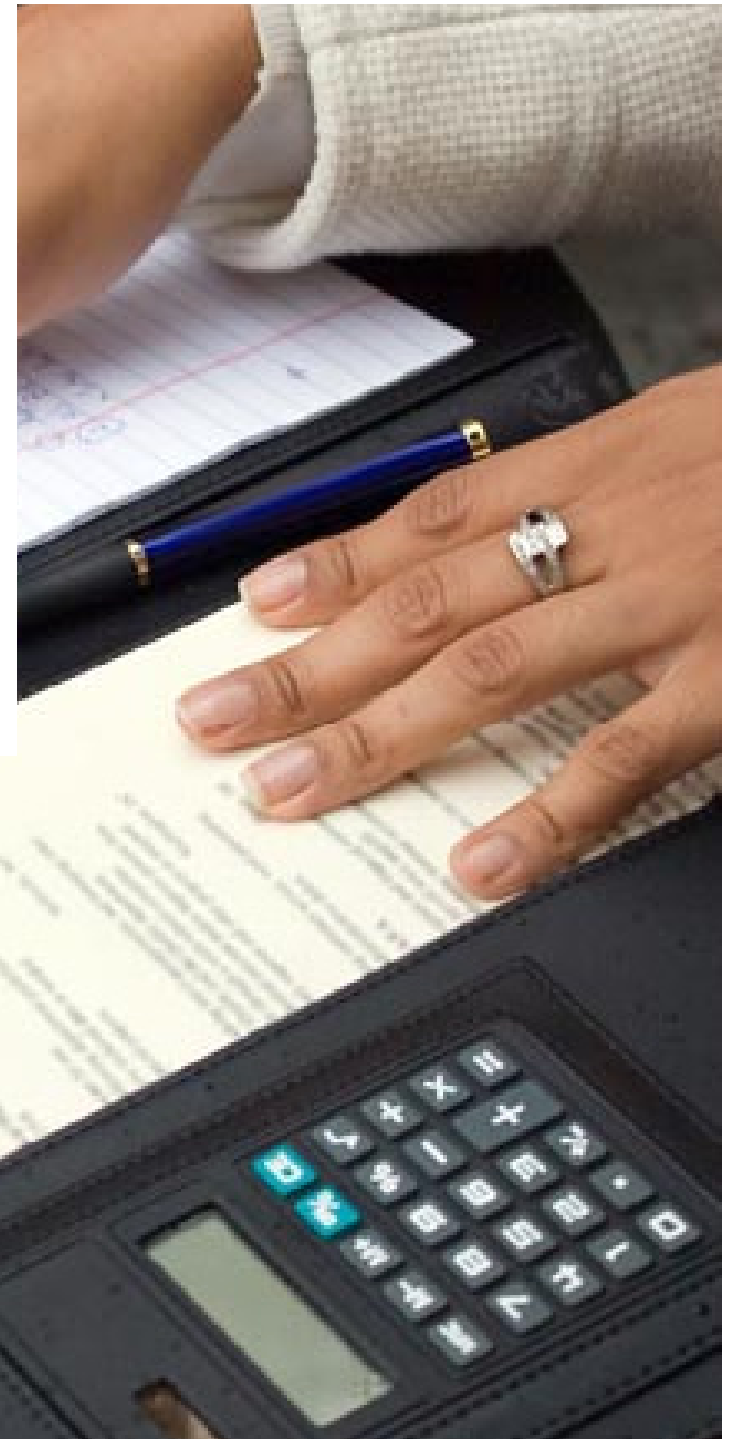


# Deloitte Haskins & Sells LLP

## Transfer Pricing Controversies and Recent Developments

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10 October 2015



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- Recap – what we witnessed so far
- Transfer Pricing (TP) - Recent developments
- Transfer Pricing Controversies
- Valuation of shares
- Loans
- Guarantees
- Location Savings
- Advertising, marketing, and promotional (AMP) expenditure
- Management Charges
- APA / MAP developments and rollback

# Recap – what we witnessed so far

# Recap – what we witnessed so far

- Transfer pricing provisions are viewed as a tool to amass tax
- Purpose of transfer pricing documentation is limited to penalty protection
- Over 24,000 cases were scrutinized by the TPOs; almost 45% of the cases scrutinized faced adjustments at the TPO level, totalling to over INR INR 2,70,328 cr. by January 2015.
- In FY 2014-15 alone, TP adjustments of approximately INR46,000 crores were made in over 2,300 cases
- Transactions beyond the purview of transfer pricing provisions were scrutinised and adjustments made
- TPOs continue to make adjustments for each of the subsequent years leading to multiplicity of cases for the taxpayers suffering year-on-year adjustments
- No certainty until a binding decision is rendered at the highest level – Supreme Court

# Recap – what we witnessed so far (cont'd)

- Introduction of Dispute Resolution Panels – effective in a limited sense, not achieved intended objectives
- Inordinately delayed resolution at ITAT level – Positive is that there has been a significant disposal of cases during FY 2014-15 (over 500 cases)
- HC rulings on significant issues are in favor of taxpayers; Tribunal Rulings also, substantially, in favour of taxpayers; being also remanded back in certain cases
- Issuance of clarificatory circulars on critical TP issues (e.g. Circular on Research and Development Centres )
- Introduction of safe-harbour guidelines
- Introduction of range concept and allowing use of multiple years data (final rules awaited)
- Dedicated DRP charge for commissioners
- Introduction of APA (along with rollback provisions)
- Introduction of risk based approach for manual selection of TP cases instead of compulsory audit of cases selected based on criteria of threshold limit (for international transactions) of INR 15 crores and above
- Acceptance of the Bombay HC decision in favour of the taxpayer on non-applicability of TP on issuance of shares and providing consequential instructions to the field officers

# Transfer Pricing – Recent developments

## Introduction

# CBDT issued draft rules on 21 May 2015 for public consultation

One of the key issues of transfer pricing disputes in India has been on the use of arithmetic mean, instead of range of data, and single year data, instead of multiple year data, for determination of ALP

CBDT introduced draft rules on 21 May 2015 for public consultation on “multiple year data” and “range” for computation of ALP

The draft CBDT rules, however, are not considered in line with the international practices

# Range

## Proposed changes and comments

### CBDT draft rules

#### Use of 40<sup>th</sup> to 60<sup>th</sup> Percentile

### Comments and recommendations

- Inter-quartile range concept (25-75 percentile) is the internationally accepted practice.
- Inter-quartile range is also more representative, as opposed to narrow 40-60 percentile range.
- Use of Inter-quartile likely to reduce TP litigation more than the use of 40-60 percentile.

#### Minimum requirement of 9 comparable companies

- Requirement of 9 comparable companies is not in line with international practices. Normally, no minimum threshold is prescribed.
- In certain situations it might be difficult to identify nine or more comparable companies for a particular industry, therefore, the taxpayer will have to apply arithmetic mean for determination of ALP.
- Prescription on the no. of comparable companies is likely to increase the dispute on comparability issues.

#### Applicability to Certain Profit-Based Methods

- Restricting the use of range and multiple year to certain methods is not aligned with the international practice.
- Concept of range and multiple year data should be extended to all TP comparability methods including Comparable Uncontrolled Price Method, and Profit Split Method.



# Multiple year data

## Proposed changes and comments

### CBDT draft rules

**Number of years  
restricted to three**

### Comments and recommendations

- Not in line with international practices. There is normally no cap on the data from the number of years.
- Taxpayers should be provided the flexibility of using 3 to 5 years of data for the purpose of determination of arm's length price
- Taxpayer should be given the flexibility of deviating from the rules in case of specific circumstance, supported with economic rationale of doing so.

