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Transfer Pricing in Oil and Gas Industry

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Agenda

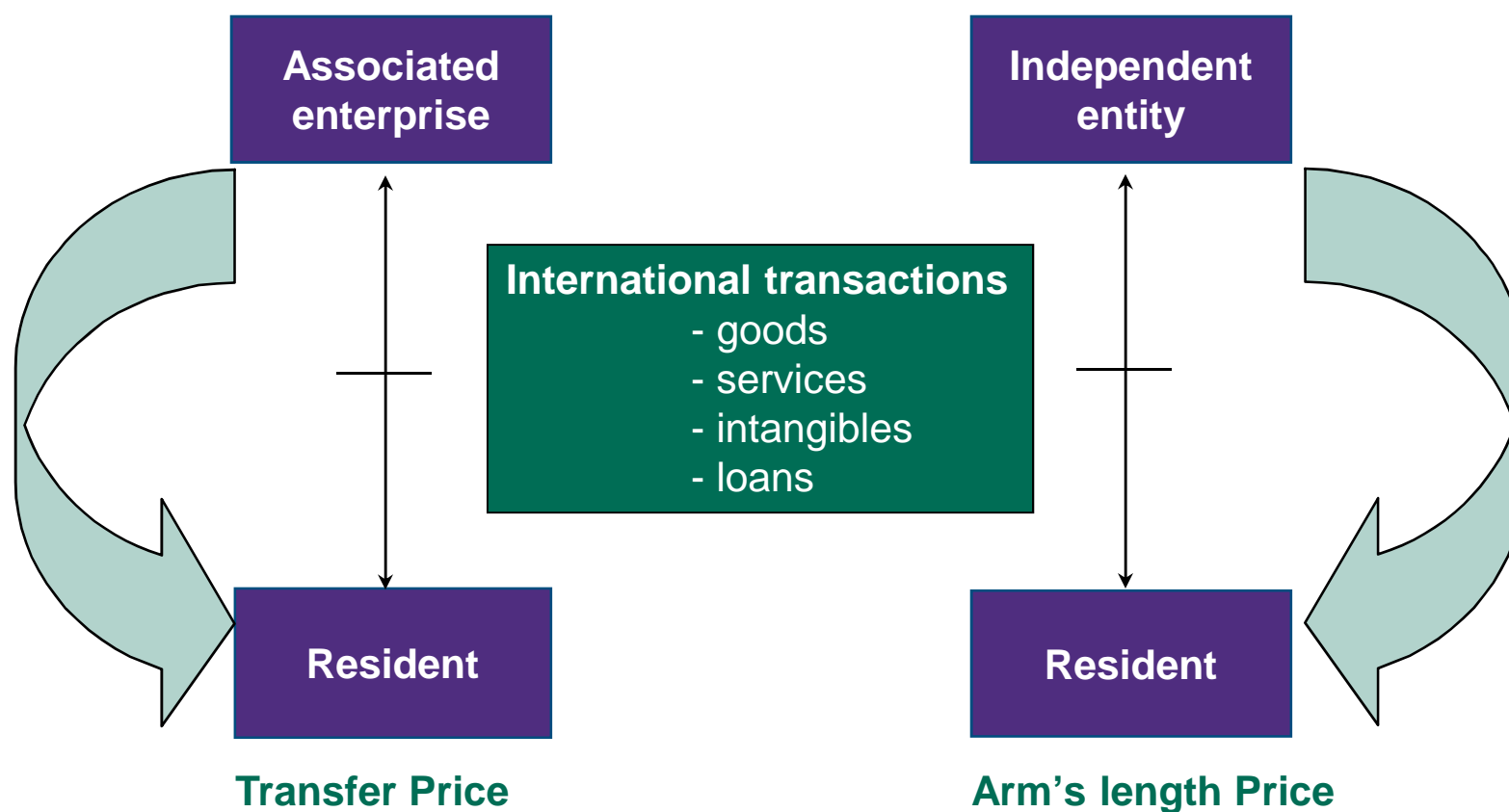
Background of Transfer Pricing

Oil and Gas – Industry Overview

Case Studies

What is Transfer Pricing?

