B) whether or not enforceable by legal proceeding



Section 92B : International Transactions

International Transaction

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

Capital Financing

- Long/short term borrowing/ lending
- Guarantee
- Purchase/Sale Securities
- Advance/receivable, Payments/ any debt

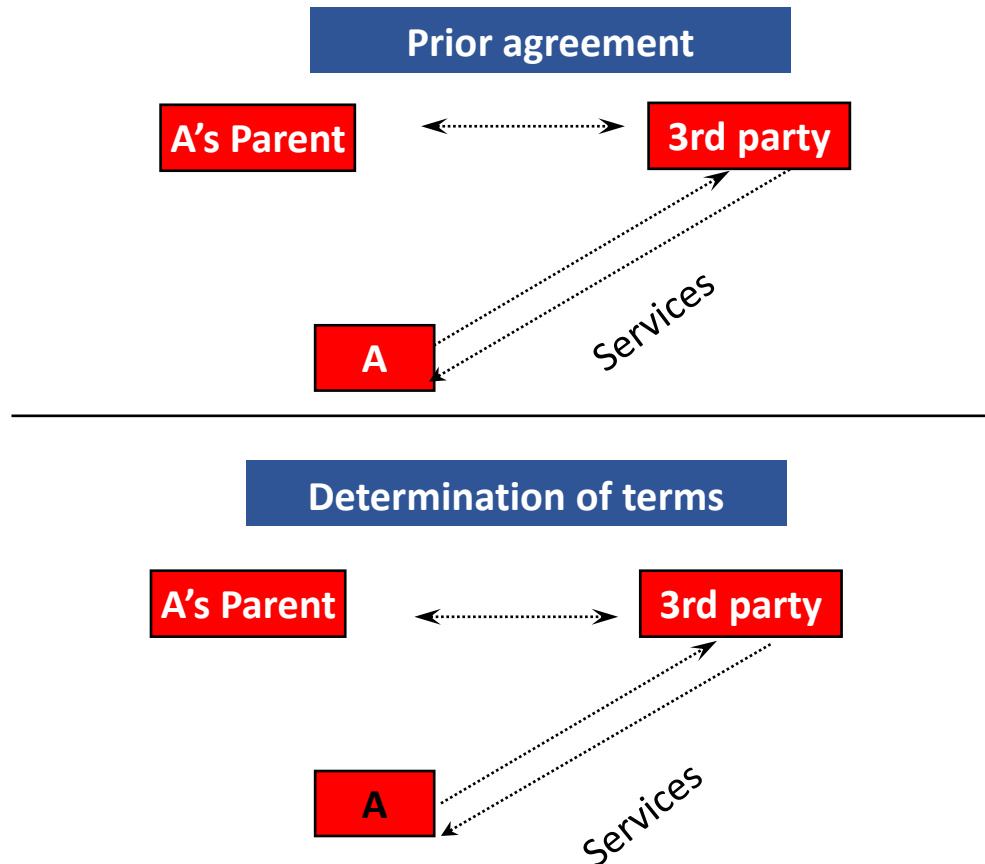
Provision of Services

- 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

Section 92B(2): Deemed International Transaction



✓ Any transaction with an unrelated company (3rd party) is deemed to be an international transaction and subject to transfer pricing regulations if:

- a **prior agreement** exists between A's AE and 3rd party in relation to services rendered by A to the 3rd party; or
- **terms of transaction** are determined in substance by A's AE and 3rd party

✓ Amendment in Finance Act, 2014.

Transactions with non-group companies may deem to be international transactions and thus, may be subject to Transfer Pricing Regulations



Most Appropriate
Method

Section 92C: Most Appropriate Method

Traditional Methods

Comparable
Uncontrolled
Price Method



Resale Price Method



Cost Plus Method



Most Appropriate
Method



Profit Based Methods

Profit Split
Method



Transactional Net
Margin Method

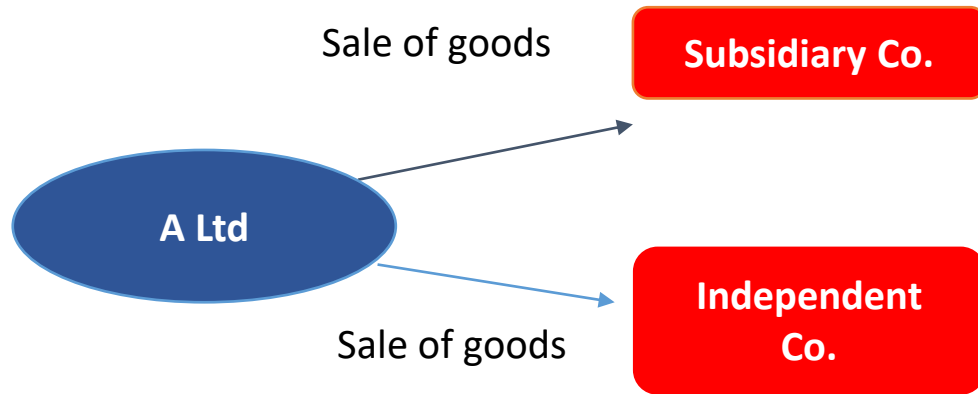


Other Method



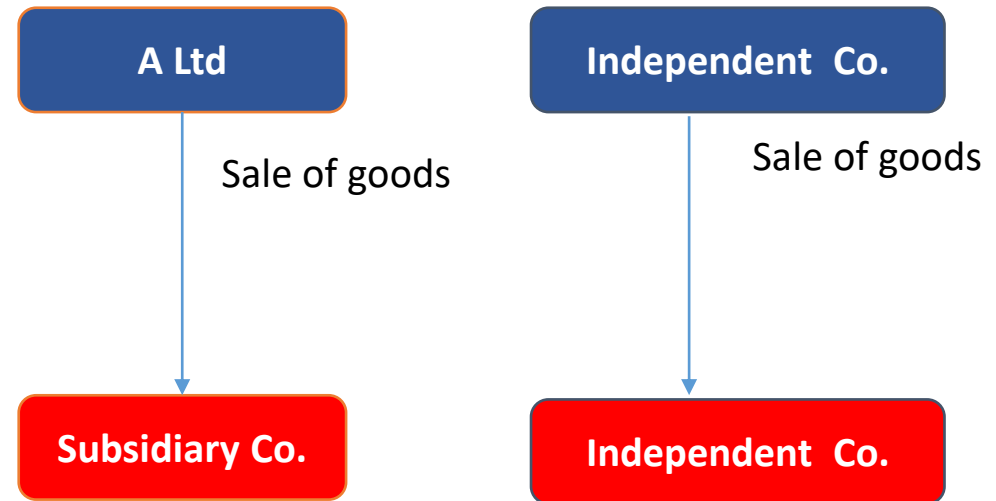
Comparable Uncontrolled Price Method (CUP)