**Use of Current Year  
Data**

- TPO uses current year data during transfer pricing litigation and rejects the TP report if current year data is not used.
- Since current year data may not be available during the time of preparation of TP report, it should not be rejected for the want of use current year data during litigation

**Applicable for PLI  
computation of  
Comparable  
companies**

- Benefit of use of multiple year data should also be bestowed to large sample analysis
- International practices allow flexibility in use of multiple year data.

# Way forward – range and Multiple Year data

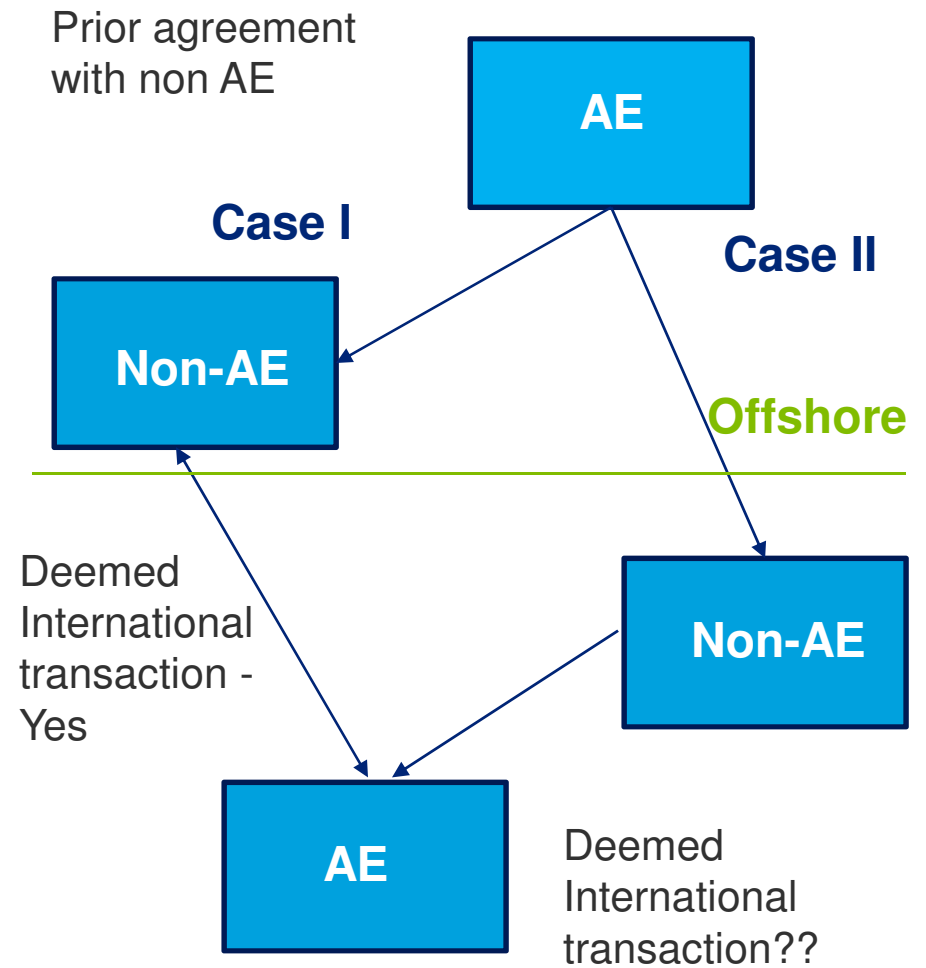
Various industry bodies and other stakeholders have submitted their comments on draft Rules

CBDT is likely to issue final guidelines soon

# Deemed International Transaction...

## Rationalization of definition

- A transaction entered into by an enterprise with a third party is deemed to be a covered transaction, if
  - There exists a prior agreement between such third party and the AE, or;
  - The term of the transaction is determined in substance between such third party and the AE.
- Whether transaction with resident third party in such cases covered under the ambit of the TP?



# ...Deemed International Transaction

## Amendment in section 92B(2):

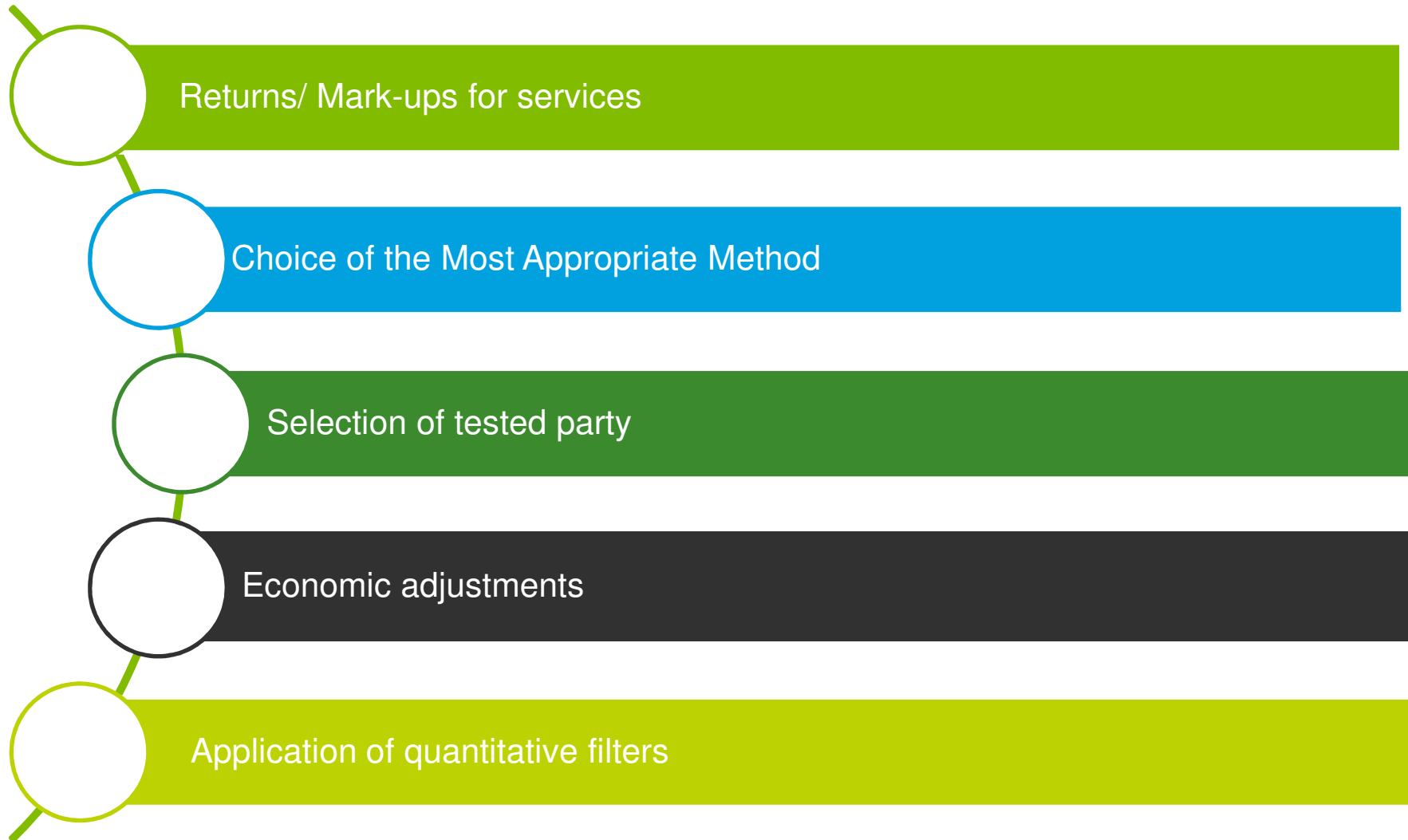
- Section 92B(2) is proposed to be amended to provide that relevant transaction shall be deemed to be an international transaction where:

*“the enterprise or the associated enterprise or both of them are non-resident, **whether or not ‘such other person’ is a non-resident**”*

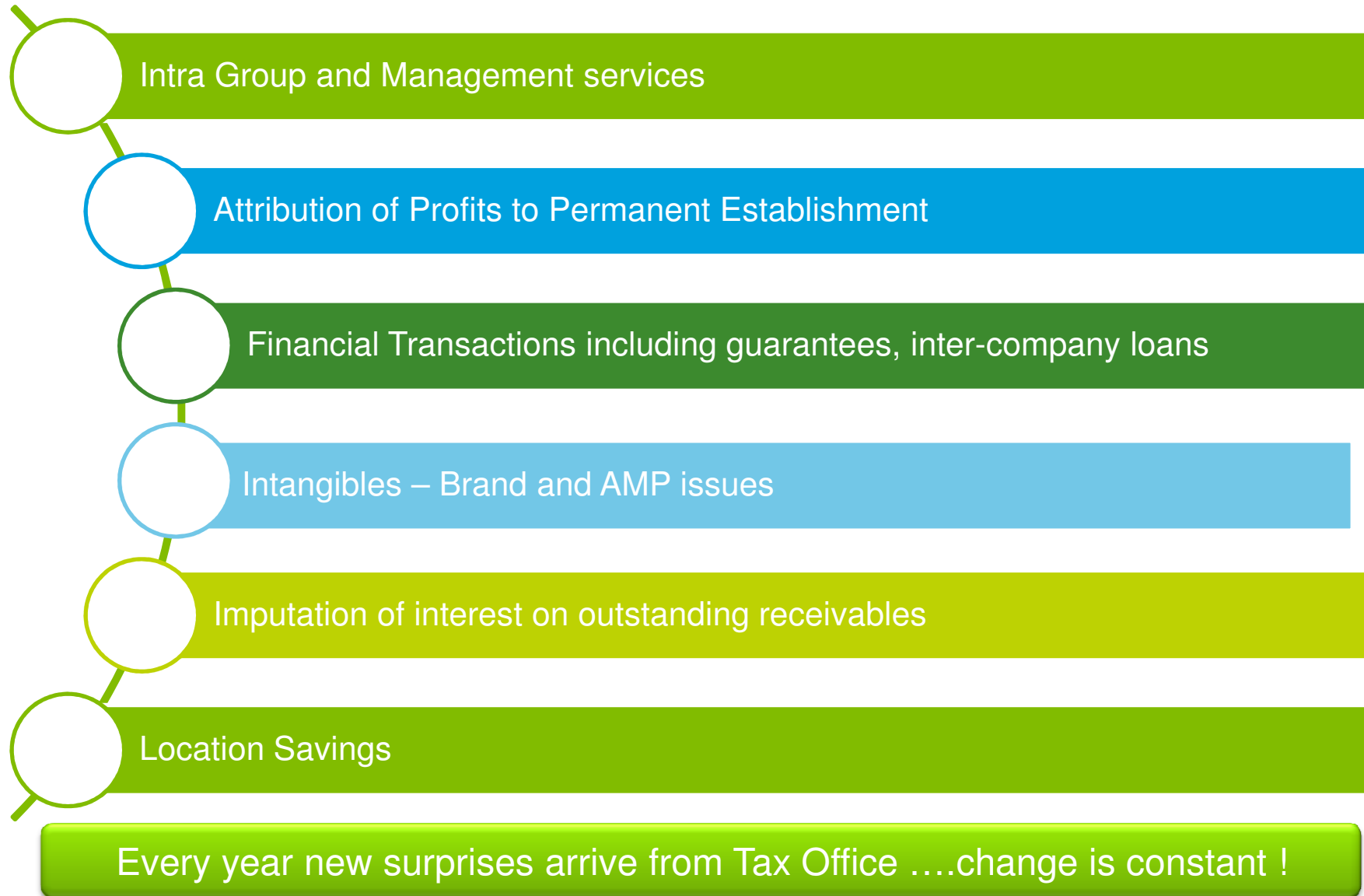
- Thus, deeming provision would also apply to cases where the third party is an Indian resident
- The provision is applicable from Financial Year 2014-15.

# Transfer Pricing Controversies

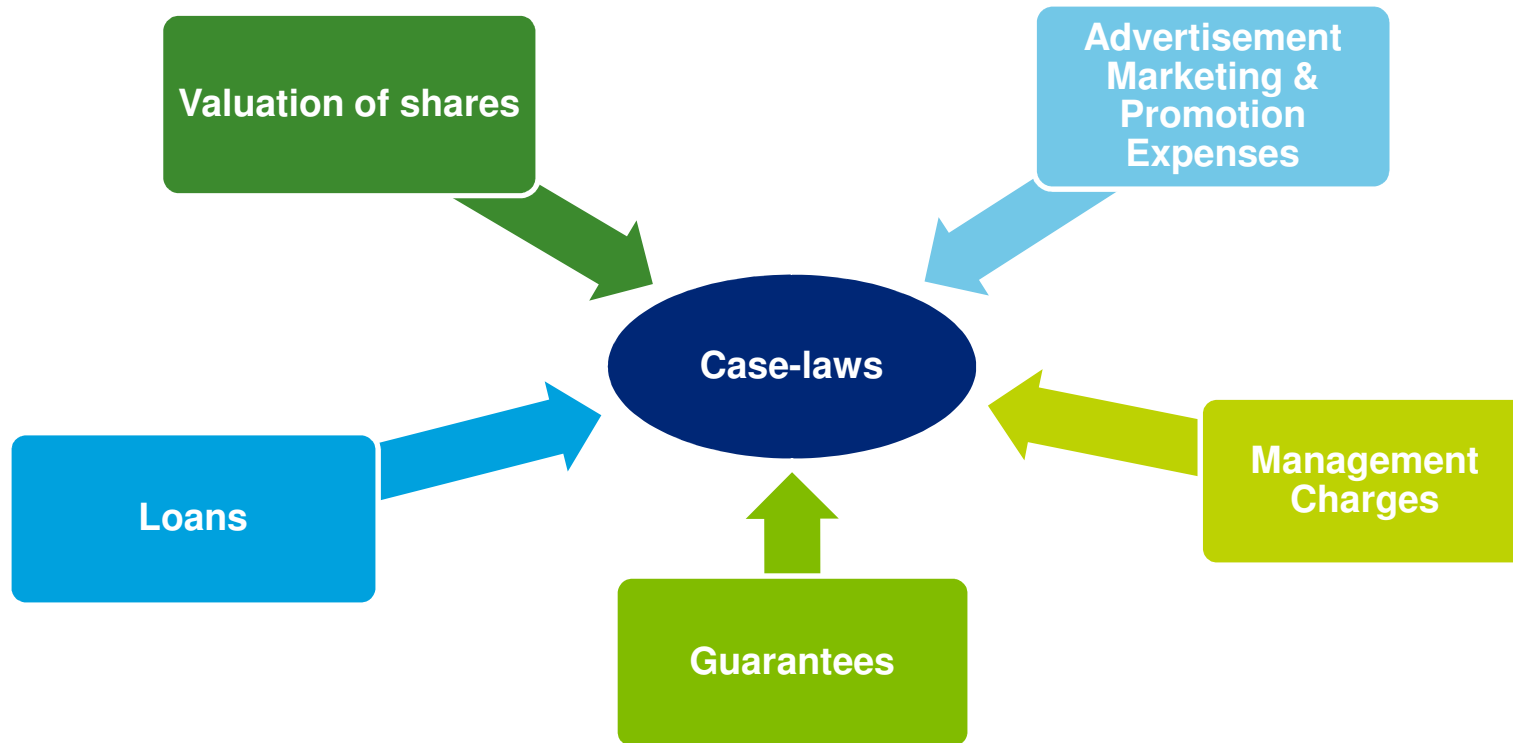
# Key Controversies – Traditional issues