The process of determining what is the arm's length price for a transaction (or a group of similar transactions)



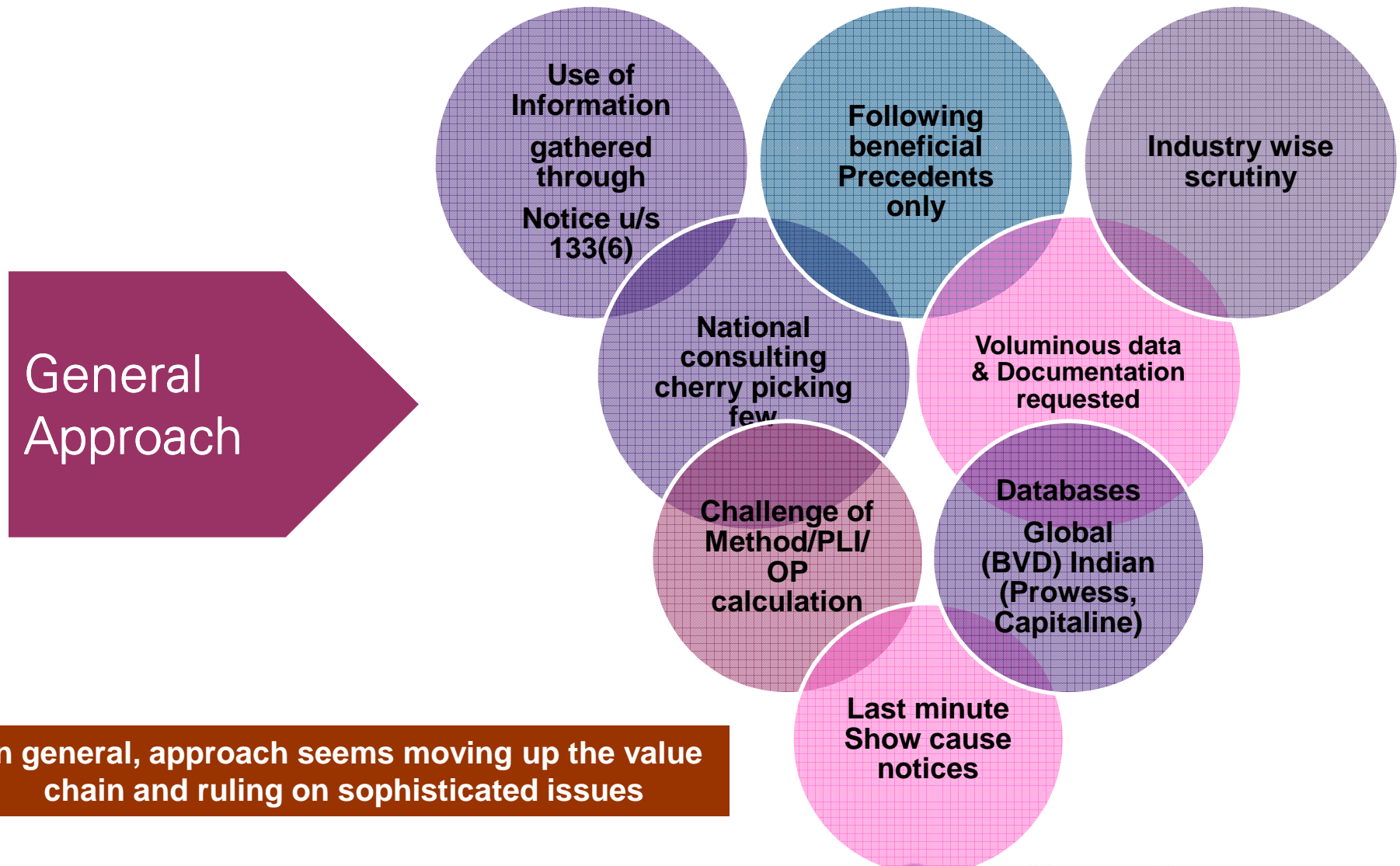
Transfer Pricing Scenario in India

- On an average 24% of the TP audits get adjusted
- India has moved up in the race for being the most aggressive tax authority w.r.t TP – now at the 6th position