Internal CUP



Internal CUP is preferable

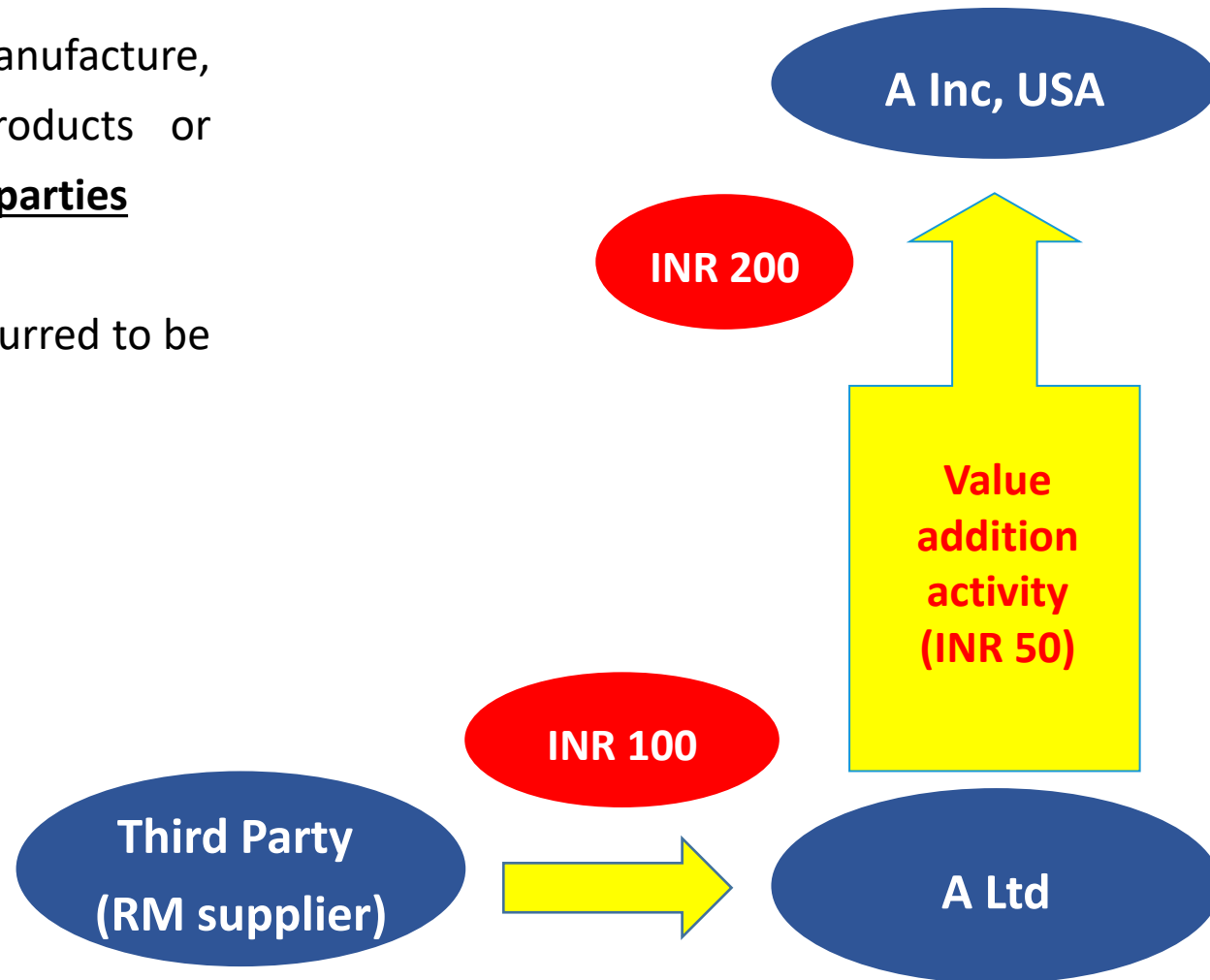
External CUP



Strict similarity of products or services?

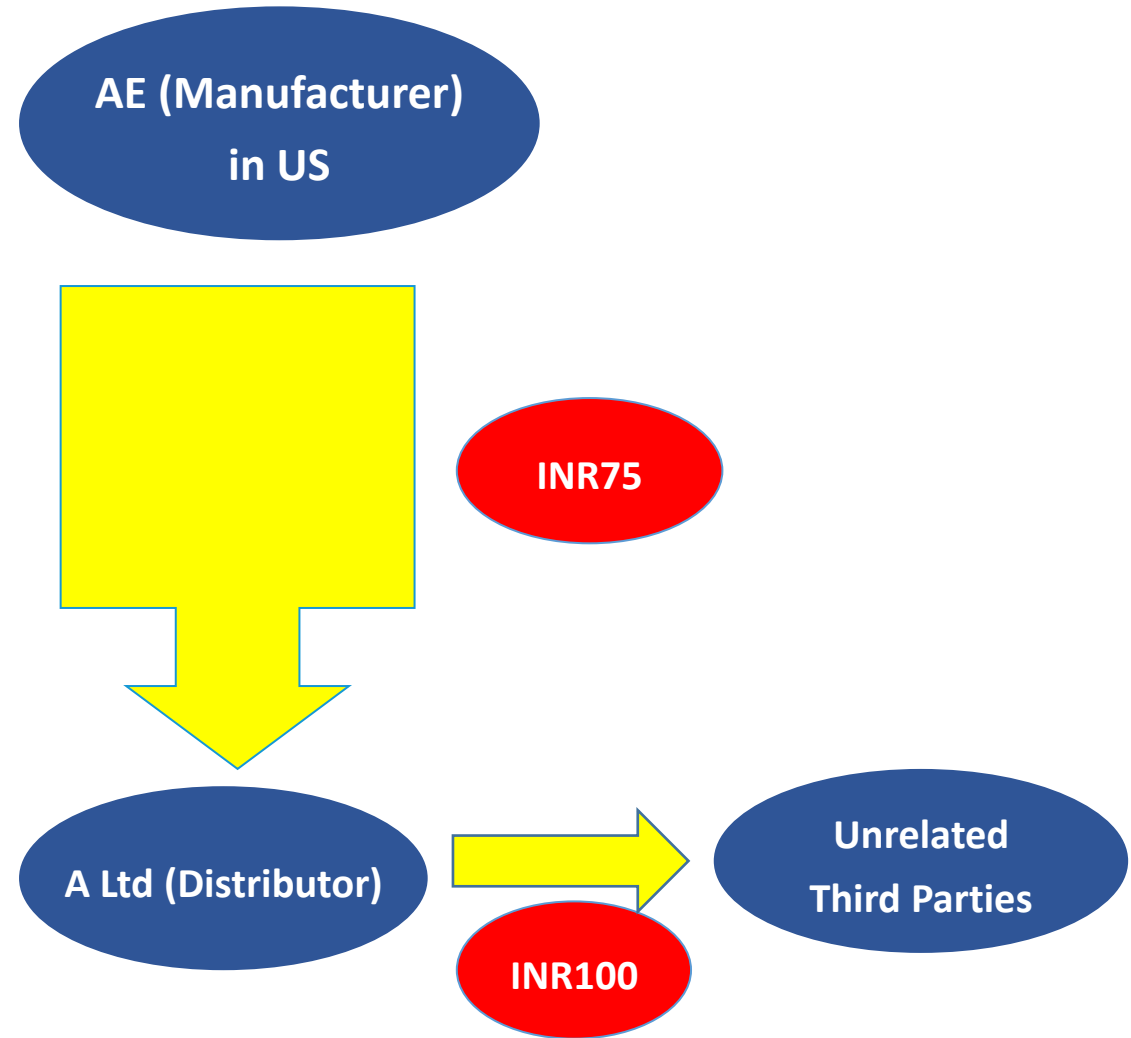
Cost Plus Method (CPM)

- Method used in cases involving manufacture, assembly or production of tangible products or services that are **sold / provided to related parties**
- The mark up on direct and indirect costs incurred to be based on unrelated comparables
- **Gross margins** are compared



Resale Price Method (RPM)

- Method used in case of purchase of goods or services from related parties for resale to unrelated parties without substantial value addition
- The price is reduced by the normal gross margins earned by unrelated party for same or similar products or services; and
- Need for similarity of functions performed and risks undertaken
- Gross margins are compared



Profit Split Method (PSM)

- Splitting the combined net profit of associated enterprises arising from international transaction between respective entities based on their relative contribution to the net profits
- Typical Transactions where PSM is applied:
 - Interrelated, integrated transactions
 - Participation in development of high Value intangibles
- Rarely used in practice



PSM is contribution analysis, rather than comparability analysis

Transactional Net Margin Method (TNMM)

- Most preferred and practical method vis-à-vis the assesses
- Examines **operating profit** from transactions as a percentage of appropriate base (can use different bases i.e. cost, turnover, capital employed etc) in respect of similar parties
- Broad level of similarity of resources employed, functions performed and risks borne
- Operating margin of Indian company from AE to be compared with either (1) Non-AE segment; or (2) Similar enterprises in uncontrolled transaction

Particulars	AE segment	Non – AE segment	Total
Sales	110	100	210
Purchases	85	80	165
Other Administrative Expenses	12	10	22
Operating Profit	13	10	23
OP/Sales (%)	11.81%	10%	10.95%



Other Method – An insight

- ✓ With the introduction of Rule 10AB(2), it is possible to use “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 transactions, with or between non-associated enterprises, under similar circumstances, considering all the relevant facts.

- ✓ Data which may be used for comparability purposes could be:
 - Third party quotations
 - Valuation reports
 - Tender/Bid documents
 - Documents relating to negotiations
 - Standard rate cards
 - Commercial and economic business models