# Key Controversies – Next wave



# Focus Area – Key rulings





# Valuation of shares

# Issue of Shares - Brief Overview

- Under the Income-tax Act, 1961 (ITA), tax can be levied only if the transaction gives rise to “income”
- However, in the recent past, this concept has been the subject matter of intense discussion since the revenue authorities took a position that shares issued at a price lower than the arm’s length price to associated enterprise would give rise to taxable income in India
- Further, the short fall (i.e. the difference between the issue price and the arm’s length price so determined) was considered as loan outstanding with AE and hence additional payment in the form of interest receivable from AE was sought by the tax department
- **Major cases:**
  - Shell India Markets – INR 15,200 cr
  - Essar Group – INR 8,000 cr
  - Vodafone India Services – INR 1,400 cr
  - HSBC Securities – INR 935 cr.
- Few other cases:
  - Bharti Airtel, Standard Chartered Securities, Havells India and Patel Engineering

**Amounts at stake – Over INR 35,000 cr.**

# Issue of Shares

## Typical Facts

- Indian subsidiary issues shares to its foreign parent company (i.e. infusion of share capital in an Indian entity)
- Shares valued as per the existing methodology (i.e. CCI or DCF)
- Usually disclosed in Form 3CEB as a note, out of precaution

## Revenue's Contentions

- To be considered as an international transaction
- Shares have been undervalued / less than the fair market value
- The difference between actual issue price and ALP is computed and two-fold adjustment made:
  - notional income of the Indian Subsidiary → treated as TP adjustment
  - notional interest on such alleged loan → treated as TP adjustment

# Issue of Shares – Whether International Transaction?...

## **Does the definition of international transaction include issue and subscription of shares?**

- Under section 92B of ITA, an "international transaction" is defined to mean "a 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..."
- Further, the Explanation introduced to section 92B in 2012 (with retrospective effect from 2002) contains an inclusive definition of "international transaction" which includes "capital financing... including ... purchase or sale of marketable securities..."
- It can be contended that the issue of shares would not fall under the phrase "purchase or sale of marketable securities" since issue of shares is different from purchase or sale of securities
- However, it is pertinent to note that as per new Form No. 3CEB, issue of shares is required to be disclosed under clause 16

# ...Issue of Shares – Whether International Transaction?

The **crucial question** is whether Chapter X of ITA confers the jurisdiction to

- treat a transaction on the capital account as a revenue transaction?
- treat a single transaction of issue of shares as two transactions
  - as that of issue of shares and of grant of a financial accommodation (equal to the difference in value of the arm's length price determined and the issue price of shares)
  - to bring to tax a notional amount as interest foregone on this notional amount of financial accommodation?

# Other issues for consideration

- Whether the difference in the share price ('alleged undervaluation') can be considered as an "income" under ITA?
- How to value equity shares? – DCF method v/s CCI method
- Valuation methodology adopted by TPO and assumptions to apply DCF
- Whether TPO correct in treating the difference in valuation of shares treated as deemed loan / deemed receivable ?
- Whether imputing a notional interest on deemed loan is correct?

# Vodafone India – Bombay High Court...

## Facts

- Vodafone India is a wholly owned subsidiary of a Mauritius Vodafone entity, issued equity shares of face value of INR 10 at a premium of INR 8,591 per share to its holding company

## TPO / DRP

- The TPO disputed the valuation of shares and re-computed the value per share [based on the Net Asset Value (NAV) to INR 53,775. The TPO treated the shortfall in the value of shares [INR 53,775 less INR 8,591 per share] as deemed loan by the taxpayer to its foreign parent and charged a notional interest @ 13.5% and accordingly made TP adjustment. DRP also upheld the TP order

## High Court Ruling

- The Mumbai High Court held that **TP regulations are applicable only to international transactions that give rise to taxable income**. Neither the capital receipt on issue of equity shares nor the shortfall (if any) in share premium can be considered as taxable income within the ambit of ITA
- Further, there is no specific provision in ITA for treating inflow of funds from shares issued to non-residents as taxable income. Hence, TP provisions do not apply to capital transaction itself

# ...Vodafone India – Bombay High Court

## Update

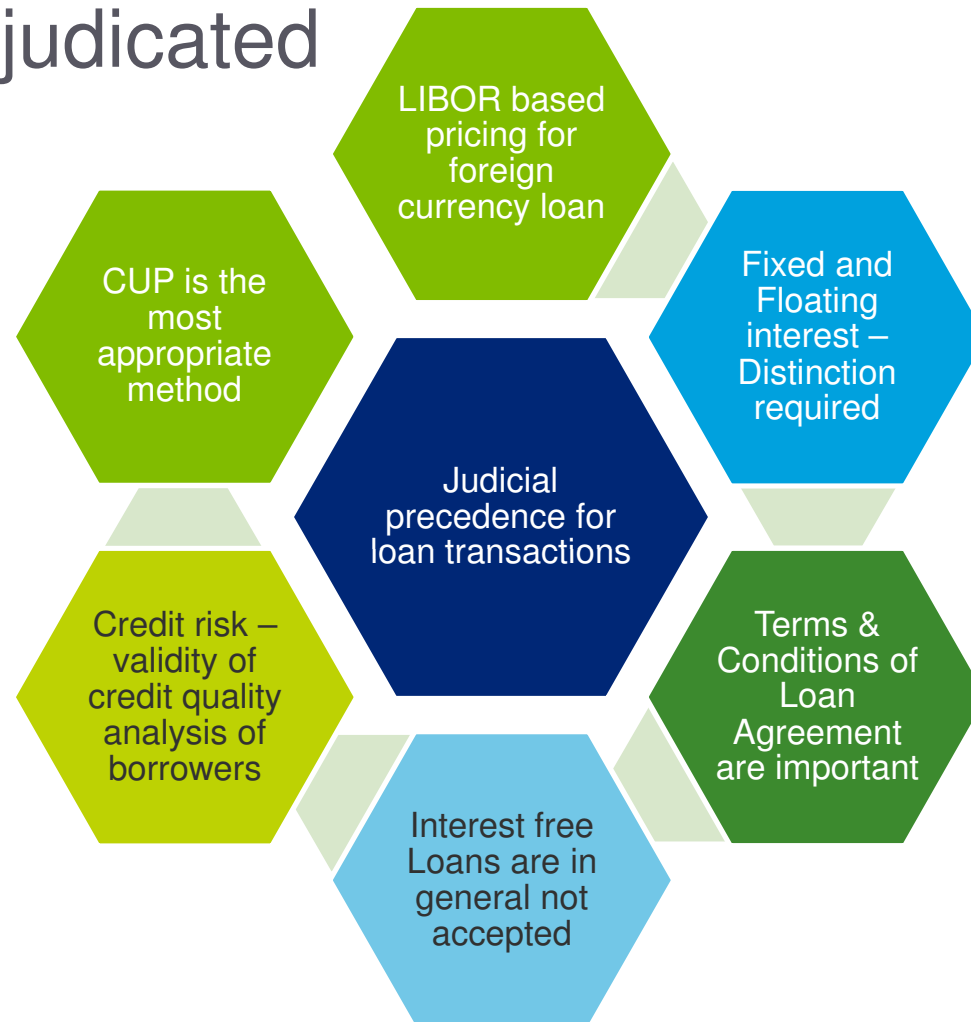
- Attorney General advised Government not to file Special Leave Petition
- CBDT instruction No.2/2015 dated 29 January 2015: Board accepted decision of HC, field officers directed to adhere
- Press release by Ministry of Finance: “bring greater clarity and predictability” and thereby improve the investment climate in the country