Assessment Year	Number of TP Audits Completed	Number of Adjusted Cases	% of Cases Adjusted	Adjustment Amount (Rs. in Crores)	Adjustment Amount (in Million US\$)
2002-03	1061	239	23	1,220	260
2003-04	1501	337	22	2,287	490
2004-05	1768	471	27	3,432	730
2005-06	1945	754	39	7,754	1,650
2006-07	1830	813	44	10,908	2,320
2007-08	2301	1138	49	23,237	4,940
2008-09*	2589	1338	52	44,500	9,470

7 rounds of TP Audits completed – Approx. 95,000 crore adjustments till date

TP Audit – General Approach



Importance of TP - stress by the Finance Minister

- Indian transfer pricing adjustments so far - Rs 45,000 crores;
- Imparting intensive training **abroad** to 36 revenue officials in the area of transfer pricing and international taxation;
- MAP, a substantial part of the additions have also been confirmed, which speaks highly about the quality of TP audits;
- About 80 Transfer Pricing Officers notified pan India – actual positions approx 32;
- On an average out of every 4 cases under TP scrutiny 1 case results in an adjustment.

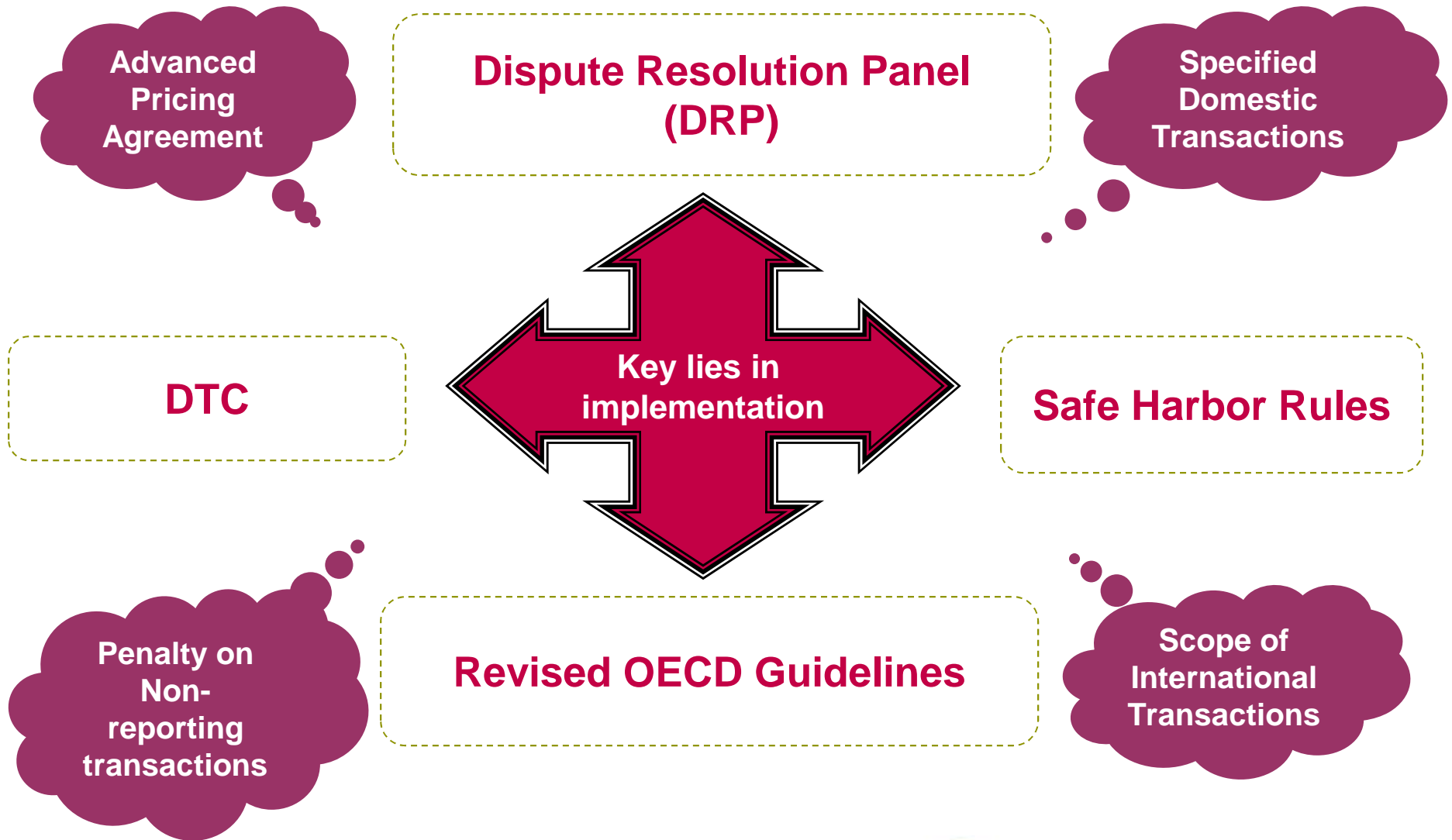
Source : <http://www.thehindubusinessline.in/2011/01/27/stories/2011012751100400.htm>