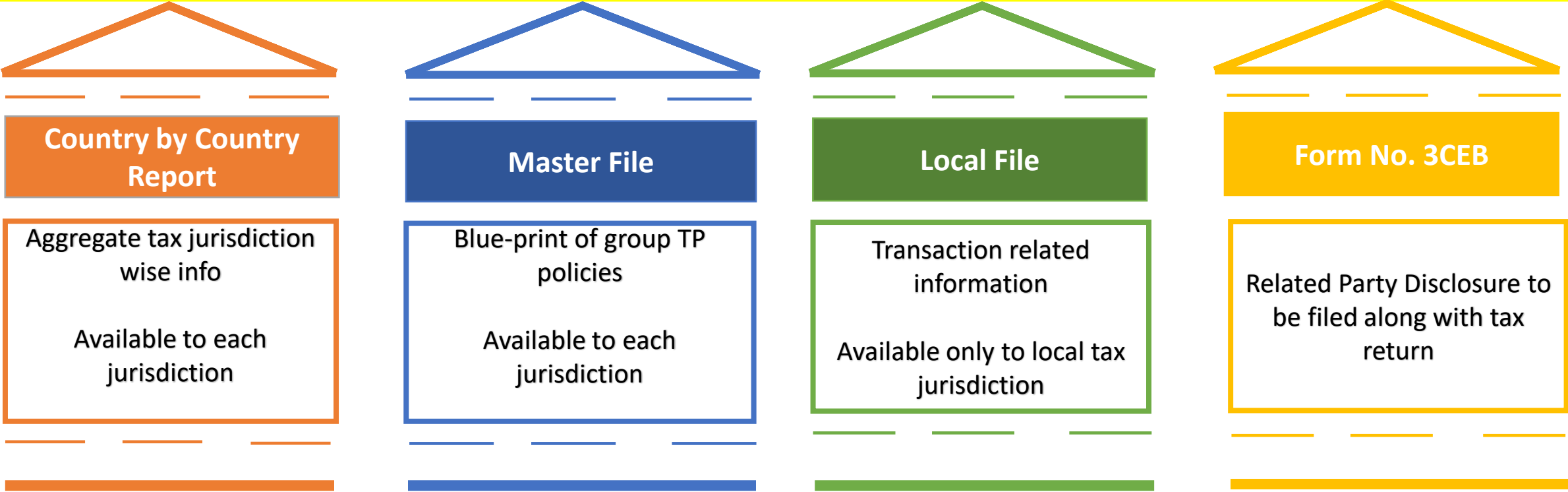
Comparability under MAM

Methods	Comparability level required	Comparison of	Suitability
CUP	High (Requires strict product comparability)	Price	Transactions including intangibles, commodity, loans where price can be compared
RPM	High (Functional comparability)	Gross Profit margin	Distribution of finished products
CPM	High (Functional comparability)	Gross Profit Margin	Provision of services, transfer of semi-finished goods, sale of finished goods
PSM	May not be relevant	Individual transaction profit margin	A group of AEs involved in integrated transactions, usually involves intangibles
TNMM	Medium (Functional comparability)	Operating profit margin	Purchase/ sale of goods, provision/ availing of services



Transfer Pricing Compliance in India

BEPS Action Plan 13 | 3-Tier Documentation



More than 135 countries adopted 3-Tier documentation approach of OECD BEPS Framework

Transfer Pricing Compliance Requirement in India

	CbC Report	Master File	Local TP File	Form No. 3CEB
Threshold	<ul style="list-style-type: none"> Group consolidated turnover of INR 6,400 crores 	<ul style="list-style-type: none"> Group consolidated turnover of INR 500 crores; and Total trn of 50 crores; or Intangible trn of 10 crore 	<ul style="list-style-type: none"> Mandatory if transaction more than INR 1 crore Recommended to prepare even if lesser transaction 	<ul style="list-style-type: none"> Single rupee of cross-border related party transaction Applicable for certain domestic transaction
Due Date	<ul style="list-style-type: none"> CbC Report – 12 months from end of FY CbC Intimation – 60 days before due date of CbC Report 	<ul style="list-style-type: none"> 30th November following the FY Designation form to be filed 30 days before 	<ul style="list-style-type: none"> 31st October following the FY To be submitted only upon request 	<ul style="list-style-type: none"> 31st October following the FY
Contents	<ul style="list-style-type: none"> Details of all Group entity Jurisdiction-wise tax., income, assets, employees, etc Jurisdiction-wise activity information 	<ul style="list-style-type: none"> List of all Group entity FAR profile; profit driver Supply chain; structuring Intra-group financing Intangible info and policy Tax ruling; Consolidated FS 	<ul style="list-style-type: none"> Business of Indian entity and related party Industry overview Functional and economic analysis TP methodology; profitability analysis 	<ul style="list-style-type: none"> Certification of Indian CA Related Party Disclosure Transaction-wise disclosure Amount; TP Methodology

Transfer Pricing Compliance | Due Date in India

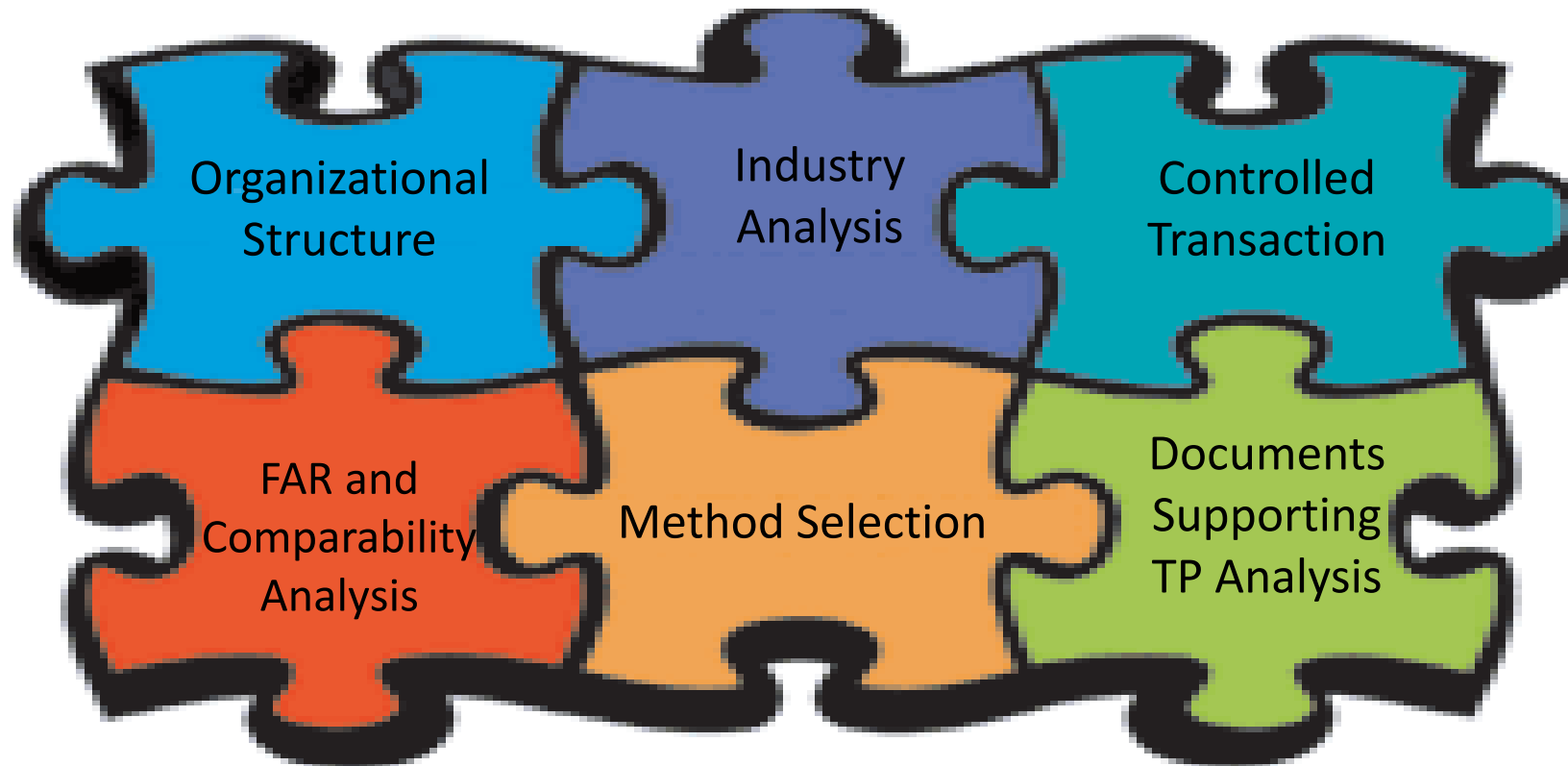
Sr. No.	Nature of Compliance	Form No.	Due Date (every year)
1	Transfer Pricing Disclosure/ Audit	Form No. 3CEB	31 st October
2	Transfer Pricing Documentation (Local File)	NA	31 st October
3	Master File Compliance	Form No. 3CEAA (Part A)	30 th November
		Form No. 3CEAA (Part B)	30 th November
		Form No. 3CEAB	31 st October
4	Country by Country Reporting (Notification) (India headquarter)	Form No. 3CEAC	31 st January
5	Country by Country Reporting (India headquarter)	Form No. 3CEAD	31 st March
6	Safe Harbour Form	Form No. 3CEFA	30 th November



3-Tier Documentation

Local TP Documentation File | Fixing the Jigsaw Puzzle

- A taxpayer who has entered into controlled transactions with AE is required to prepare contemporaneous local Transfer Pricing Documentation



Local Transfer Pricing Documentation

Entity Related	Price Related	Transaction Related	Supporting Documents
<ul style="list-style-type: none"> ➤ Industry Overview ➤ Corporate Background ➤ Profile of unit of the entity claiming tax holiday ➤ Profile of related parties 	<ul style="list-style-type: none"> ➤ Pricing Policy ➤ Functional analysis ('FAR') ➤ Economic analysis (method selection, comparable, benchmarking) 	<ul style="list-style-type: none"> ➤ Agreements ➤ Invoices ➤ Pricing related ➤ Correspondence (letters, emails, etc.) 	<ul style="list-style-type: none"> ➤ Official publications, reports by Government, institutions of repute, Stock exchanges ➤ Financial statements

