



Secondary Adjustments

What Lies beneath

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Transfer Pricing Adjustments

Transfer Pricing Adjustments

Primary Adjustment	Corresponding Adjustment	Secondary Adjustment
<ul style="list-style-type: none">• First adjustment made by tax authority or taxpayer• Adjustment is made when underlying transaction is not undertaken at arm's length• It triggers the corresponding and secondary adjustment	<ul style="list-style-type: none">• Made by the other tax jurisdiction to eliminate or mitigate double taxation• Correspondent to the primary adjustment made by first tax jurisdiction• Recommended by OECD TP Guidelines	<ul style="list-style-type: none">• Made by the same jurisdiction that makes the primary adjustment• To address the issue of remittance of difference between transaction price and arm's length price• Seeks to reflect actual allocation of profit in the books of taxpayer and AE

Primary and secondary adjustment lead to double taxation whereas corresponding adjustment is what eliminate or mitigates the impact of double taxation

Secondary Adjustments - Provisions

Secondary Adjustments- Provisions

- Finance Act, 2017 enacted to introduce the concept of secondary adjustment by way of insertion of a new section 92CE to the Act
- As per section 92CE of the Act,
“secondary adjustment means an adjustment in the books of account of the assessee and its associated enterprise to reflect that the actual allocation of profits between the assessee and its associated enterprise are consistent with the transfer price determined as a result of primary adjustment, thereby removing the imbalance between cash account and actual profit of the assessee.”
- Concept of secondary adjustment has been debated and used by the revenue authorities in the past to make transfer pricing adjustments in certain cases
 - Interest on overdue receivables
 - issue of shares
 - APA / MAP

Secondary Adjustments- Provisions

Introduced with effect from April 1, 2018 (ie AY 2018-19)

Sr. No	Proposed provisions	Summary of the provisions
1	Section 92CE(1) of the Act states that a secondary adjustment shall be made only in case of the specified primary adjustments:	<ul style="list-style-type: none">• Suo moto adjustment in the return of income; or• Acceptance of adjustment proposed by the assessing officer; or• Determination in an APA; or• Adoption of safe harbour rule; or• Resolution under MAP
2	Proviso to section 92CE(1) not applicable where:	<ul style="list-style-type: none">• The primary adjustment does not exceed INR 10 million and• If the primary adjustment is made in respect of an AY commencing on or before the 1st day of April, 2016

Secondary Adjustments- Provisions

Sr. No	Proposed provisions	Summary of the provisions
3	Section 92CE(2) of the Act:	<ul style="list-style-type: none">• Secondary adjustments introduced where primary adjustments result in increase in total income or reduction in loss• Excess money available with its AE as a result of primary adjustment, if not repatriated to India within the prescribed time, to be treated as an interest bearing advance
4	Section 92CE(3) of the Act:	<ul style="list-style-type: none">• Definitions (next slide)