Methods Challenged & Approach of Officers

Method Applied	% of Cases
Transactional Net Margin Method	72%
Comparable Uncontrolled Price	19%
Cost Plus Method	6%
Resale Price Method	3%
Profit Split Method	0.1%
Total	100%

- About 80 Transfer Pricing Officers (TPO) notified pan India – actual positions approx 32
- TPOs thoroughly review and revise Benchmarking Strategy of the taxpayer
- Routinely update comparables data
- Scrutiny levels
 - < 15 Crores by AO
 - > 15 Crores by TPO

Evolving Developments



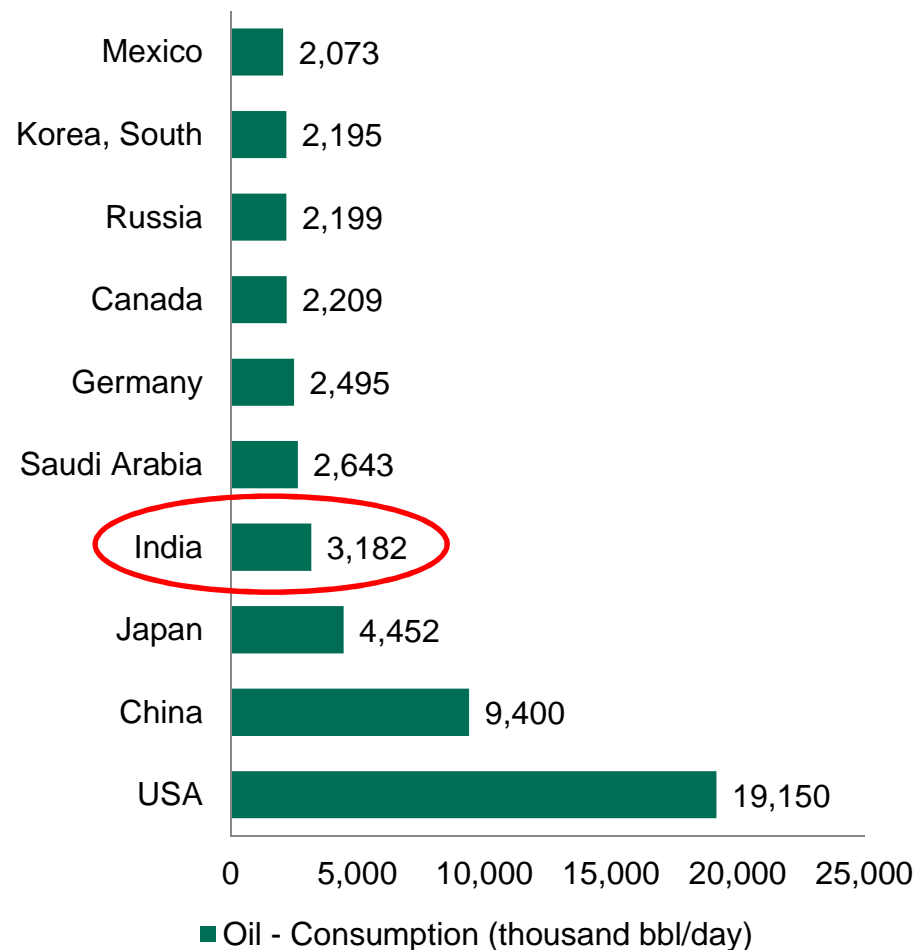
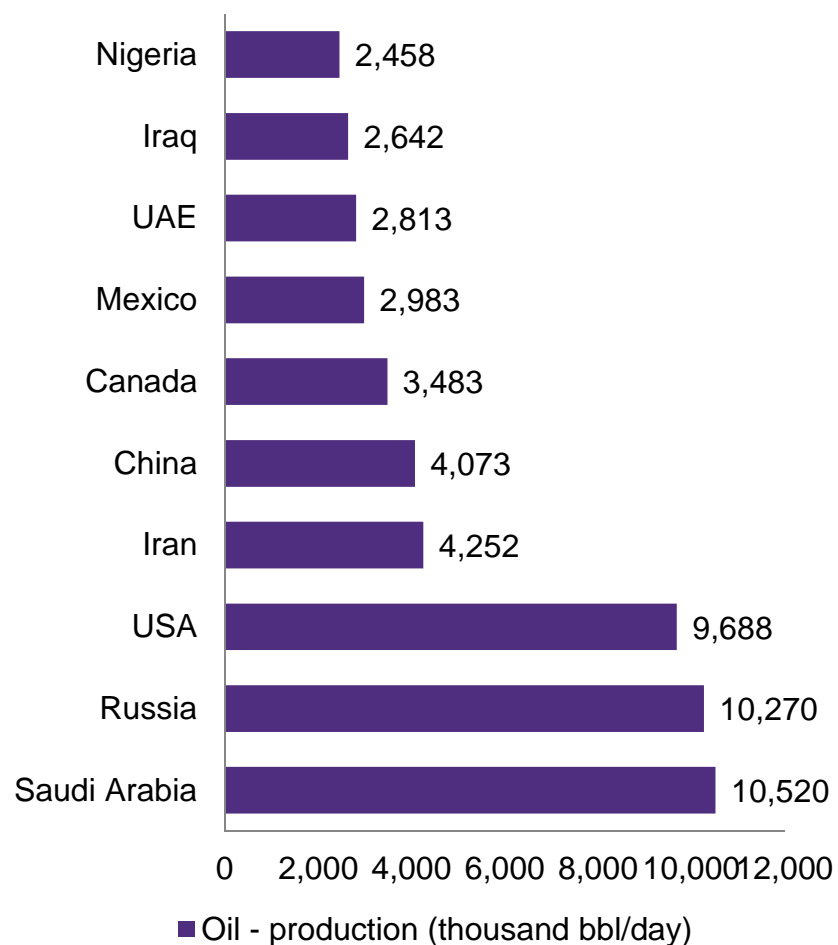
Oil and Gas Industry