Master File Documentation

Business:

- List of operating entities world-wide & business
- FAR of principal contributors
- Key drivers of profit
- Supply chain of products/ services
- Revenue generating geographical markets
- Intra-group services
- Business restructuring

Intangibles:

- Important intangibles
- Strategy for development/ ownership/ exploitation
- Agreements
- TP Policies for R&D
- Intra and Inter-group transfers

Contents

Intra-Group Financing:

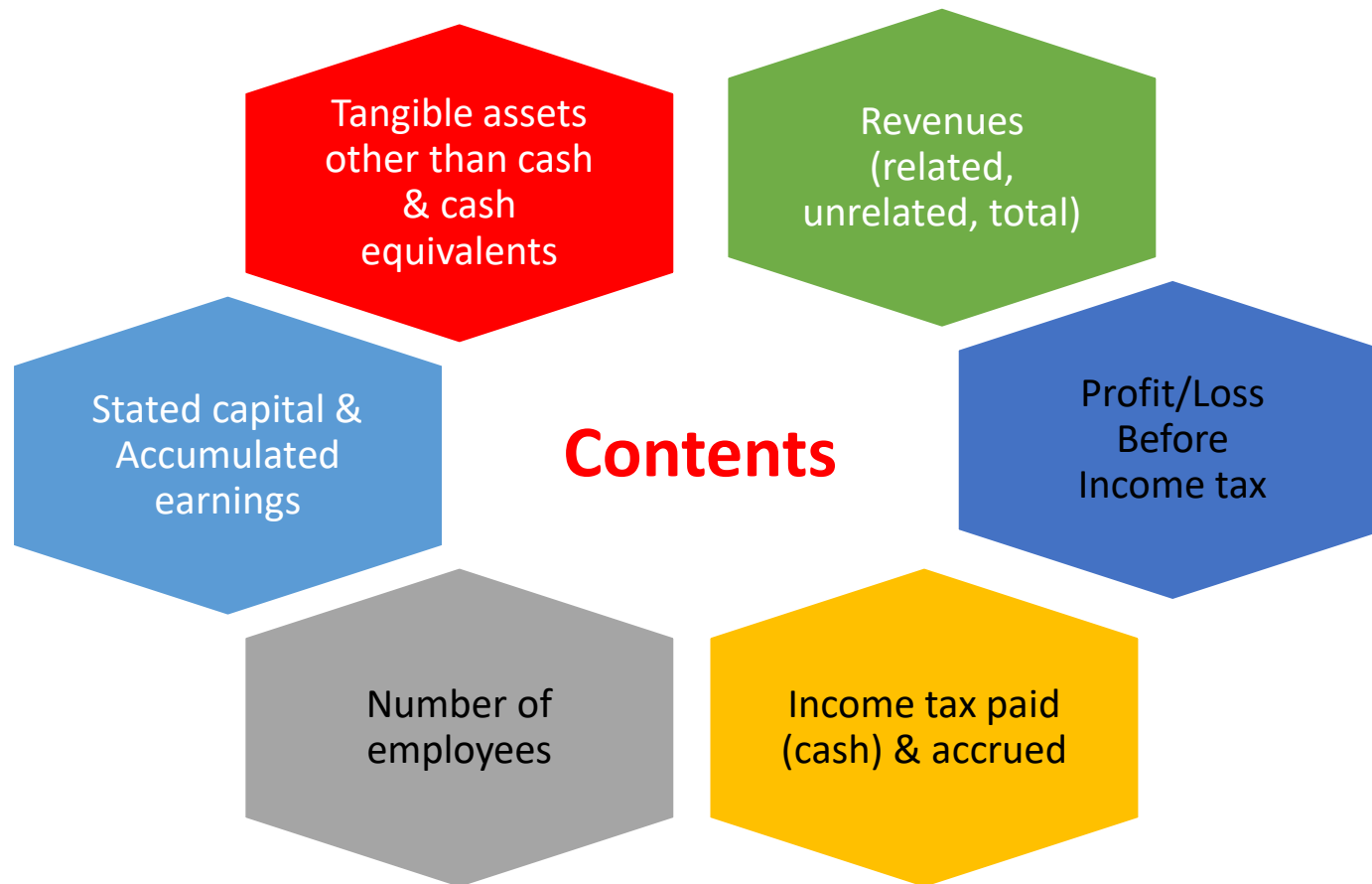
- How group is financed
- Top ten lenders
- Identification of central financing companies
- TP policies

Financial and Tax Positions:

- Consolidated Financial Statements
- Unilateral APA
- APA/ Tax rulings (in any jurisdiction) relating to allocation of incomes

Country by Country Report

Part A



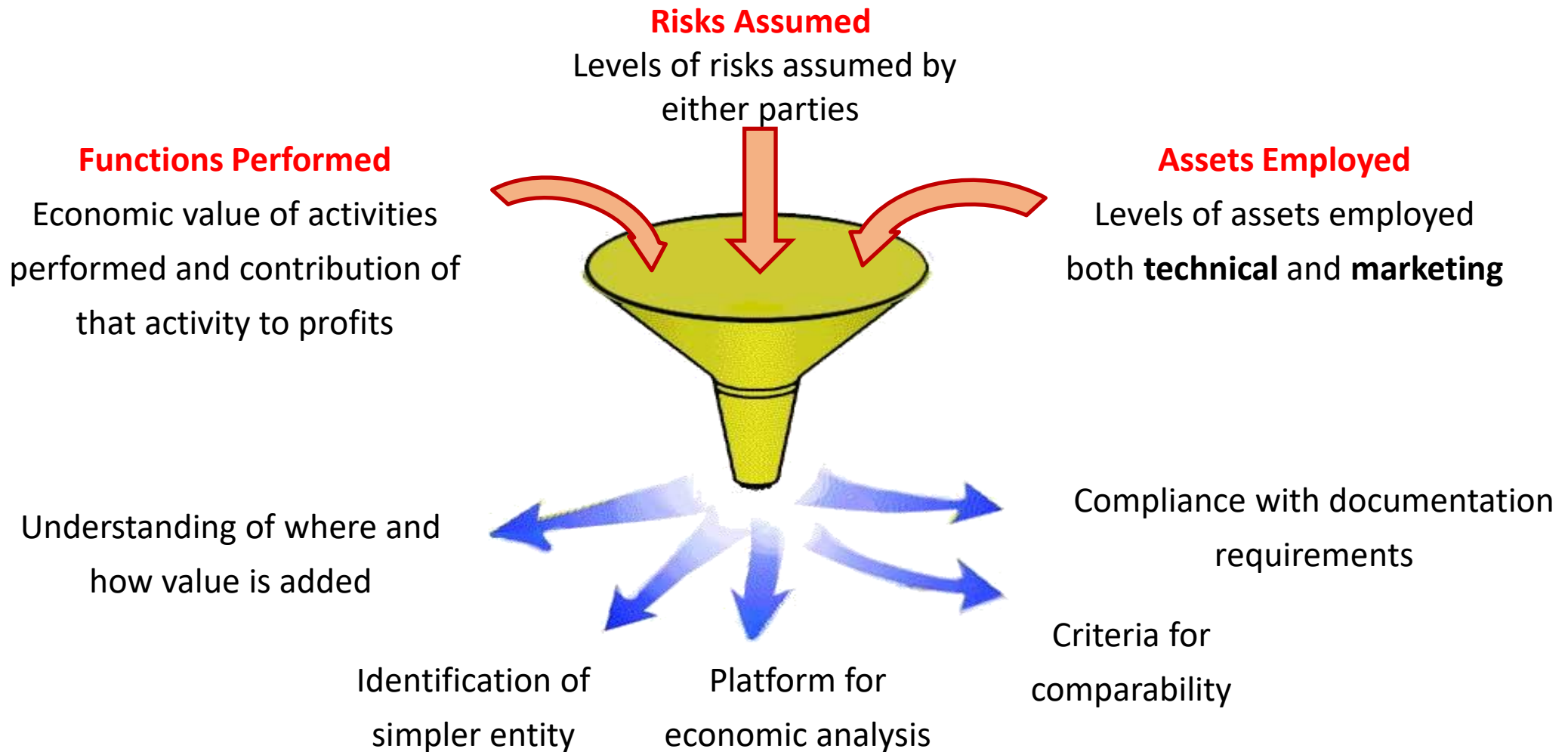
Part B

- List of all the Constituent Entities
- Country of incorporation
- Country of residence
- Main business activity
 - Research and development
 - Holding/ managing IPs
 - Purchase/ procurement
 - Manufacture/ production
 - Sales, marketing or distribution
 - Admin, management or support
 - Internal group finance
 - Financial services
 - Insurance
 - Holding shares or other instruments
 - Dormant
 - Others



FAR Analysis

FAR Analysis – Heart of the Documentation!!





