

Institute of Chartered Accountants of India

Seminar on Transfer Pricing

Recent Trends in Transfer Pricing Assessments and Benchmarking

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Transfer Pricing Assessments



TP Litigation Trend in India



- Low threshold for TP audit till 2016 resulted in voluminous adjustments
- Large number of APAs concluded
- Risk-based assessment instrumental in reducing disputes

Lingering Effects

- Significant pendency at CIT(A) / ITAT / Courts [including AMP]
- Remand / set aside orders to lower authorities
- Field Officers inclined to follow past precedents
- High-risk and base-eroding transactions – Royalty / intra-group services under the scanner

Transfer Pricing – key focus since 2001

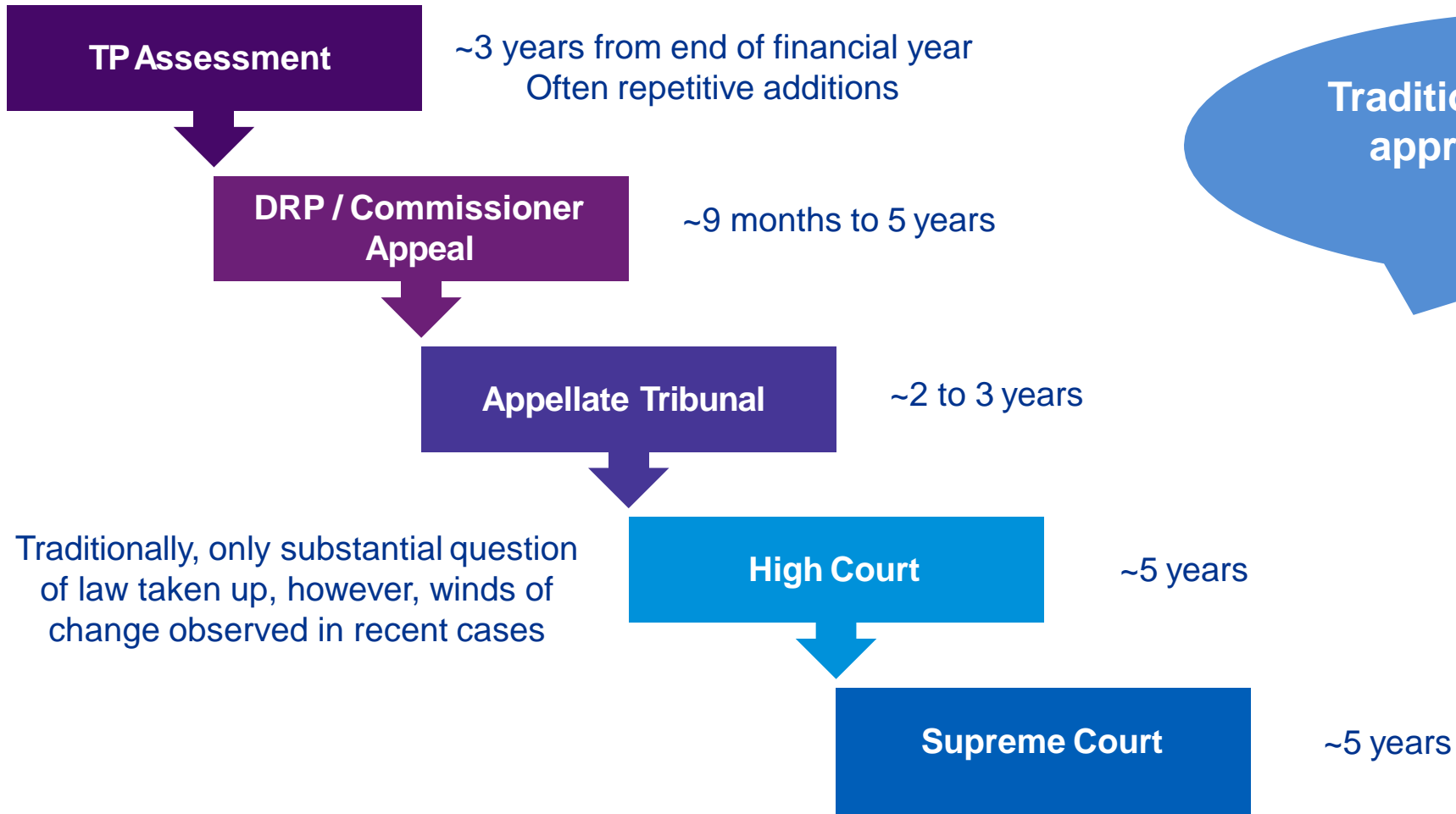
- Alternate dispute resolution programme - MAP, APA, Safe Harbour
- Moving towards transparent approaches – adoption of BEPS Action Plan 13
- Shift in Audit approach in prior years – from ‘Monetary thresholds’ to ‘Risk based parameters’