Indian Oil and Gas Industry

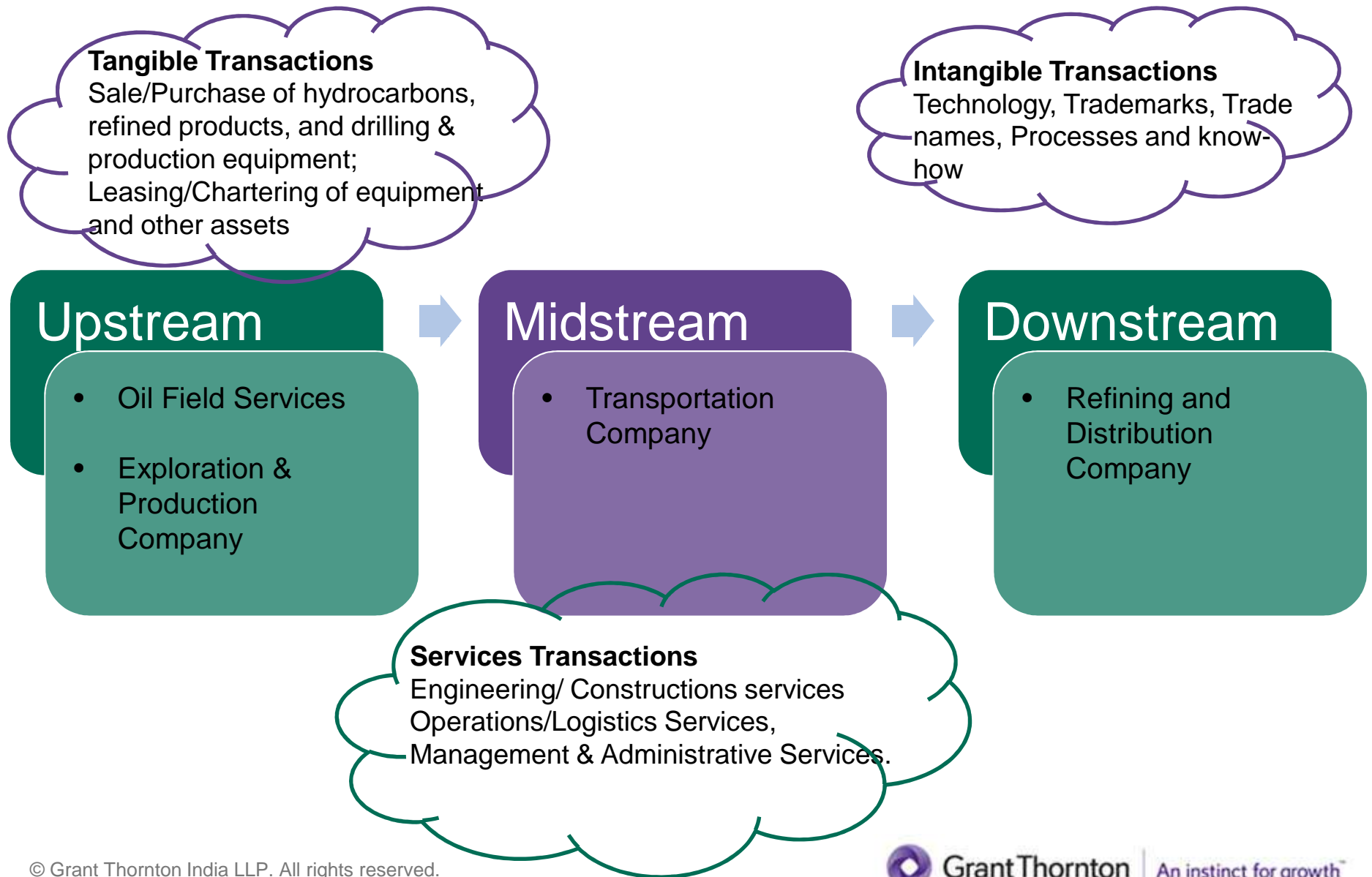
- Oil & Gas industry is the most important but highly regulated sector in Indian economy
- Oil and Gas Industry Components:
 1. Upstream Operations (Exploration)
 2. Midstream Operations (Refining)
 3. Downstream Operations (Distribution and Sales)
- Volatility of Prices
- Multiple entities involved in the structure
- Transactions such as oil, gas and refined products can easily be priced using well-known index pricing, journals, etc.
- However, challenges in pricing of intangibles such as services, financing and intangibles, etc.
- Use of technology

Indian Oil and Gas Industry

Top 10 Oil producers and consumers



Entities involved in the each process



Transfer Pricing of Oil Companies

Transfer pricing comes into the picture when:-

- Purchase of equipment used in exploration on lease basis
- Export / Import of products
- Managerial and technical services shared by the company's international operations
- Licensing the use of intellectual property (IP)
- Specialized knowledge in exploration (e.g. surveying techniques)
- Drilling technologies
- Charter rates for offshore rigs
- Tanker / vessel rates for transporting crude oil and natural gas lines
- Advance given or paid (interest free / interest)
- International financial transactions (e.g. financing, loans, etc)