Economic Analysis

Are these comparable?

Are these comparable with each other?



Are these comparable?

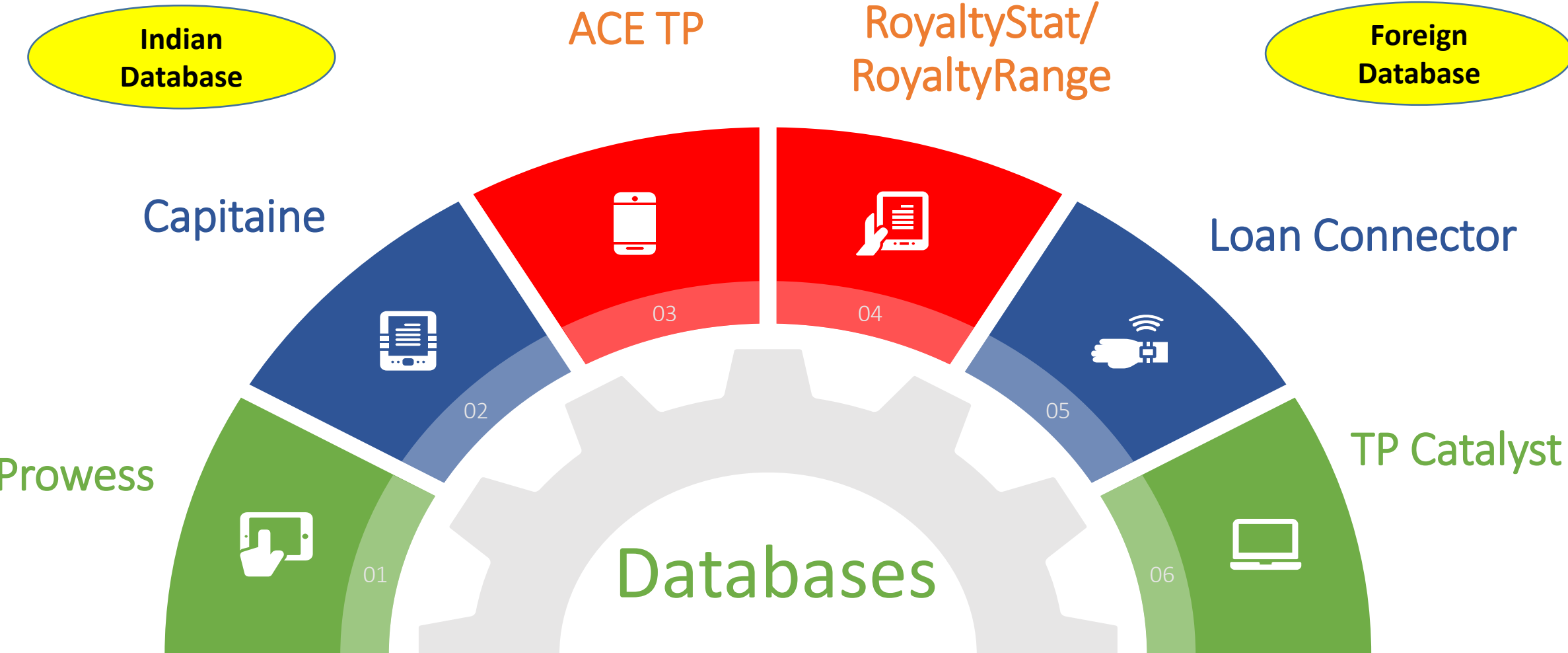
Are these comparable with each other?



Process for Economic Analysis



Overview of Databases



Quantitative analysis – filters

Government Ownership

Inadequate data

Net worth

Turnover



Related party transaction

Chronically loss making

Industry specific filter

Different Accounting policies and period

Qualitative analysis

Business line

Companies falling under different category of business activity shall be rejected

Segmental data

Profitability of only comparable segment is to be considered



Amalgamation/ Merger

Exclude comparable undergone merger/ demerger during the relevant year

Capital employed

If huge variations in the level of capital employed, may consider operating profit before depreciation as the most appropriate PLI.

Qualitative analysis – Industry specific comparability

Shipping and logistics

- ✓ Ship/ vessel owner vs NVOCC
- ✓ Freight forwarders vs courier company
- ✓ Agent vs Principal

IT-ITeS

- ✓ High-end services vs Low-end services
- ✓ Software development vs contract R & D
- ✓ Software distributor vs developer

Gems & Jewelry

- ✓ Manufacturing vs trading
- ✓ Diamond vs Jewellery vs Both
- ✓ Business model – Retail outlets/ online sale
- ✓ Segmental Info

Infrastructure

- ✓ Right to develop from GOI
- ✓ Toll collection rights
- ✓ Period of above rights

Review of Financial statements / Annual report

Auditors report

Qualified opinion by auditor on the financial results of the company may lead to non-comparability

Management strategy and challenges

- Provide insight on pricing policy adopted e.g. penetration or skimming pricing for capturing market
- Whether company has faced any observations / remarks from regulatory authorities



Management analysis

- Provides insight on good/bad performance of a company in the reporting year.
- Abnormal event if any may become a reason for accepting / rejecting a company in comparable analysis.

Date of incorporation of the company

To eliminate comparable companies in start-up phase.

Adjustments | Eliminate differences

Abnormal loss adjustment

Working Capital Adjustment

Depreciation adjustment

Adjustment on account of accounting difference

Capacity utilization adjustment



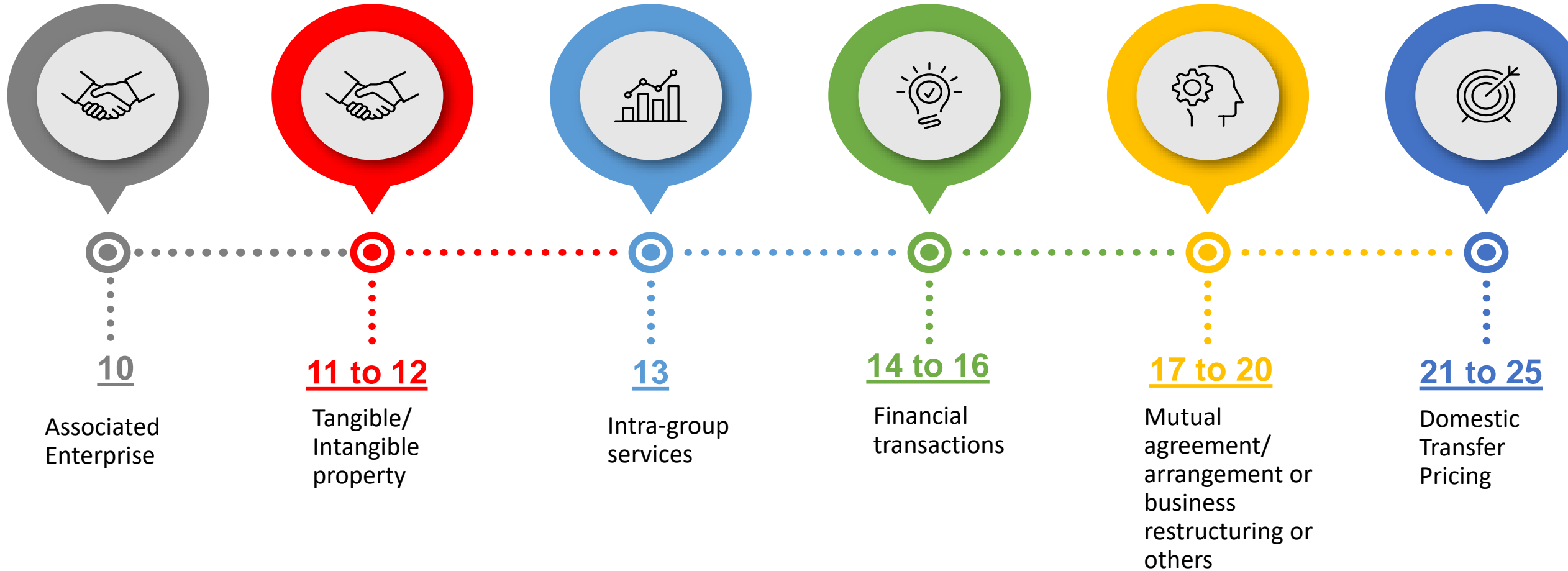
Customs duty adjustment

Foreign exchange adjustment



Accountant's Report
(Form No 3CEB)