# Loans

# Loans

## Principles Adjudicated



Due care for terms and conditions in the Loan agreement  
-- interest can vary accordingly

# Cotton Naturals – Delhi ITAT Ruling

- Comparable transaction would be foreign currency lent by unrelated parties.
- Domestic prime lending rate have no applicability and international rate being LIBOR to be taken as the benchmark rate
- Reliance placed on following case laws:
  - Siva Industries & Holdings Ltd.
  - Four Soft Ltd.
  - Tech Mahindra Ltd.
  - Tata Autocomp Systems

# Cotton Naturals – Delhi High Court

- Chapter X and Transfer Pricing rules **do not permit** the Revenue authorities to step into the shoes of the assessee and decide whether or not a transaction should have been entered
- TPO's comparability test of loan advanced to Indian unrelated party with similar financial health as AE → unacceptable and illogical
- What the assessed would have earned → in case he would have entered into or gone ahead with a different transaction (say with a party in India); is not the criteria
- Different parameters should not be applied for inbound and outbound loans
- Currency in which the loan is to be re-paid normally determines the rate of return on the money lent, i.e. the rate of interest.
- Accepted parameters recommended by Klaus Vogel in **Article 11 of Double Taxation Conventions (Third Edition)** to dismiss applicability of PLR rate for determining interest rate of loan to be repaid in foreign currency
- Klaus Vogel in **Article 11 of Double Taxation Conventions:**  
*“The existing differences in the levels of interest rates do not depend on any place but rather on the currency concerned...”*

# Guarantees

# Audit Experience

- Revenue authorities fail to evaluate whether the guarantee actually leads to any savings or benefit to the borrower or is a mere administrative arrangement, like letters of comfort or letter of awareness
- Adopt the interest saved approach but the applications have been erroneous – adoption of domestic credit rating, Indian yield rates, data not available in public domain, credit rating of borrower derived arbitrarily
- Fail to distinguish between performance guarantees and financial guarantees – adopt a common pricing system
- Arbitrary adaptation of 3 % guarantee fee without any rationale for all guarantee fee transaction across industry – some other cases the arbitrary application of interest approach resulted in a guarantee commission of up to 11%
- Application of bank quotation for guarantee commission charged by Indian banks without analyzing the terms and conditions
- Generally is not supportive of the “Shareholder’s Service” argument

# Bharti Airtel – Delhi ITAT Ruling

- Analysed section 92B of the Act alongwith the Explanation to the definition of ‘International Transaction’ as amended by Finance Act, 2012
- Observed that since the Explanation is *clarificatory* in nature, the retrospective amendment does not alter the basic character of the definition of international transaction
- Any transaction including capital financing, guarantees, business restructuring / reorganization can be regarded as an ‘international transaction’ only if such a transaction has a bearing **on the profits, income, losses or assets of an enterprise** (either immediately or in future)
- Impact in the future has to be certain (and not contingent) for covering a transaction in the definition of international transaction.
- Corporate guarantees issued by the taxpayer did not have any implication on the profits, income, losses or assets of the taxpayer. AE had not taken any borrowing from the bank based on the taxpayer’s guarantee
- Held that when a taxpayer extends any assistance to its AE without incurring any expenditure and for which the taxpayer otherwise also could have not realized any income by giving it to any third party, such assistance has no bearing on profits, income, losses or assets of the taxpayer
- Distinguished the case from the preceding Tribunal cases (on quantification of arm’s length guarantee fee) by holding that none of the earlier cases dealt with the issue of coverage of the guarantee transaction in the scope of international transaction as defined in the Act

# Advanta India Limited – Bangalore ITAT Ruling

- Differentiated the case of Bharti Airtel; Noted that in that case, it was an undisputed position that the issuance of the guarantee did not cost the taxpayer anything, and it was for this reason that the Delhi bench concluded that the issuance of guarantee did not have any "bearing on the profits, income, losses or assets or such enterprise", thus taking it out of the ambit of 'international transaction'
- In the present case, as the taxpayer had incurred costs on issuance of the guarantee, the issuance of guarantee indeed had a bearing on the profits and income of such enterprise, and hence, it cannot be said that the issuance of guarantee did not constitute an 'international transaction'.



# Glenmark Pharmaceuticals – ITAT Mumbai Ruling

- Approves guarantee commission fee at 0.53% and 1.47% charged by Glenmark Pharmaceuticals Limited in connection with bank loans and L/C facilities
- Explains distinction between corporate guarantee and bank guarantee
- The comparables adopted by TPO are IUPs (i.e. Incomparable Uncontrolled Prices) and dismisses the TPO's CUP and orders deletions of the additions made by AO
- Naked bank guarantee quotes given on public websites not good external CUPs unless they are adjusted as per Rule 10B to factors like risk profile of respondents for guarantee, financial position of applicants, quantum of amount, terms of guarantee, etc.
- Rejects use of guarantee commission rates available on websites of Bank of India, Allahabad Bank, HSBC, EXIM Bank-USA and Rabo India Finance P Ltd.

# Everest Kanto Cylinders –Mumbai High Court

- The anomaly pertaining to rates applied by TPOs (guarantee commission charged by various bank in the range of 2% -3%) has been set right by a recent ruling of the Bombay HC in the case of CIT v/s Everest Kanto Cylinders Ltd.
- The Bombay HC held that the comparison was not between like transactions; Guarantees as issued by commercial banks, as against a corporate guarantee issued by a holding company for the benefit of its AE (i.e. a subsidiary company).
- Thus, the higher rate of 3% as guarantee commission was thereby not justified, and a rate of 0.5%, as charged by the taxpayer, was ultimately upheld.

The above ruling provided much needed relief to taxpayers facing TP adjustments arising out of comparison of guarantee rates of commercial banks with the rates of corporate guarantees. This emphasises the importance of having a comprehensive comparability analysis to support application of Comparable Uncontrolled Price method for determining the arm's length rate of guarantee commission.