Definitions

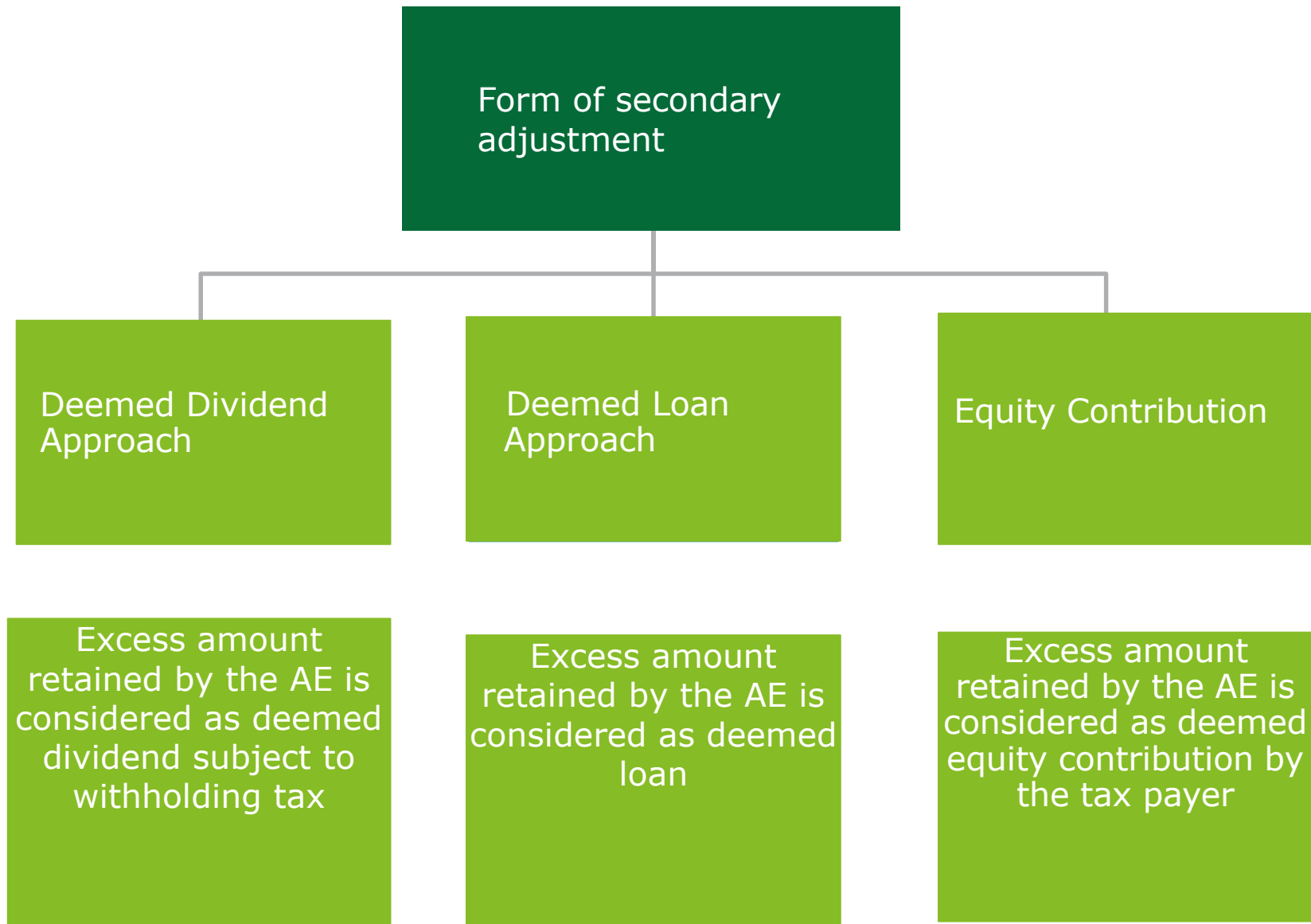
- **AE** : as defined under subsection (1) and subsection (2) of section 92A of the Act
- **ALP**: shall have the meaning assigned to it in clause (ii) of section 92F of the Act
- **Excess money** : difference between the ALP determined in the primary adjustment and the price at which the international transaction has actually taken place
- **Primary adjustment** : Determination of transfer price in accordance with the arm's length principle, which increases the total income of the Assessee or reduces the loss
- **Secondary adjustment** : means an adjustment in the books of the Assessee and its AE to reflect that the actual allocation of profits between the AE and the Assessee are consistent with the transfer price determined as a result of the primary adjustment

Global Practices/ OECD

Global practice / OECD

- Article 9 of Model Tax Convention does not deal with the issue of secondary adjustment and it is a matter of domestic law of contracting states
- The OECD Guidelines define secondary adjustments as '***an adjustment that arises from imposing tax on a secondary transaction***

A secondary transaction is further defined as 'a constructive transaction that some countries will assert under their domestic legislation after having proposed a primary adjustment in order to make the actual allocation of profits consistent with the primary adjustment.
Secondary transactions may take the form of constructive dividends, constructive equity contributions, or constructive loans.



Global practice

The following gives a brief of the treatment of secondary adjustment followed by various countries

Deemed dividend approach	Deemed loan approach
France	South Africa*
USA	India
Canada	UK**
South Africa*	
Korea	
Spain	
Bulgaria	
Luxembourg	
Netherlands	
Germany	
Austria	

Further, few of the countries listed in the table that follow the deemed dividend approach also follow the capital contribution approach

*South Africa had earlier adopted the loan approach. However, due to practical difficulties, with effect from January 1, 2015, South Africa has also adopted deemed dividend approach

**United Kingdom reflects the proposed Indian approach (although this was in consultation stage till August 2016 – no finality reached as yet)

Key Issues

Key Issues

Topic	Issues
<p>Period of secondary adjustment</p>	<ul style="list-style-type: none"> • Proviso to section 92CE of the Act provides that secondary adjustment <u>should not be made</u> when the <ul style="list-style-type: none"> i. primary adjustment does not exceeds INR 10 million in any previous year; <li style="text-align: center;">AND ii. the primary adjustment is made in respect of an AY commencing on or before the 1st day of April, 2016 <p>Whether the amendment is applicable prospectively or retrospectively?</p>
<p>'Accepted' by Assessing Officer</p>	<ul style="list-style-type: none"> • Whether payment of taxes under protest would qualify as accepted • Whether acceptance of the draft assessment order and moving on the litigation resolution route through CIT(A) rather than the DRP route would amount to "acceptance" • Whether not litigating (Tribunal, High Court or Supreme Court level) would be construed that adjustment has been accepted. • Whether assessment order under remand back proceedings, if accepted, would be regarded as 'acceptance' of the assessment order for imposition of secondary adjustment • The assessee being a loss making entity and may not have any tax payment liability