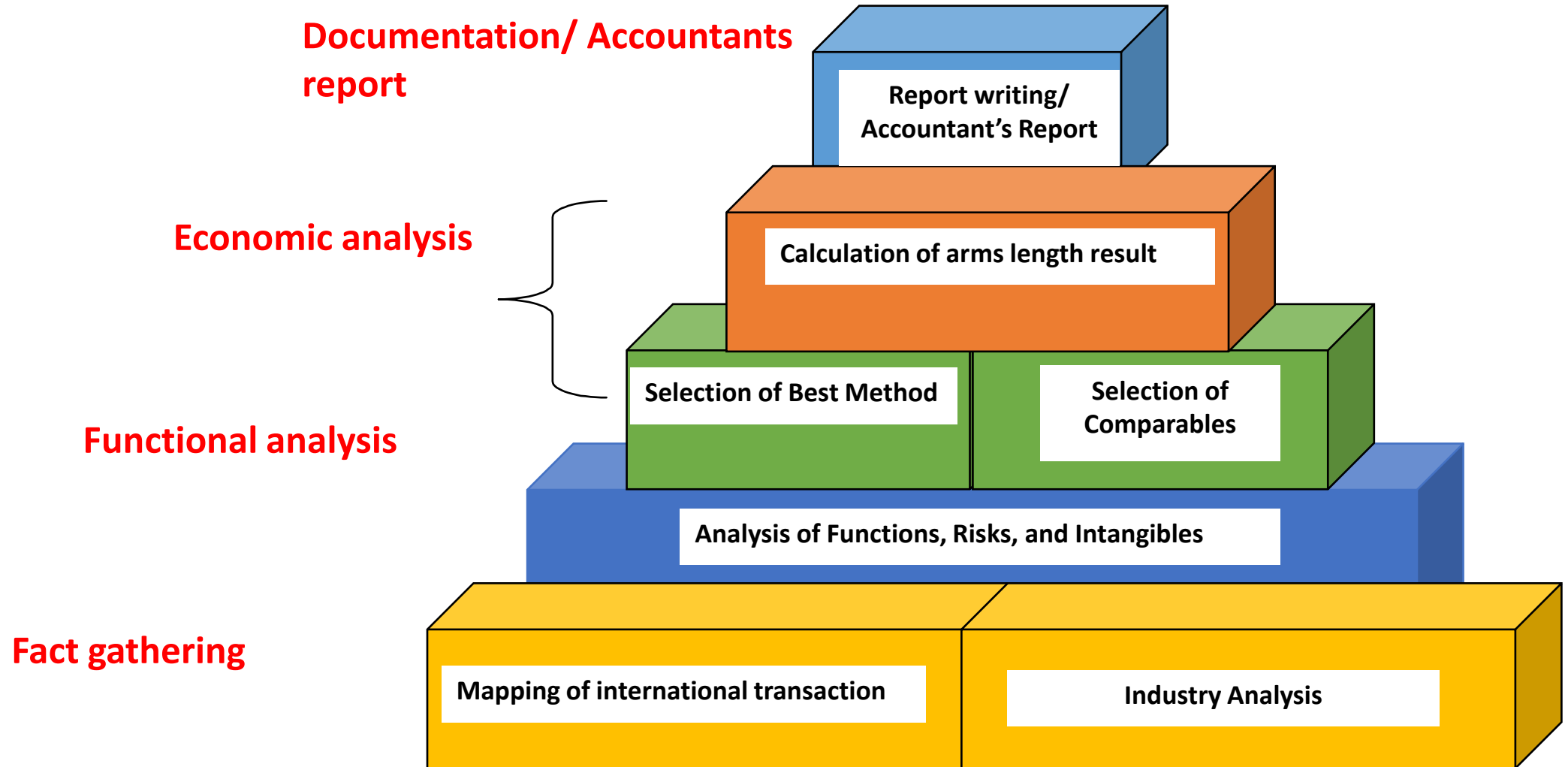
Accountant's Report – Form No. 3CEB





Transfer Pricing Audit Process

Typical Process for Transfer Pricing Audit





Dispute/ Litigation Mechanism in India

Dispute/ Litigation Mechanism in India

Litigation

- DRP/CIT (A)
- ITAT
- HC/SC

Safe Harbor

- Prescribed level of benchmark, if maintained, requires no further scrutiny
- Prescribed for - Provision of Software development services, Provision of ITES, Provision of KPO, Advancing of Intra Group Loans, Corporate guarantee, Contract R &D, Manufacture and export

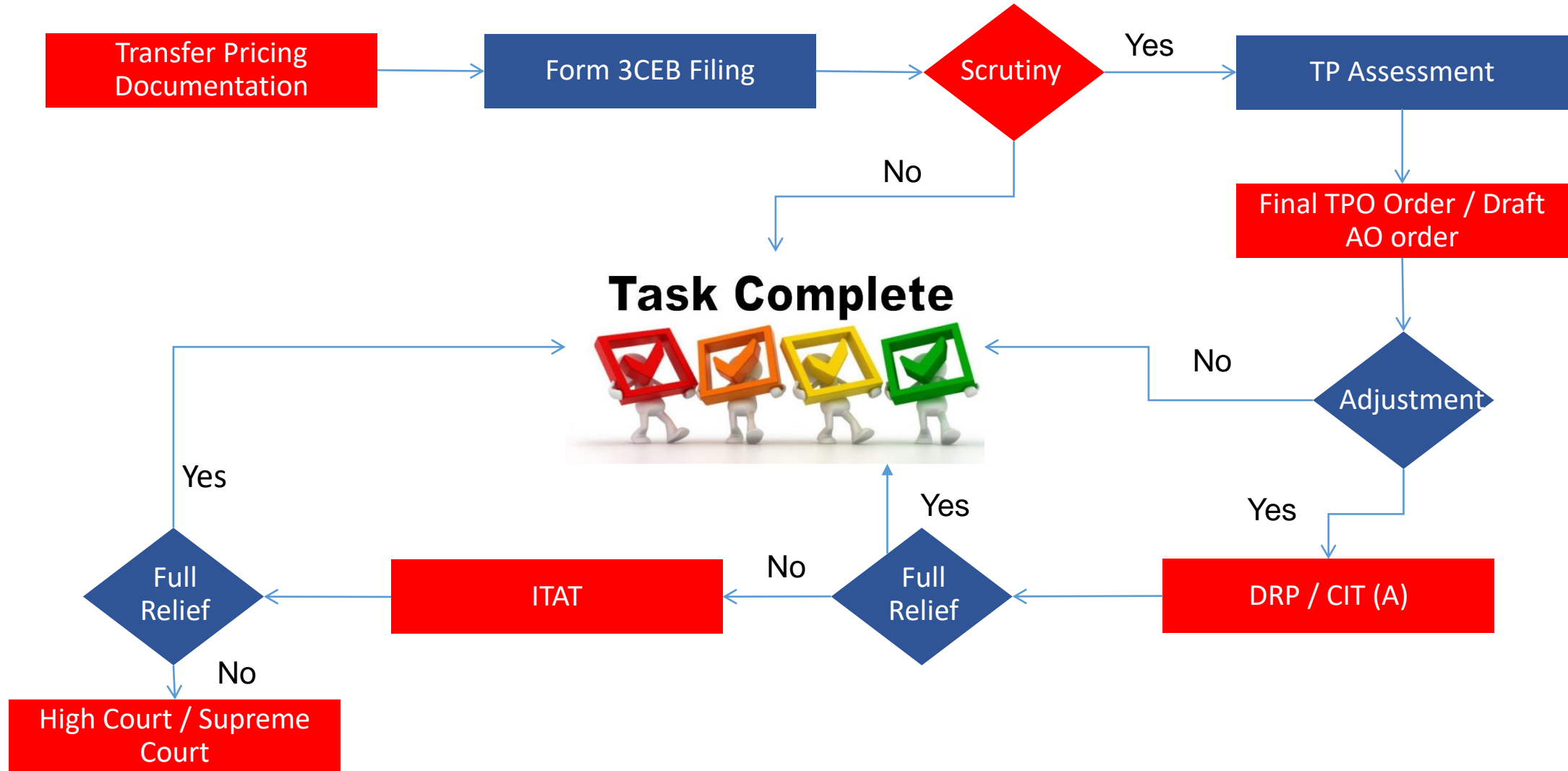
Advanced Pricing Arrangement

- An APA is an agreements made in advance regarding the pricing of a taxpayer's related party transactions, for a specific period of time
- Agree with Authorities on facts, methods and an ALP to avoid litigation

Mutual Agreement Procedures

- Taxpayers can apply to Authorities to enter into discussions with home country's tax treaty partners to eliminate any double taxation arising from transfer pricing adjustments