# Location Savings

# GAP International – Delhi Tribunal...

## Facts

- GAP International Sourcing (India) Pvt. Ltd. ('taxpayer') was a wholly owned subsidiary of GAP International Sourcing Inc., USA ('AE') facilitating sourcing of apparel merchandise from India for the Group
- Taxpayer claimed that TNMM with cost plus 15% remuneration to be the most appropriate method for determination of ALP
- The authority view was that the taxpayer:
  - Played a critical role in the AE's value chain;
  - Undertook 'high value' procurement functions; and
  - Owned 'procurement intangibles'
- Tax authority asserted that 'location savings' arising from sourcing from a low-cost country such as India was not factored in the cost plus 15% compensation
- Authority held that commission of 5% on the Free-on-Board ('FOB') value of goods sourced by the foreign enterprise through Indian vendors was ALP

# ...GAP International – Delhi Tribunal

## Issues before the Delhi Tribunal

- Whether the taxpayer's case is covered by the judgment given by the Delhi Tribunal in case of Li & Fung India Pvt. Ltd

## Observations and ruling of the Delhi Tribunal

- Upheld the characterisation of the taxpayer as a routine service provider and observed that its activities did not result in creation or development of procurement related intangibles
- Acknowledged that location savings is generally passed on to the end customer in a competitive market
- Mentioned that the question of allocation truly needs to be addressed in light of the relative bargaining powers/intangible ownership
- Did not observe any distinctive competitive advantage vis-à-vis other sourcing companies which could have led to taxpayer wielding significant bargaining power
- Location specific savings, if any, would be captured in the profitability of the comparables used for benchmarking the international transaction. Accordingly, no separate allocation is called for on account of locational savings

# Watson Pharma (India) Private Limited – Mumbai Tribunal...

## Facts

- Watson Pharma (taxpayer) was engaged in rendition of contract manufacturing and contract Research and Development ('R&D') services to its AEs
- The taxpayer used the transactional net margin method ('TNMM') to benchmark the said transactions
- Indian tax authorities accepted the use of TNMM; however, tax payer **should additionally receive extra compensation on account of the location savings** that have arisen pursuant to the AE transferring the manufacturing activity from UK and other European countries to a low cost jurisdiction (i.e., India)

# ...Watson Pharma (India) Private Limited – Mumbai Tribunal

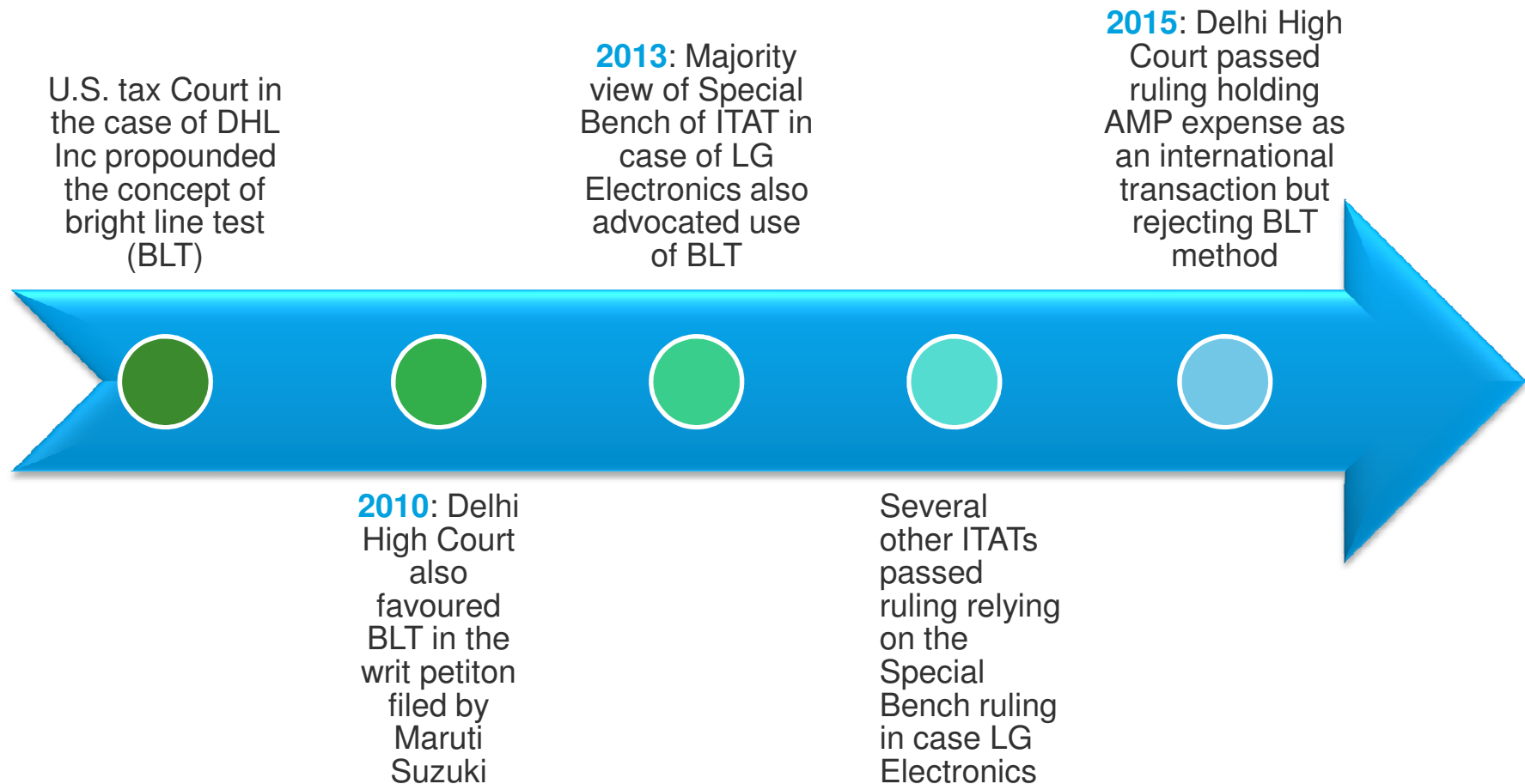
## Observations and ruling of the Mumbai Tribunal

- While observing the overall bargaining power, options realistically available and the general market competition, the Tribunal noted that the tax payer and the AE, both, operated in a perfectly competitive market.
- Tribunal, following the ruling in the case of GAP International, held that location savings (if any) would be reflected in the profitability earned by the local comparables (operating in similar economic circumstances as the taxpayer) which are used for benchmarking the international transactions → ***Hence, no separate compensation is called for on account of such location savings.***
- The Tribunal mentioned about India’s participation as a part of G20. It categorically stated the position which G20 countries have concurred upon on the pertinent matter - *“where reliable local market comparables are available and can be used to identify arm's length prices, specific comparability adjustments for location savings should not be required”*.
- As regards India’s views in the UN TP Manual, the Tribunal specifically observed that the claimed position is that of the Indian tax administration and not the view of Indian Government.

# Advertising, marketing, and promotional (AMP) expenditure



# Advertisement, Marketing Promotion (AMP)



# Sony Ericsson and Others – Delhi High Court...

## Background

- The special bench of the Delhi Tribunal dealt with the issue of marketing intangibles in detail in the case of LG Electronics .
- It was held that where AMP expenses are incurred by the licensee of a brand in excess of the AMP expenses of the comparables, the licensee (being the licensed manufacturer) should claim a reimbursement of this excess amount from the licensor of the brand (i.e. the AE), along with a mark-up, since it has allegedly provided the service of 'helping' the licensor to develop its brand.
- The excess of AMP expenses would be worked out using the AMP/sales ratio of the taxpayer (i.e. the licensee) and the comparables, termed as the 'Bright Line' test.

## Ruling of the Delhi High Court

- AMP was accepted as being a transaction with an associated enterprise, i.e., as an international transaction. The Delhi HC judgment has been challenged before the SC, and one of the grounds appealed is that the AMP transaction is not an international transaction, and therefore, it is not liable to TP.
- Brand value is created by synergetic impact of reputation, quality and other facts relevant to a particular business and not just by incurring AMP expense.
- The High Court rejected the application of bright line test for determining non-routine AMP expense and TP adjustment on account of separate consideration for such alleged non routine AMP expense incurred by the taxpayers.