Renewed Focus

- Good governance for RPT arrangements
- Era of transparency – CbCR / Master File
- Information exchange with other countries and with other authorities in India
- Increased media and public scrutiny
- Emphasis on substance over form



Typical Tax Litigation Cycle



Traditional litigation route
approx 10 to 15 years

Guidelines for Compulsory Scrutiny

2003

Instruction No. 3/2003

Aggregate value of International Transactions exceeds **INR 5 Crores**

Parameters:

- Not filed Form 3CEB or not disclosed all transactions
- TP Adjustment of INR10 crore or more in earlier AY and upheld by Judicial authorities/ pending in appeal
- Search and seizure or survey operations and findings on TP issues recorded by investigation wing/ AO
- Declared IT/SDTs in Form 3CEB but made qualifying remarks that transactions are not IT/SDTs or do not impact income

2016

Instruction No. 3/2016

Cases selected under CASS or manual selection, based on TP / non-TP risk parameters

2007 - 2015

CBDT Action Plans – Procedure for selection of cases for scrutiny

Aggregate value of International Transactions exceeds **INR 15 Crores**; TP audit results in adjustment of more than **INR 10 Crores** in earlier years



2023

Guidelines for compulsory selection of Returns for scrutiny

TP Addition in an earlier AY on a recurring issue of law / fact exceeds **INR 25 Lakhs** in 8 metro charges (Delhi, Ahmedabad, Bengaluru, Chennai, Hyderabad, Kolkata, Mumbai, Pune) and **INR 10 Lakhs** in other than 8 metro charges; AND

Addition has become - final as no further appeal preferred against AO order or upheld by Appellate Authorities in Revenue's favour even if further appeal of assessee is pending against such order

Scope of selection of cases for scrutiny widened; Likely to result in increased litigation cases

Recent TP Assessment Experience

Royalty

- **Critical impact on business** to be established
- **Value addition** for brand and technology royalty to be established
- **Tiered** and **Bundled** royalty models
- Focus on **need-benefit documentation** along with **benchmarking**

Intra-group services

- Differentiation of **direct / business / technical services vs support** services
- Focus on **need-benefit documentation** and **certification of costs** incurred
- **Basis of charge** – based on cost plus or revenue / profits
- Consistent and reasonable **cost allocation** methodology
- **Outbound services – POEM** exposure mitigated, **Benefit** quantified vs costs incurred

Covid related impact

- **Quantification** of extra-ordinary expenses / capacity adjustments – in line with industry
- Reliance placed on **RBI, industry reports**

Recent TP Assessment Experience

Financial transactions

- **Interest on convertible instruments** – Impact of accounting standards treating part debt as equity disallowing consequential interest
- **Guarantees** - Benchmarking and cost benefit, impact of safe harbor
- Impact of **limitation on deductibility of interest** under **Section 94B**
- **Overdue receivables** – imputation of interest

Non-residents

- **Attribution** of profits to Permanent Establishment
- Ask to **maintain separate documentation** and not just placing reliance on Indian AE's documentation
- Focus on **disclosures under notes to Form 3CEB**

