

Overview of Transfer Pricing



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TP Regulations in India - Section 92

Any income

arising from

an international transaction

shall be computed

having regard to

arm's length price



Transfer Pricing Regulations (TPR) in India

☞ Income under any head is covered under the ambit of TPR

☞ Section 4 - Income must be chargeable to tax

☞ Preconditions:

- Two or more associated enterprises
- Enter into an international transaction
- Specified Domestic Transaction (w.e.f. AY 2013-14)

☞ Consequence:

- Income/ Expenditure to be computed having regard to the arm's length price



Applicability of TPR

☞ The provisions of Section 92 to 92F of the Act are applicable only if:

- There are two or more enterprises (Section 92F)
- The enterprises are associated enterprises (Section 92A)
- The enterprises enter into a transaction (Section 92F)
- The transaction is an International transaction or a specified domestic transaction (Section 92B and Section 92BA)

☞ Provisions do not apply in certain cases [Section 92(3)]

☞ Consequences of these provisions:

- Computation of income/ expenses having regard to the arm's length price [Section 92(1)]
- Maintenance of prescribed documentation (Section 92D read with Rule 10D)
- Obtaining of Accountant's report (Form 3CEB) (Section 92E)
- To ensure compliance with the arm's length principle, stringent penalties have been prescribed



Arm's Length Price

Section 92F(ii) of the Indian TPR

“arm's length price means a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions”

Under Rules 10A to 10E of Income-tax Rules, 1962 (Rules);
“Uncontrolled transaction” – transaction between enterprises other than associated enterprises, whether resident or non-resident

- ✧ The ALP under Section 92F of the Act denotes price which is applied or proposed to be applied in a:
 - ✧ comparable transaction between
 - ✧ unrelated independent parties in
 - ✧ uncontrolled conditions
 - ✧ Usually corresponds to the open market price



Background of BEPS



Background

- ❧ Increased integration of national economies and markets has put a strain on the international tax framework, which was designed more than a century ago
- ❧ The current rules have revealed weaknesses that create opportunities for Base Erosion and Profit Shifting (BEPS)
- ❧ G20 countries mandated the Organisation for Economic Co-operation and Development (OECD) to come out with recommendations to prevent BEPS. With the intention of :
 - ❧ Restoring the trust of ordinary people in the fairness of their tax systems;
 - ❧ Creating a level playing field among businesses; and
 - ❧ Providing governments with more efficient tools to ensure the effectiveness of their sovereign tax policies



Introduction to BEPS

☞ The OECD released the final BEPS package in October 2015 to

- ☞ Prevent double taxation
- ☞ Prevent no or low taxation by shifting of profits
- ☞ Ensure fair share of tax revenues
- ☞ Prevent treaty abuse

☞ What's in the BEPS Package?

- ☞ Minimum standards
- ☞ Reinforced international standards on tax treaties and transfer pricing
- ☞ Common approaches and best practices for domestic law measures
- ☞ Analytical reports with recommendations (digital economy and multilateral instrument)
- ☞ Detailed report on measuring BEPS



THE BEPS PROJECT

Coherence

Action 2: Neutralising the effects of hybrid mismatch arrangements

Action 3: Designing effective controlled foreign company(CFC) rules

Action 4: Limiting base erosion involving interest deductions and other financial payments

Action 5: Counter harmful tax practices more effectively, taking into account transparency and substance

Substance

Action 6: Preventing the granting of treaty benefits in inappropriate circumstances

Action 7: Prevent the artificial avoidance of permanent establishment status

Action 8-10: Aligning transfer pricing outcomes with value creation (Intangibles, Risks & Capital, High-Risk Transactions)

Transparency

Action 11: Measuring and monitoring BEPS

Action 12: Mandatory Disclosure Rules

Action 13: Transfer Pricing documentation and Country-by-Country Reporting

Action 14: Making dispute resolutions mechanism more effective

Action 1: Addressing the tax challenges of the digital economy

Action 15: Multilateral Convention to implement tax treaty related measures to prevent BEPS

BEPS Action Plan 13 –
Guidance on Transfer Pricing
Documentation and Country-by-Country
Reporting (CbCR)



Overview of BEPS Action 13

- ✎ Action 13 contains revised standards for transfer pricing documentation, including a template for Country-by-Country reporting of income, taxes paid, and certain measures of economic activity, to enhance transparency while taking into consideration compliance costs.
- ✎ The revisions to Chapter V of the 2017 OECD Transfer Pricing Guidelines align with Action Plan 13 of BEPS Report
- ✎ A three-tiered standardised approach to transfer pricing documentation has been designed:
 - I. Master file
 - II. Local file
 - III. CBC report