Key Issues

Topic	Possible views
<p>Assessee accepts primary adjustment at a later point in time after assessment or an appeal.</p> <p>(Accounting Treatment)</p>	<ul style="list-style-type: none">• Adjustment is required to be made in the books of accounts, however, it would not be possible to revise the books of accounts closed in the earlier years and therefore the entry of the receivable would have to be passed as a prior period item <p>How the secondary adjustment can be made?</p>
<p>Applicability of Section 2(22)(e)</p>	<ul style="list-style-type: none">• Section 92 CE (2) provides that if the cash equivalent to primary adjustment is not repatriated, it would be deemed as an advance by the assessee to the AE• Section 2(22)(e) of the Act mentions that where a company (other than company in which public is substantially interested) makes advance or loan to the shareholder beneficially holding more than 10% stake, such loan would be deemed as 'dividend' and accordingly taxable in the hands of the shareholder attracting withholding tax• Two separate deeming provisions get attracted for non-repatriation of the secondary adjustment amount (This would also require clarification from the government)

Key Issues

Issue	Possible views
Primary adjustment is made on all international transactions aggregated under TNMM	<ul style="list-style-type: none">• Possibility is to apportion the adjustment amongst the AEs, however there can be a situation where the AEs may refuse to pay• It is not clear whether the whole amount of primary adjustment or only the balance amount not repatriated would be regarded as deemed advance
Time limit for secondary adjustment	<ul style="list-style-type: none">• No time limit prescribed as on date. CBDT needs to prescribe time limits
Impact of secondary adjustment on other regulations such as FEMA	<ul style="list-style-type: none">• Timelines for repatriation of money should be in sync with the FEMA provisions
Computation of interest in perpetuity ?	<ul style="list-style-type: none">• The law provides for repatriation of funds within a specified timeline. Once the timeline is passed, the balance would continue to be treated as deemed advance and the tax on interest thereon shall always be subject to tax in India. Perpetuity results in undue hardship.
Corresponding relief through MAP	<ul style="list-style-type: none">• Whether corresponding relief of the secondary adjustment shall be available ?

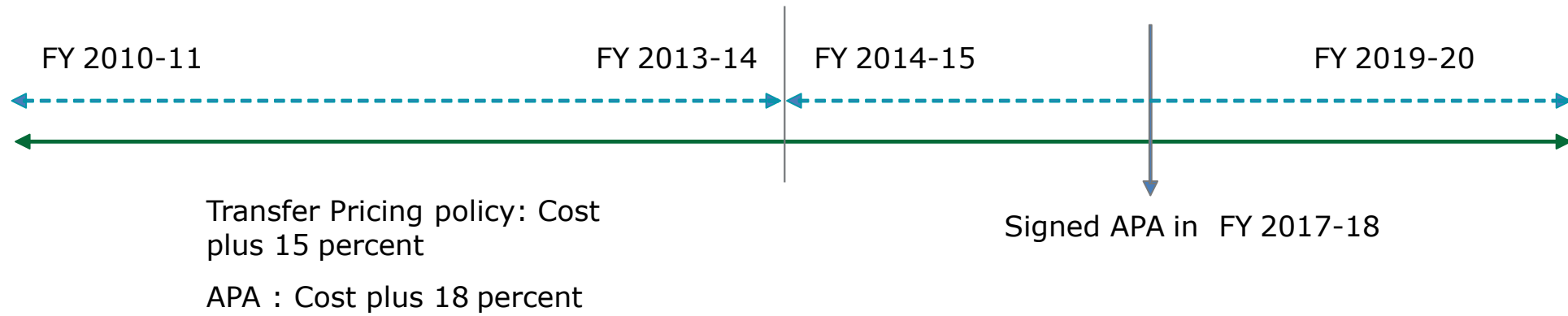
Illustrations

Suo-Moto Adjustment

International Transaction (Sale Price by A Ltd to B Ltd)	Arm's length Price of sales	Suo-moto Adjustment by A Ltd. in the tax return
1000	1300	300

- Increase in Company A's profit by INR 300 (primary adjustment) does not address from the benefit obtained from retention of INR 300 by B Ltd.
- Primary (suo-moto) adjustment does not address the issue of remittance of INR 300 from B Ltd to A Ltd and reflect the actual allocation of profit in the books of A Ltd and B Ltd.
- As per the provisions of the secondary adjustment, A Ltd is to bring Rs. 300 from B Ltd., within the specified period of time.
- If A Ltd. does not bring the amount, Rs. 300 shall be considered as advance given by A Ltd. to B Ltd and interest shall be charged on the same.

APA scenario



Whether secondary adjustment applicable to roll back years for differential 3 percent mark-up?

Way Forward

Way forward

1

Determine transfer price prior to closing books of accounts rather than making suo-moto adjustment

2

Consider MAP and bilateral APAs to avoid double taxation