Information related

- Detailed questionnaires arising seeking **information of global group entities**
- **Information exchange** with various **countries** [extending time limit for assessments] and within **India** [with other **departments** like GST, customs]

Recent TP Assessment Experience

Emerging Issues

- **OECD concepts** relied on for:
 - **Intangibles** – questions on DEMPE, Significant People Functions
 - **Valuation of securities** – challenge on methodologies used, comparison of projected vs actuals, appropriateness of assumptions, justification for valuation parameters such as discounting rate, growth rate, Reference to various valuation standards
- **Stringent view** taken on **lack of adequate supporting documentation** – penalty proceedings initiated in some cases
- **Deemed international transactions** – new area of litigation

Other Developments

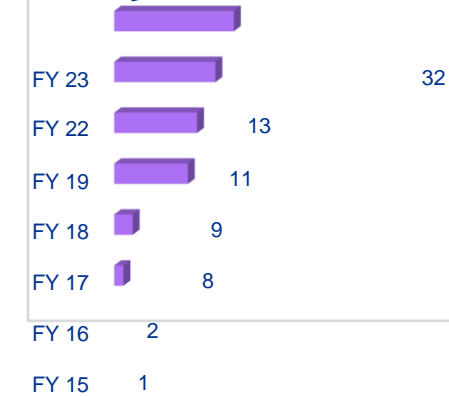
- Robust **knowledge sharing** amongst officers across locations in India - Industry and issue focus
- In select cases, appearance required from Management, Auditors, Experts
- Stringent timelines for AY 2020-21 (July end) and AY 2021-22 (October end) – timebound targets

APA – Recent Update

21 Record single day APA signings on March 24, 2023

Maximum number of BAPAs

in any FY till date

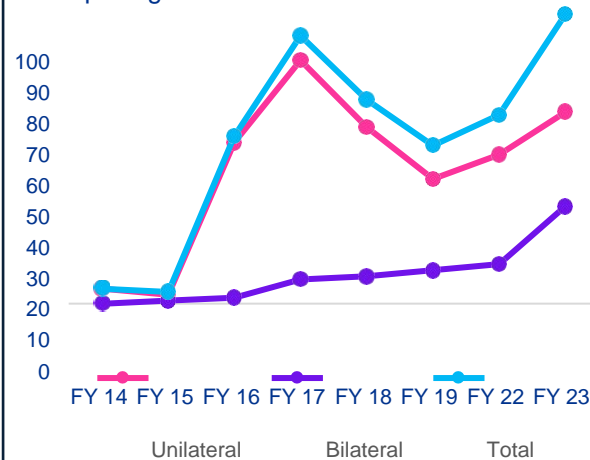


Mutual Agreements with Finland, UK, US, Denmark, Singapore, Japan

[1] CBDT Press release dated March 31, 2023, Press release dated March 14, 2022, APA Annual Report (2018-19)
 [2] Announcement and Report concerning Advance Pricing Agreements

APA Agreements signed year-wise

Total number of APAs since inception of the APA programme has gone up to 516, comprising 420 UAPAs and 96 BAPAs



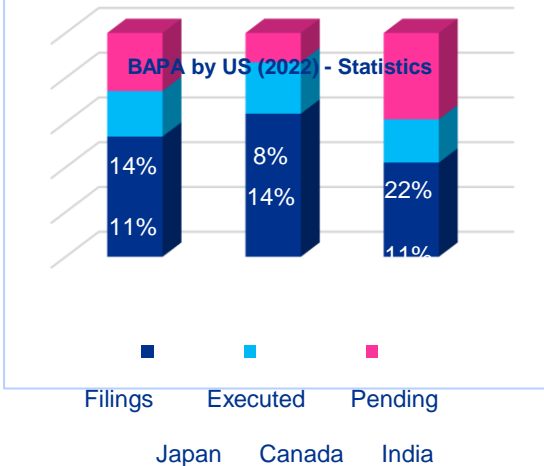
95 APAs



CBDT recorded the highest ever APA signings in any FY -

3rd Highest no. of executed BAPAs by USA with India in 2022, after

As per the annual APA Report for 2022 by Internal Revenue Service (USA), for India, there were 20 new filings, 6 executed and 105 still pending applications of BAPA