2017 OECD TP Guidelines: Chapter V - Documentation

Master File	To provide the MNE's blueprint
	The group's organisation structure
	A description of the group's business, intangibles, intercompany financial activities and financial and tax positions
Local File	To provide material transfer pricing positions of the local entity/ taxpayer with its foreign affiliates
	Demonstrates arm's length nature of transactions
	Contains the comparable analysis
Country-by-Country Report	Jurisdiction-wise information on global allocation of income, taxes paid/ accrued, the stated capital, accumulated earnings, number of employees and tangible assets
	Entity-wise details of main business activities which will portray the value chain of inter-company transactions

Master File and Country-by-Country Report (Indian Perspective)

☞ India's first step in incorporating Action 13 into its transfer pricing legislation was taken in the Finance Act, 2016 (as amendments to the Income-tax Act, 1961).



☞ Central Board of Direct Taxes (CBDT) on October 31, 2017 issued Final Rules (Rule 10DA and 10DB) in respect of keeping, maintaining and furnishing information and documents with respect to Country-by-Country report (CbCR) and Master File

☞ Rule 10DA - thresholds for applicability, timelines, requirements and procedure in relation to Master File. The relevant information and intimation related to Master File is required to be filed in Form No. 3CEAA and 3CEAB

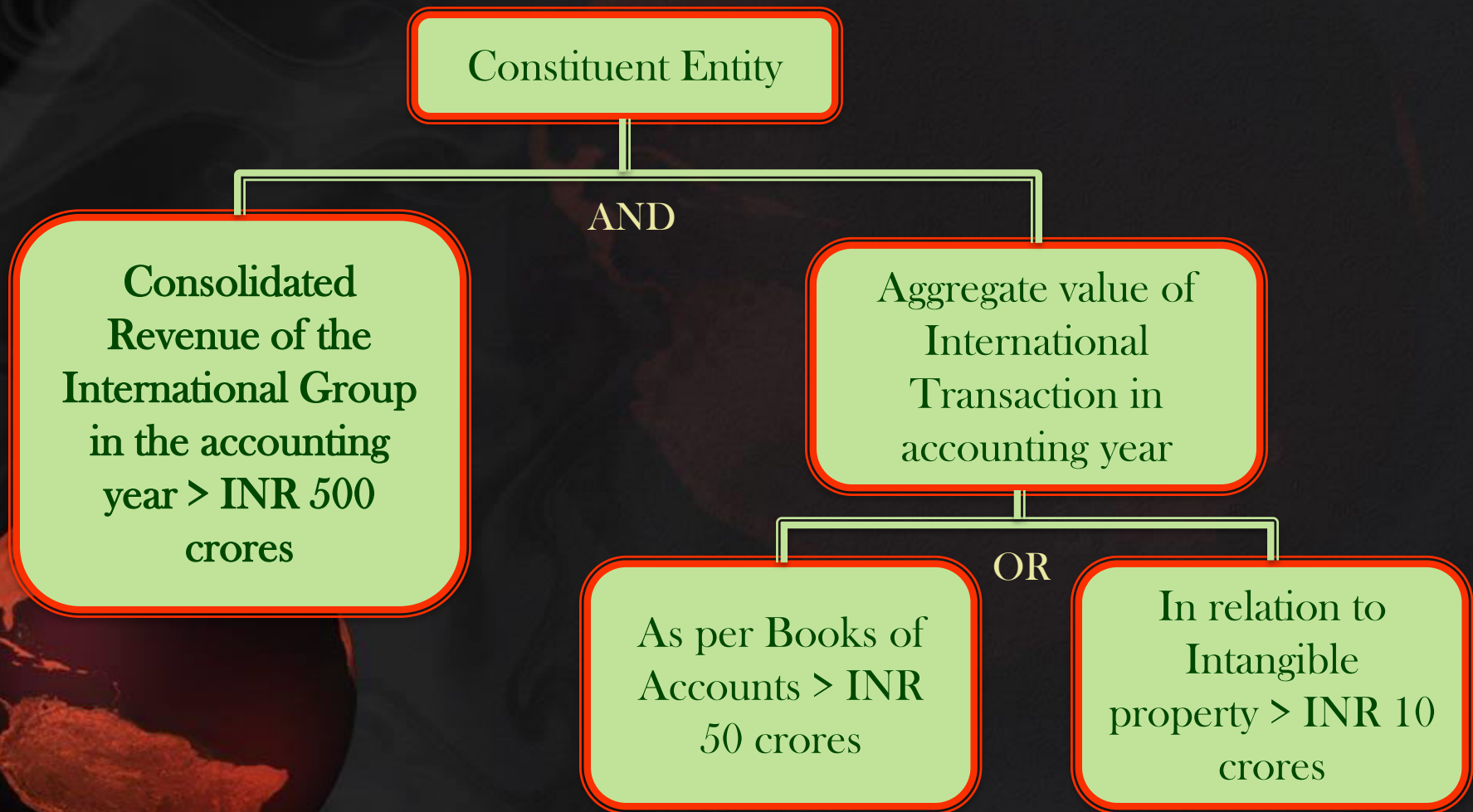
Master File and Country-by-Country Reporting (Indian Perspective) cont...