# ...Sony Ericsson and Others – Delhi High Court

## Ruling of the Delhi High Court (Contd..)

- When marketing and distribution functions are closely connected and reliable comparables are available, then they could be aggregated and the arm's length price can be computed together, and TNMM would be appropriate to use in such situations.
- TNMM relies on the assumption that the functions, assets and risks are broadly similar, and that once suitable adjustments have been made, net profit margins should be compared. If the profit margin of the tested party matches with that of the comparables, it affirms that the transaction meets with arm's length standard.
- TNMM would not be an appropriate method in case of significant value addition by the Indian company, i.e., where the company is engaged in manufacturing activities, and also carrying out distribution and marketing activities.
- If on comparability analysis, gross profit earned by taxpayer is in line with the comparable margins earned by comparables carrying similar AMP function as that of the taxpayer, no further TP adjustment is warranted. In such cases, the gross profit margin includes the compensation for AMP expenses.
- Economic ownership concept was recognized and the High Court held that the economic ownership arises only in case of long term contracts. Further, the valuation of such economic ownership is not done regularly but is done when it is transferred to third party or the rights are terminated. TP valuation would be mandated only at that point of time.

# What lies ahead



Although the HC Ruling in the Sony Ericsson case is applicable to only state of Delhi, Tribunals are using the analytical content of the order

Various Tribunals have adopted the Sony Ericsson HC decision. The Tribunals have remitted the matter to the TPO to decide the cases afresh in light of the High Court ruling.

Miscellaneous application / appeals have been filed by various companies facing AMP issues with HC and Tribunals in various jurisdictions post-Sony HC ruling

# Management Charges

# Management Charges

Generally, the management charges / payments made for Intra Group Services include the following kinds of services:

- Corporate Risk Services – internal audit and risk management services
- Financial Management and Reporting Services – external financial reporting, financial strategy and management services
- Legal Services – legal support and legal advice
- Human Resource Services – capability development and organizational health and safety services
- Technical Services – sharing market intelligence reports and provision of insights on competition
- Trading and Marketing Services – strategic services, risk management services and assistance in marketing to international customers
- Information Technology Services – IT services and E-business services

# Management Charges contd..

- What constitutes “Service” is not defined in Indian Transfer Pricing regulations and hence guidance could be availed from International Transfer Pricing regulations.
- In this regard, as per OECD Transfer Pricing guidelines, to qualify an activity to be service, test is whether the activity provides the respective group member with economic or commercial value which enhances its commercial position.
- The following two criteria are useful in determining this aspect:
  - Whether an independent enterprise in comparable circumstances would have been willing to pay for the activity if performed for it by an independent enterprise or
  - Whether the entity would have performed the activity in-house for itself.
- Following activities do not qualify for IGS charge :
  - *Shareholder activities*
  - *Duplicative activities*
  - *Services resulting in Incidental Benefits*

# Cushman & Wakefield – Delhi High Court

- It was necessary to test if third party in an uncontrolled transaction would have charged lower, equal or greater amount as compared to what was charged by AE
- Whether the cost itself is inflated or not is a matter to be tested under comprehensive TP analysis
- The High Court ruled that the authority of the TPO is restricted to the determination of ALP and not to determine whether there is a services or not from which the taxpayer benefits
- Details of the specific activities for which cost was incurred by both AEs and the attendant benefit to the taxpayer have not been considered till date

The Delhi HC, in another landmark judgement pronounced in the case of EKL Appliances held that the TPO cannot question the business decision of the taxpayer, and cannot determine the ALP of a transaction as 'Nil' on the basis that the assessee did not receive any benefit from the transaction.



# Safe Harbour Rules

# Safe Harbour Rules - Overview

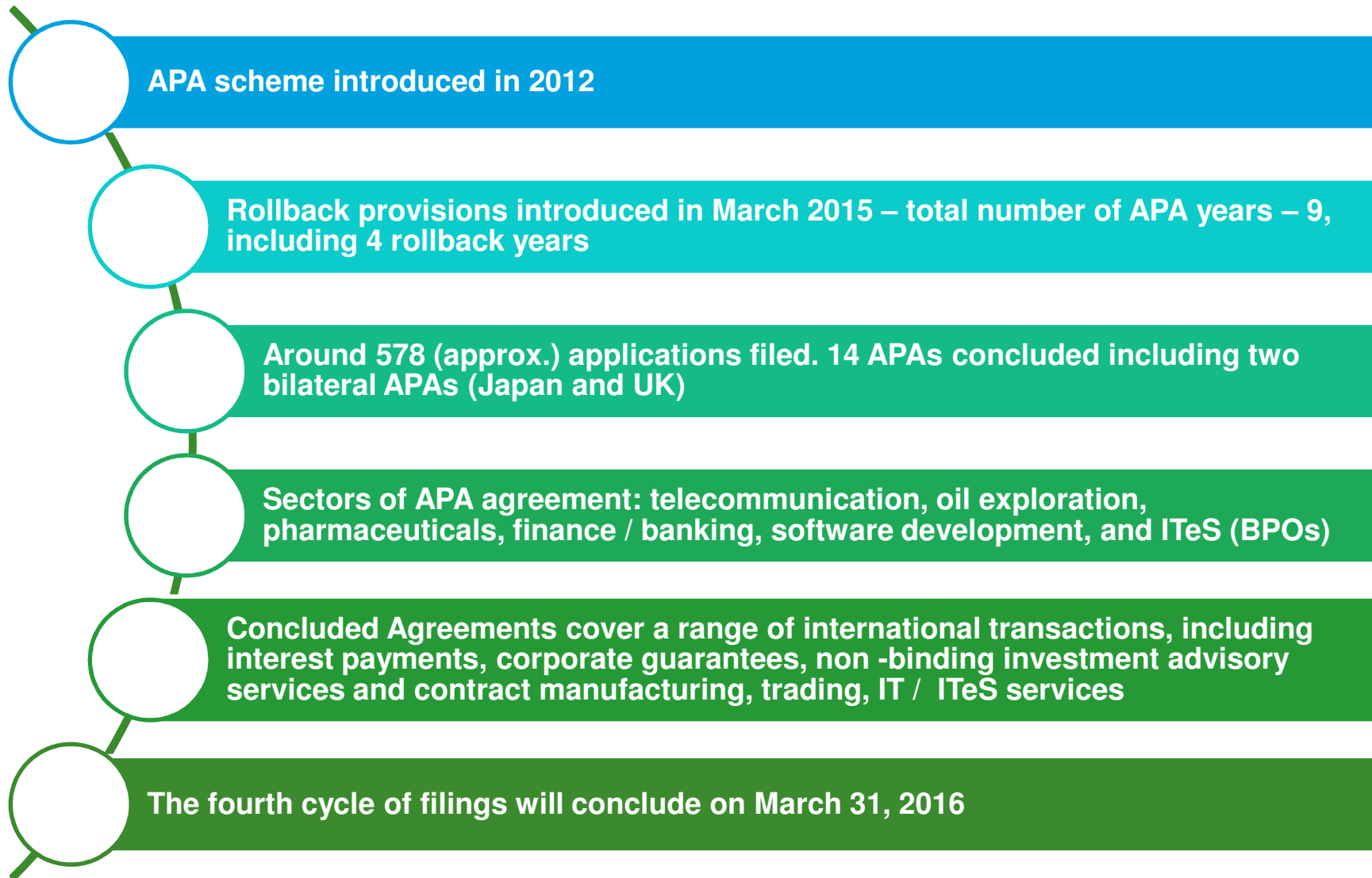
- Safe Harbour is a mechanism under which in certain circumstances tax authorities accept the transfer prices declared by taxpayers without undertaking detailed audit
- The safe harbour provisions would be available only if the taxpayer / transaction satisfies the eligibility conditions provided in the rules
- The rules cover international transactions in six categories/ sectors, i.e. Information Technology (IT), IT Enabled Services (ITES), Contract Research & Development (R&D) in the IT and Pharmaceutical Sector, Financial transactions (Outbound loans and Corporate Guarantees) and Auto Ancillaries Manufacturing
- The transfer price contained in the safe harbour rules applicable for five years beginning from assessment year 2013-14 (financial year 2012-13)
- The taxpayer is required to maintain transfer pricing documentation and furnish Form 3CEB irrespective of the fact that the taxpayer opts for safe harbor provisions
- The rules also set out that no comparability adjustments and benefit of arm's length range (1% to 3%) would be available to the transfer price declared while opting for safe harbour rules
- Where transfer price as declared by the taxpayer in accordance with safe harbor provisions is accepted by the revenue authorities, the taxpayer shall not be entitled to invoke Mutual Agreement Procedure (MAP) for avoidance of double taxation.
- The benefits of the safe harbor provisions cannot be availed by a taxpayer who has transactions with associated enterprises, which are domiciled in a "No tax or low tax country or territory" i.e. countries / territory where the maximum marginal rate of income-tax is less than 15 per cent