TP Litigation Life Cycle

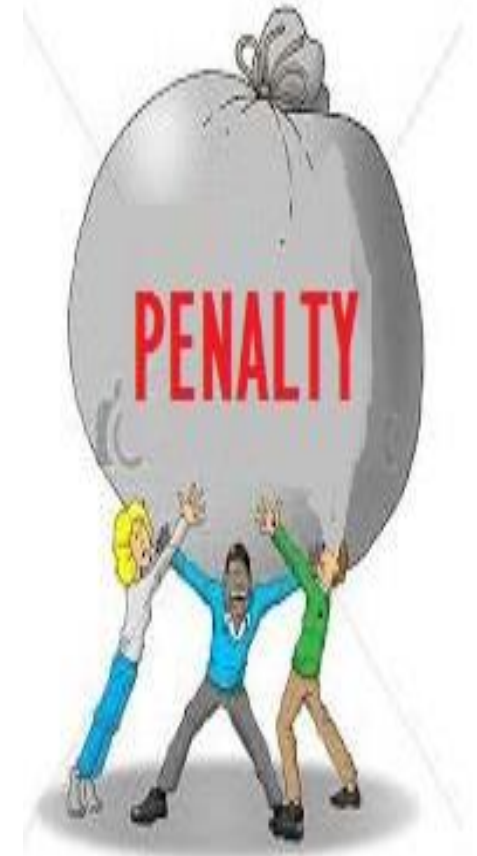




Penalties

Section 270/ 271 – Penalties for non-compliance

Section	Nature of Default	Penalty
270A	Under-reporting/ Mis-reporting of income	50%/ 200% of tax
271AA	Failure to maintain documents/ report transaction/ furnishing inaccurate info	2% of the transaction value
271G	Failure to furnish documents	2% of the transaction value
271BA	Failure to furnish accountants report	Rs 100,000





Recent Introduction/
Amendment

2012 to 2016 : Landmark reforms

2012



- Introduction of APA Programme in India
- Introducing domestic transfer pricing in India
- Inserts explanation to Sec 92B with retrospective effect

2014



- Introducing Range concept to determine ALP (significant relief from rising disputes on comparables due to High margin comparables)
- Permits use of Multiple Year Data over single year data
- Deemed international transaction provisions to include transaction with domestic parties
- Introduces APA rollback mechanism

2015

- Enhancing Domestic TP threshold limit from Rs. 5 Crores to Rs. 20 Crores

2016

- India adopts BEPS Action Plan 13: CbCR and Master File provisions introduced in Indian TP regulations

Recent amendments to TP provisions

2017



- Introduction of Secondary Adjustment related provisions
- Introducing Interest limitation rules (Thin capitalisation) on related party borrowings
- Base Erosion focus: Rationalising domestic TP provisions to exclude instances where tax base is unlikely to be eroded [40A(2)(b) transactions excluded]

2019



- Rationalizes secondary adjustment provisions – provides for alternative “one time payment option” – 18% tax (excluding surcharge/cess)
- Base Erosion focus: SDT provisions to apply to certain manufacturing companies availing benefit of reduced tax u/s 115BAB (Pursuant to Taxation Laws (Amendment) Ordinance, 2019)

'Range' concept and Multiple Year Data

- CBDT has introduced a notification on 19 October 2015 wherein a revised range concept has been introduced for the purpose of arm's length analysis and usage of multiple year data from **FY 2014-15**
- Use of multiple year data while carrying out transfer pricing analysis is permissible
- Range concept would be used for all methods (depending on the facts) **except for PSM and Other Method**. For PSM and Other Method, only arithmetic mean concept would have to be used
- Range concept will be applicable only if **6 or more comparable** companies are available. If not, arithmetic mean concept will continue to be used
- The arm's length range will constitute of the values falling between the **35th and 65th percentile** of the weighted average margins of comparable companies
- If the transaction price falls outside the arm's length range, the median value of the comparable prices shall be considered as ALP
- Use of multiple year data can be split into 2 categories; first, at the time of compliance and second, at the time of transfer pricing assessment

Scope of Domestic Transfer Pricing

92BA. "Specified Domestic Transaction" means any of the following transactions, not being an international transaction:

(i) [***]

(ii) any transaction referred to in section 80A;

(iii) any transfer of goods or services referred to in sub-section (8) of section 80-IA;

(iv) any business transacted between the assessee and other person as referred to in sub-section (10) of section 80-IA;

(v) any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of sub-section (8) or sub-section (10) of section 80-IA are applicable; or

Following clause (va) shall be inserted after clause (v) of section 92BA by the Taxation Laws (Amendment) Ordinance, 2019, w.e.f. 1-4-2020:

(va) any business transacted between the persons referred to in sub-section (4) of section 115BAB;

(vi) any other transaction as may be prescribed,

and where the aggregate of such transactions entered into by the assessee in the previous year exceeds a **sum of twenty crore rupees.**

Section 94B – Limitation on Interest deduction

Restriction on interest expenditure applicable only when all the following conditions are applicable cumulatively

Payer



- Any Indian Company except Banking or Insurance Company
- PE of foreign company

Payee



- Non-Resident - AE
- Third-party lender to whom NR-AE has provided guarantee or matching funds

Threshold



Excess of INR 10 million in particular FY

Nature of Interest



Deductible expenditure against income taxable under PGBP

Disallow



- Total interest paid/ payable in excess of 30% of EBITDA; or
- Interest paid/ payable to AE; whichever is lesser

Secondary adjustment

- S.92CE(2) mandates repatriation of 'excess money' within prescribed time limit in certain circumstances.
- Failing repatriation, the excess money is treated as an advance made by taxpayer to its AE and interest on such advances will be charged on excess money which is defined as under:
- Secondary adjustment u/s 92CE will need to be made in all cases of a primary adjustment except where
 - Primary adjustment is <1Cr; **or**
 - Primary adjustment is for A.Y. 2016-17 and earlier years (i.e. 31 March 2016 and earlier years)

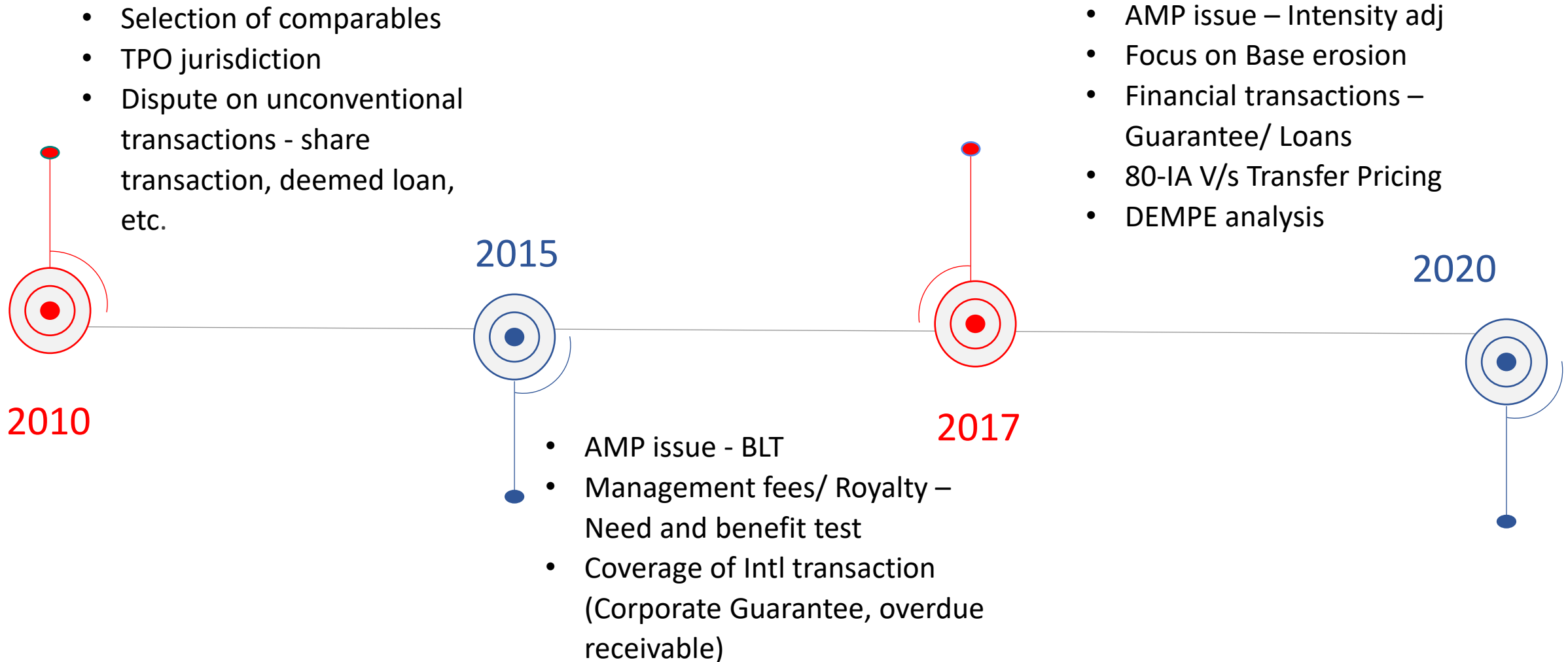
One time alternative tax payment

Finance Act 2019 provided one time tax payment option at **18%**
on amount to be repatriated plus surcharge at **12%**