- ❧ Rule 10DB - the requisite details and procedures for CbCR filing. The relevant information and intimations are required to be filed in Form No. 3CEAC, 3CEAD and 3CEAE
- ❧ In line with the BEPS Action 13, India has become a signatory to the Multilateral Competent Authority Agreement (MCAA) for the automatic exchange of CBC Report with the other signatories of the Agreement on 12 May 2016 and notified on 28 July 2017
- ❧ Master File requirements provided in Part A of Form No. 3CEAA are applicable to every constituent entity of the international group, whether or not it satisfies the dual thresholds



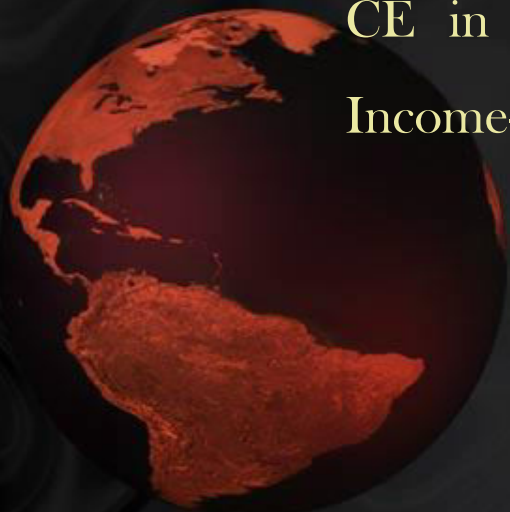
Master File Applicability (Rule 10DA)

Master File requirements provided in Part B of Form No. 3CEAA are applicable, if:



Master File Applicability (Rule 10DA) cont...

- ❧ Master File is an onerous documentation which depicts sensitive information and is supposed to provide a bird's eye view of the working of the group
- ❧ Where there is more than one constituent entity of an international group, resident in India, then the information would need to be filed by the designated constituent entity and intimation of the same is required to be filed by the designated CE in Form No. 3CEAB before the Director General of Income-tax (Risk Assessment) (DGIT-RA)



Master File Applicability (Rule 10DA) cont...

- ❧ Information and documents prescribed in Form No. 3CEAA would need to be kept and maintained for nine years from the end of the previous year
- ❧ The telegraphic transfer buying rate (same meaning as assigned in the Explanation to Rule 26 of the Income-tax Rules, 1962), on the last day of the accounting year shall be used for the calculation of the value in Indian rupees of the consolidated group revenue available in foreign currency
- ❧ Form No. 3CEAA should be verified and signed by the person who is competent to verify the income-tax return of the constituent entity under the Act



Country-by-Country Report (Rule 10DB)

- ☞ CbCR is applicable to an international group having total consolidated group revenue of more than INR 5,500 crore (approx. \$ 750mn) in the accounting year preceding the FY 2017-18, i.e., group revenue threshold should be tested for accounting year 2016-17
- ☞ Every parent entity or an alternate reporting entity, resident in India, would need to furnish CbCR prescribed under Form No. 3CEAD.
- ☞ Intimation under Form no. 3CEAC has to be filed by every constituent entity resident in India, of an international group, the parent entity of which is not resident in India