# Safe Harbour Rules

Sector	Threshold limit	Safe Harbour operating margins
Software development services and Information technology enabled services (other than Contract R&D)	Up to INR 500 crores	20 percent or more
	Above INR 500 crores	22 percent or more
Knowledge process outsourcing services (other than Contract R&D)	-	25 percent or more
Software related contract R&D services	-	30 percent or more
Contract R&D services wholly or partly relating to generic pharmaceutical drugs	-	29 percent or more
Manufacture and export of core auto components (engine parts)	-	12 percent or more
Manufacture and export of non-core auto components (non engine parts)	-	8.5 percent or more
Intra company loans by Indian entity to a non-resident wholly owned subsidiary	Up to INR 50 crores	Interest rate equal to or greater than base rate of SBI as on 30th June of the relevant previous year plus 150 basis points
	Above INR 50 crores	Interest rate equal to or greater than base rate of SBI as on 30th June of the relevant previous year plus 300 basis points
Provision of explicit corporate guarantee	Up to INR 100 crores	Fee or commission rate is 2 per cent or more per annum on the amount guaranteed
	Above INR 100 crores	Fee or commission rate is 1.75 per cent or more per annum on the amount guaranteed

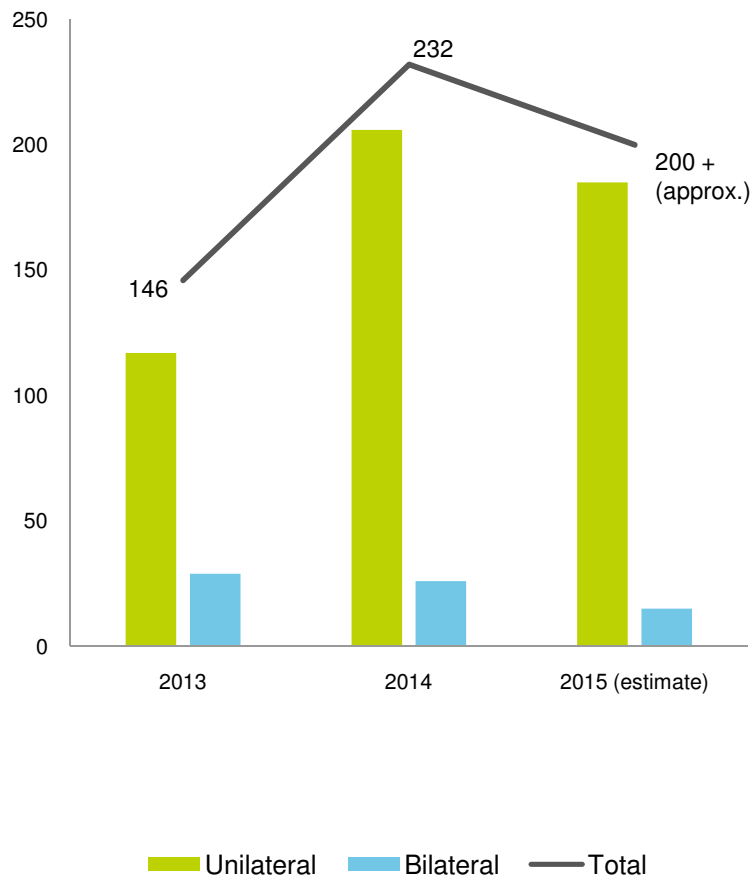
# APA / MAP developments and rollback

# APA development in India



# APA statistics summary

## Statistics of APAs filed and concluded



## Some milestones in India APA Scheme

- CBDT notification on introduction of APA on 30 August 2012
- CBDT APA Guidance with FAQ on APA in 2013
- Rollback introduced on 14 March 2015
- CBDT notification on rollback released on 31 March 2015
- Rollback FAQ released on 10 June 2015
- CBDT press release on rollback and APA on 6 August 2015

**12 Unilateral and 2 Bilateral APAs concluded so far..**

- 5 unilateral on 31 March 2014
- 1 bilateral on 19 December 2014
- 3 unilateral in March 2015
- 4 unilateral and 1 bilateral after 31 March till date (Including 1 rollback APA)

# APA developments

Pre-filing conference meetings for India bilateral APA started by the U.S. IRS in May 2015



The U.S. IRS has released on 12 August 2015 guidance on the process of requesting and obtaining APAs. Another India–US competent authority meeting took place in September 2015



A number of unilateral and bilateral APA's with the UK and Japan are at advanced stage of negotiation



# MAP developments



India – U.S. CA relationship on fast track after Jan 2015  
200 MAP cases of IT / ITeS likely to be resolved during the current fiscal year

So far, 35 IT / ITeS U.S. MAP cases resolved within 6 months. Another 100 cases likely to be resolved in the next three months



The above progress is part of the framework agreement signed by India with the U.S. and opens doors for more bilateral APAs



# APA Rollback

- APA Rollback is applicable for any covered transactions as mentioned in Form 3CED
- Rollback years will include four years, preceding the first year of the APA covered period
- Some of the challenges with respect to applicability of rollback provisions faced by the APA applicants are provided below:

## Merger

If two entities merge to form a new entity (which is the APA applicant), then merged entities' transactions are not eligible for rollback

Rollback eligibility is only for the APA Applicant's (new entity's) rollback transactions

## Transacting Associated Enterprise

The requirement that transacting associated enterprise during APA period and rollback period should be same

## Rollback Period

Applicant does not have the option to pick and choose the years of rollback for the eligible period of 4 years

It is either all 4 years or none (unless some years are not eligible)

# Conclusion

- Transfer pricing provisions are still evolving in India
  - Tax authority views
  - Judicial precedents
- Government keen in providing various opportunities to ensure transfer pricing certainty and reduce litigation; issuance of certain positions to revenue officers and taxpayers on various contentious issues could help
- Taxpayers should have comprehensive TP documentation clearly capturing the value chain analysis and the functional and risk profile of the entities involved in related party transaction; maintenance of necessary supporting documentation is vital to substantiate intra-group transactions.

# Questions & Answers

# Deloitte Haskins & Sells LLP

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