~50%
Service transactions covered in majority

Complex transactions/ diverse industries also part of APA

- Marketing intangibles
- Brand Royalty
- Investment advisory services
- Corporate guarantee
- CCDs
- Intra-group service charges
- R&D services

MAP – Guidance Note



Endeavor to resolve MAP cases in **average timeframe of 24 months** (in conformity with the minimum standards recommended in the BEPS Action 14 final report)



Preferred in cases/ situation - **TP adjustments**; determination of existence of PE; profit attribution to a PE; characterisation / re-characterisation of income/ expense like royalty or FTS or interest



Consequential issues of interest/ penalty administered under domestic law; Secondary adjustment part of MAP; **Indian CA may go below income already offered to tax in ITR to implement MAP**



Correlative relief at treaty partner level if a taxpayer has entered UAPA/ applied for Safe Harbour / received ITAT order on the subject matter for which MAP is invoked



Access to MAP even in a situation where the Indian tax authorities apply **domestic anti-abuse provisions**



Resolution of disputes through the intervention of Competent Authorities; **Positive bilateral relationship should prove beneficial**

Way Forward

- **Effective governance models** to develop price setting and **regular monitoring** of related party transactions
- Strategizing required from **implementation** and **compliance** stage
- **Proactive** approach for **assessments**
- Strengthen documentation and submissions – **on facts** as well as **judicial precedents**
- **Transparency is the key** while sharing data with various authorities – **use technology** judiciously
- Focus on **technical updates** and **follow procedural aspects**
- **Customized alternate dispute resolution** to be evaluated as per facts of the case:
 - **APA** – to achieve **certainty**
 - **MAP** – to **avoid double taxation**
 - **Safe Harbor** – to **avoid future dispute**

Transfer Pricing Benchmarking



Manufacturer / Distributor / Service Provider

- **Shift in models** on account of **evolving commercial factors** and **international practices**:
 - Commission ---->>> Distributor
 - Low risk distributor / service provider ---->>> Routine distributor / service provider
 - Routine manufacturer ---->>> Licensed manufacturer ---->>> Contract manufacturer
- **Change in methodology and methods**:
 - Remuneration based on Functions vis-à-vis Risks
 - Aggregation vs transaction-by-transaction analysis
 - Price based vs Profit based analysis
 - Methods change e.g. RPM to TNMM
 - Identification of routine and non-routine parameters
 - Impact of R&D spends / AMP spends
- **Shift of functions** can require analysis from potential **exit charge** – valuation methodologies, estimation involved