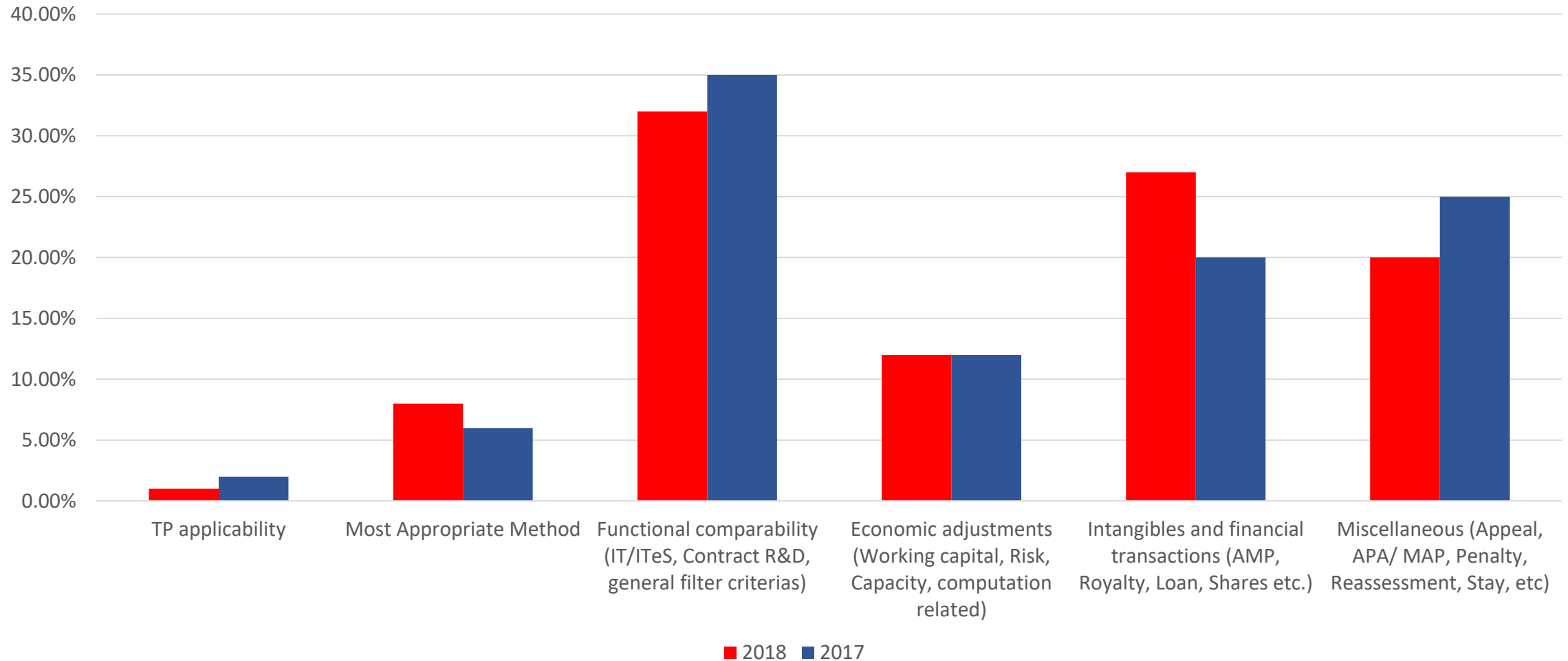
Complex Issues/
Litigation

Transfer Pricing adjustments | Shift of Wind



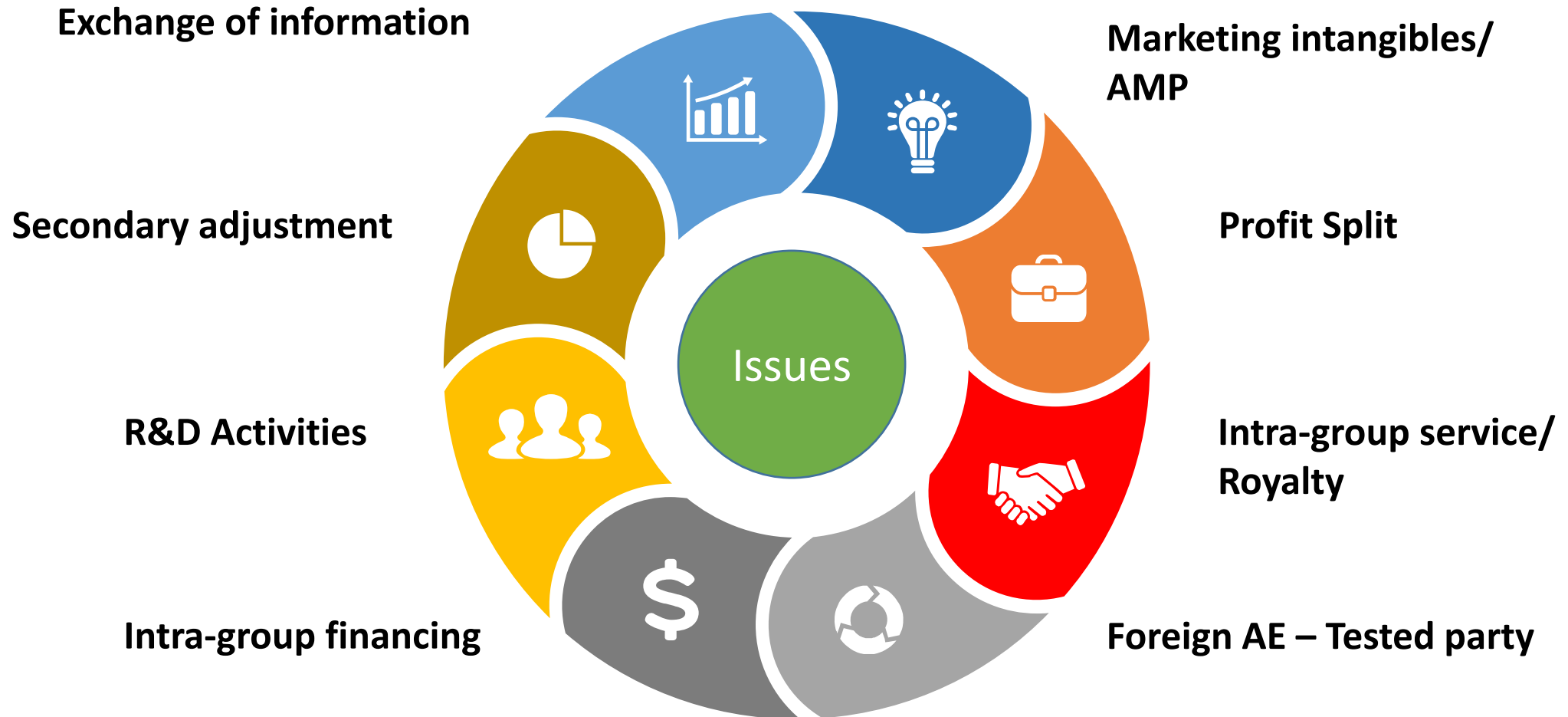
Transfer Pricing Rulings | 2017 & 2018

Issues covered in TP judgements during 2017 & 2018



Note: These are broad numbers based on our analysis of public domain data

Complex Issues in TP



Future of Transfer Pricing

- Taxpayers as well as Tax authorities have become matured in terms of understanding and implementing Transfer Pricing provisions
- Over the years, sufficient guidance available on various issues:
 - Especially, there is very limited dispute on quantitative filters such as – RPT filter, Export filter and sales filter, etc
- Introduction of Multiple year data and range concept has eliminated impact of outliers (such as very high profit making companies etc):
 - Most Transfer Pricing additions initially revolved around comparable companies selection (Turnover criteria being one of the disputed area)
- Field level officers are now appreciative of economic adjustments such as working capital adjustment or other such reasonable adjustments (given the guidance available in the form of various ITAT/ HC rulings)
- Tax office is now more focused towards 'Base erosion' cases rather than Intra-group transactions which do not impact Income in India (e.g. Share transactions, SDT [40A(2)(b)] transactions)



Opportunities for CAs

Opportunities for Cas – Transfer Pricing Domain



**3-Tier Document
(CbCR, Master File
and Local File) +
Form No. 3CEB**



**Transfer Pricing
efficient business
model**



BEPS Advisory



**Tax efficient supply
chain management**



**Litigation and
Dispute**



**Arm's length
valuation**



**Inter-company
agreement**



**Benchmarking
studies on global
database**



Way Forward

Way forward

Applicability

- Keep intent of Regulation in mind
- Re-examine the facts and assess the applicability of Regulation

Implementation

- Maintain all documentation
- Re-align contracts vis-à-vis conduct



Identify Gaps

- Re-evaluate requirement and fact pattern
- Identify potential gaps/ challenge areas

Compliance

- Undertake timely compliance requirement