CBDT Instruction on Appropriate Use of CbCR

- ❧ India signed a Multilateral Competent Authority Agreement (MCAA) for Automatic Exchange of CbCR
- ❧ Pursuant to the MCAA, the Indian tax authorities will now have access to the CbCR relating to MNE groups who have constituent entities in India
- ❧ The CBDT vide Instruction No. 2/ 2018 dated 27 June 2018, provides a much needed clarity on various issues such as
 - ❧ restricted access of CbCR to specified authorities,
 - ❧ the manner of using information in CbCR,
 - ❧ conditions concerning confidentiality and measures to prevent the abuse of CbCR data, etc.
- ❧ The jurisdictional tax officer will have access to all the CbCR information related to a taxpayer, once selected under scrutiny (tax audit)
- ❧ The standard operating procedure for the tax officer will be formulated by the Centralised Risk Assessment Unit (CRAU) set up in the office of Director General of Income-tax (Risk Assessment) (DGRA)

CBDT Instruction on Appropriate Use of CbCR

- ❧ The CbCR information can be used by the tax officer for the following purposes:
 - ❧ Identifying high level TP risk assessment
 - ❧ Assessment of other BEPS related risks
 - ❧ Economic and statistical purposes
 - ❧ Planning tax audit
 - ❧ Making further enquiries into the group's transfer pricing arrangements and tax matters in the course of audit

- ❧ The information contained in the CbCR on its own does not constitute conclusive evidence to propose TP adjustment in course of audit

- ❧ The CbCR will not be a substitute for a detailed transfer pricing analysis resulting in determination of arm's length price of any international transaction

CbC Report (Contd.)

Establishing substance/
Confidentiality

Risk and readiness
assessment

Defend the overall
design of the group

CBC report will enable the tax authorities to compare the revenue/income accruing in a tax jurisdiction vis-à-vis, the tangible and intangible assets situated in the tax jurisdiction, the number of employees, the income tax actually paid on the earnings in that jurisdiction

Identify the availability of data and potential weaknesses in the tax structures or in control over certain (business) processes

The methodology of doing business, the structuring of the operations, assets and income of various entities and having robust documentation to demonstrate control manifest in each legal entity

CbC Report (Contd.)

Identification of
resources

Planned policy

Preparedness

Undertake the
exercise of
documentation

Exchange of requisite
information and to
facilitate the co-
ordination of the
same between all the
legal entities and the
reporting entity

The tax, finance and
IT departments are in
a state of
preparedness for
CBC reporting.

Master File and CbC Report - Penalty

Section	Particulars	
Section 271AA	Penalty for failure to keep and maintain Master File (INR 500,000)	
Penalty for failure to furnish CbC report u/s 286(2)	a. INR 5,000 per day upto one month; or b. INR 15,000 per day beyond one month	Failure continues after penalty order INR 50,000 per day
Penalty for non-furnishing information asked for u/s 286(6)	INR 5,000 per day	
Inaccurate report / information	INR 500,000	NA