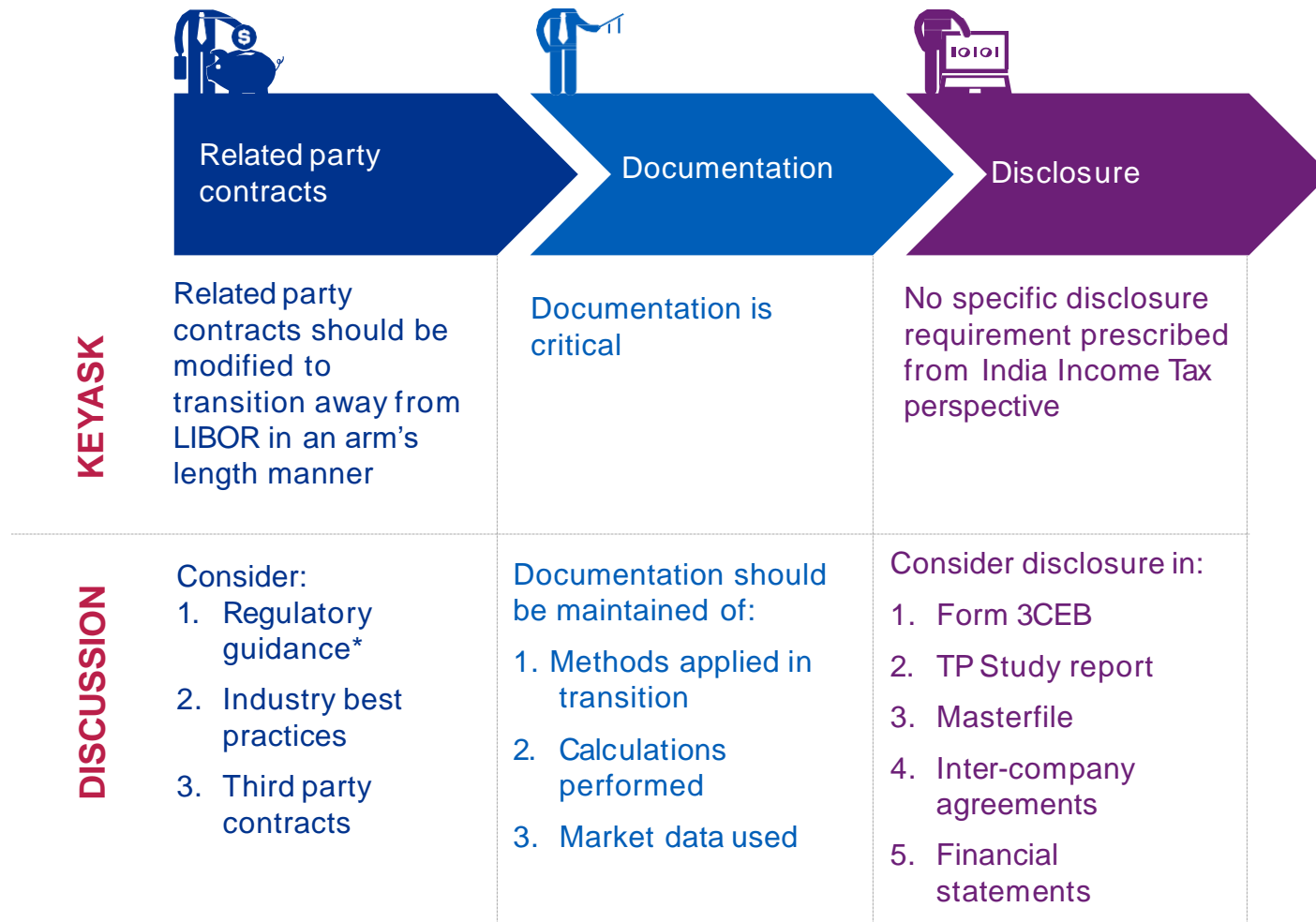
Transition from LIBOR to RFRs

- **Need to shift from LIBOR to RFR – publication stopped after 31 December 2021 / 30 June 2023**

LIBOR	RFRs
Unsecured	Secured
Reflects bank cost of funds	Risk-free rate
Term structure	Overnight (to begin)

Current Interest Rate Benchmark	Alternative RFRs	Borrowing Type	Alternative RFR Administrator	Calculation method
USD LIBOR	Secured Overnight Financing Rate (SOFR)	Secured	Federal Reserve Bank	Trimmed transaction weighted median ("trimming" the bottom 25% of the rates)
GBP LIBOR	Reformed Sterling Overnight Index Average (SONIA)	Unsecured	Bank of England	Trimmed (remove top and bottom 25%) volume weighted mean
EURIBOR EONIA	Euro Short Term Rate (ESTER)	Unsecured	European Central Bank	Trimmed (remove top and bottom 25%) volume weighted mean
CHR LIBOR	Swiss Average Rate Overnight (SARON)	Secured	SIX Swiss Exchange	Real time computation
JPY LIBOR / TIBOR / Euroyen TIBOR	Tokyo Overnight Average Rate (TONAR)	Unsecured	Bank of Japan	Volume weighted average