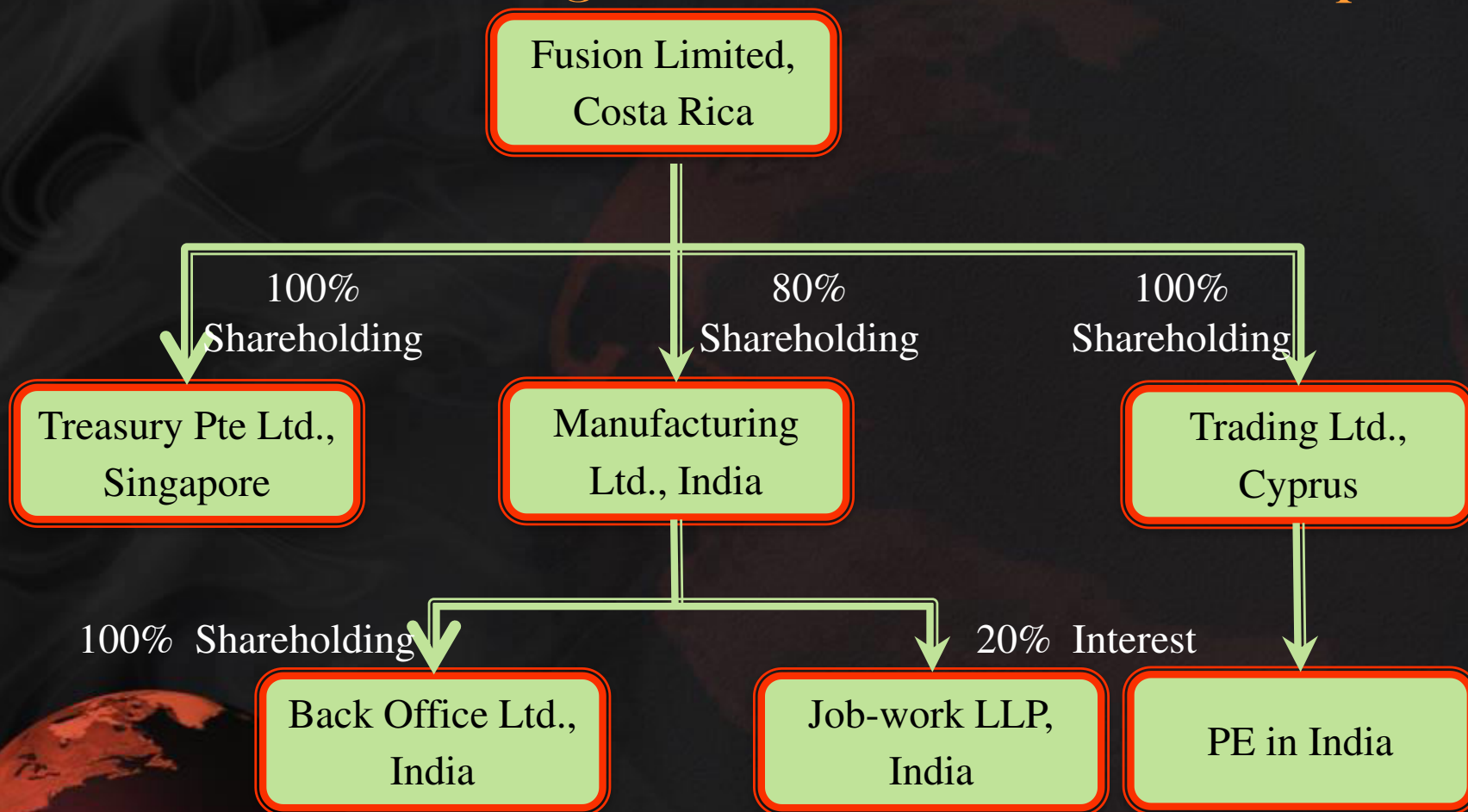
Illustration 1

❧ Fusion Ltd. is an Ultimate Parent Entity of the International Group i.e. Fusion Group. Fusion Limited is incorporated in Costa Rica and acts as a Holding Company. Total turnover of the Fusion group exceeds INR 5,500 crores

❧ Entity-wise summary of the Group Revenue:

Name of Entity	Residential Jurisdiction	Main Business Activity	Total Turnover (<i>equivalent INR in crores</i>)
Fusion Ltd	Costa Rica	Holding	150
Treasury Pte. Ltd	Singapore	Finance and Treasury operations	350
Manufacturing Ltd	India	Manufacturing operations	5,000
Back Office Limited	India	Back-office operations	250
Trading Limited	Cyprus	Trading	2,500
Trading Limited (permanent establishment in India)	Cyprus	Trading	400
Job-work LLP	India	Job-work	500

Shareholding structure of Fusion Group



Note:

Job-work LLP is not controlled by the Fusion Group and it is not considered for preparing consolidated financial statement, as per Costa Rica corporate regulations

Illustration 1 (Cont...)

Details of the Related Party Transactions:

Name of Entity	Nature of Related Party Transactions	Name of Entity	Amount (equivalent INR in crores)
Fusion Ltd	Receipt of dividend from	Treasury Limited	5
		Manufacturing Ltd	40
		Trading Limited	5
	Loan given to	Manufacturing Ltd	800
		Back Office Ltd	200
	Interest income from	Manufacturing Ltd	80
		Back Office Ltd	20
Manufacturing Ltd	Sales to	PE of Trading Limited	300
	Payment of Job-work charges to	Job-work LLP	100
Back Office Ltd.	BPO services	Fusion Ltd.	25

Illustration 1 (Cont...)

Following points need to be discussed:

1. Applicability of Section 286(1) of the ITA:

- a) Which constituent entities need to notify the Director General of Income-tax (Risk Assessment) [DGIT (RA)], under section 286(1)?
- b) What are the consequences, if the constituent entity fails to comply with section 286(1)?
- c) If Fusion Ltd, e.g. was an Indian Parent Company, then would there be any change in the applicability of section 286(1)?

2. Applicability of proviso to section 92D(1) and section 92D(4):

- a) Which entity needs to furnish Part A and / or Part B of Form 3CEAA as per Rule 10DA?
- b) If Fusion Ltd, e.g. was an Indian Parent Company, than would there be any change in the applicability of proviso to section 92D(1) and section 92D(4)?



THANK YOU

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