Transition from LIBOR to RFRs – TP impact



CBDT clarification awaited on following areas

Safe Harbour Rules for loans in foreign currency have prescribed interest rate denominated in LIBOR

Secondary adjustment – Interest on funds not repatriated based on LIBOR

Recent **APAs** have used fallback rates for overdue receivables and payables

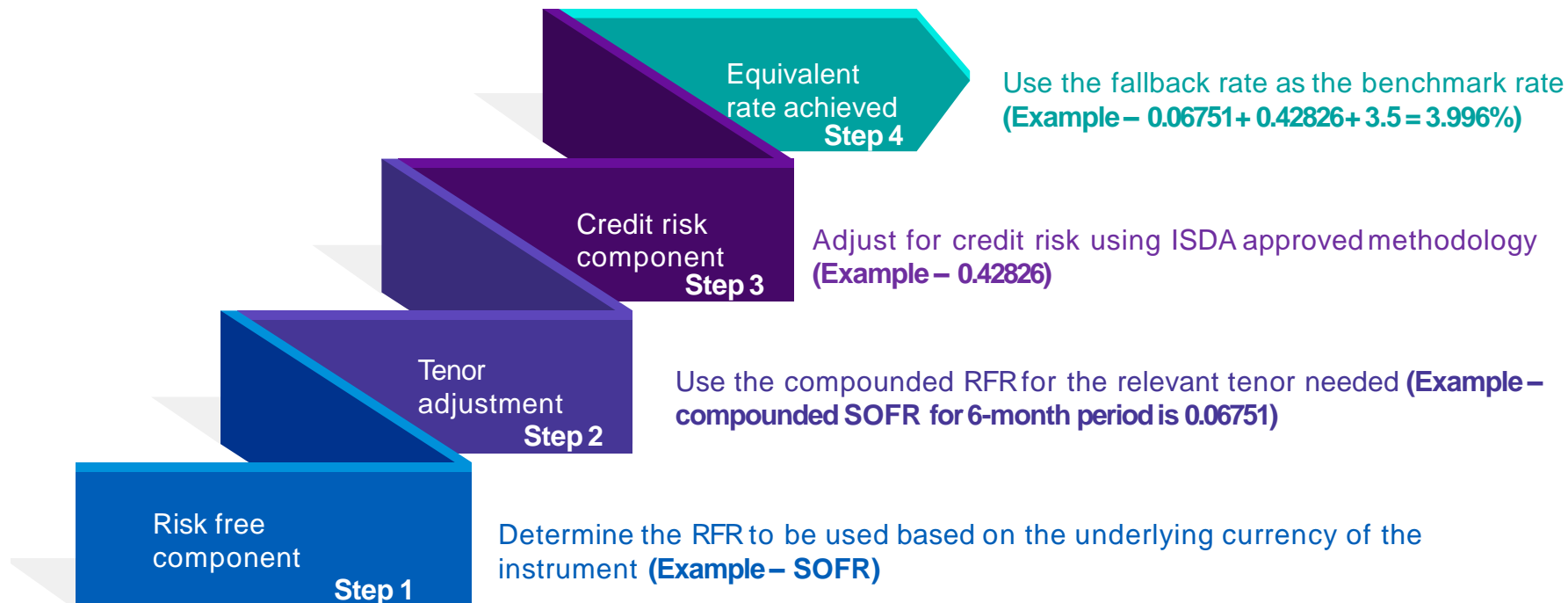
Long term tenors of LIBOR still existing – Need to be transitioned

Transition from LIBOR to RFRs – Benchmark

LIBOR = Risk Free Component + Tenor Adjustment + Credit Risk Component

RFRs = Risk Free Component

To transition a LIBOR based instrument to a fallback rate-based instrument, following adjustments to be made
(Example – a USD loan at 6m LIBOR plus 350bps):



Thank You

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