Transfer Pricing Methods

Comparable Uncontrolled Price Method (CUP)

- Purchase of equipment
- Purchase / Sale of products
- Interest received / paid on advances

Transactional Net Margin Method (TNMM)

- Managerial and technical services
- Payment of royalty, know-how, technical fees

Challenges

Comparable Uncontrolled Price Method (CUP)

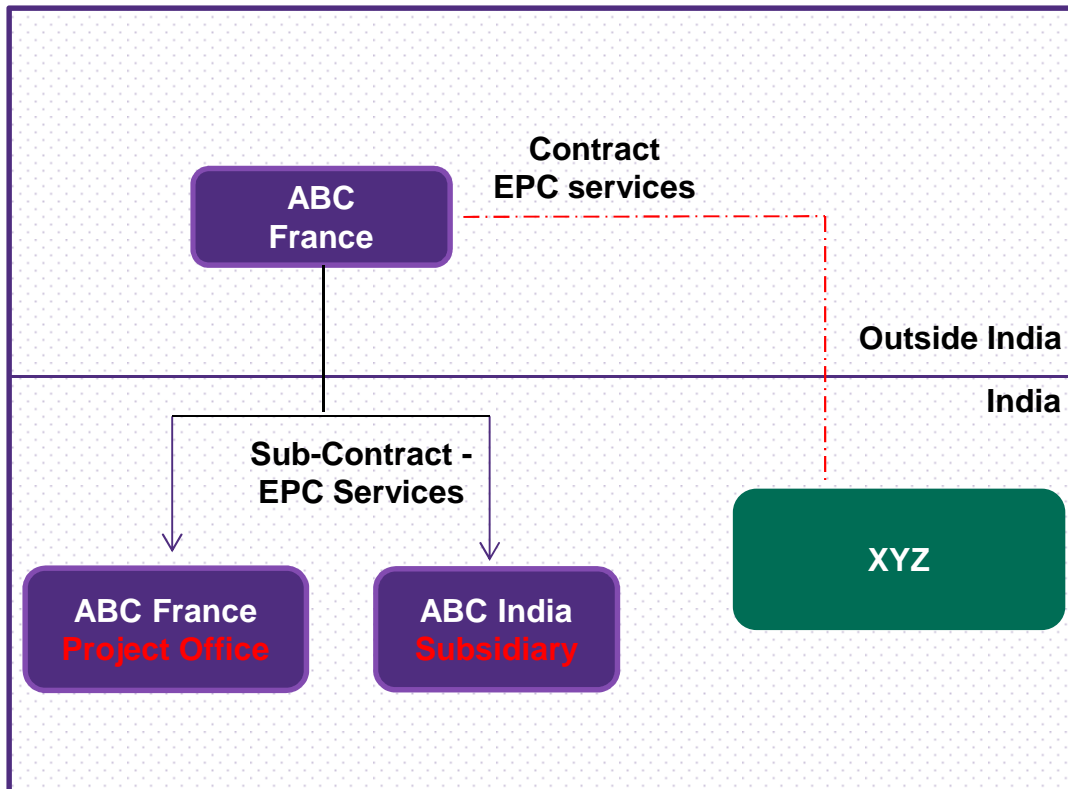
- External CUP generally not available
- Exact comparables may not be available for third parties

Transactional Net Margin Method (TNMM)

- Issues as comparables
- Transfer Pricing Officers may select high margin/mark-up companies as comparables

Case Studies

Case Study I – Oil Industry



Facts:-

XYZ

It is an oil and gas exploration and production company in India. It is also into refining of oil.

ABC France

It is an EPC company, engaged in construction fired heaters required in refining of oil for XYZ. It has secured a contract from XYZ for setting up fired heaters, cracking furnaces and reformers at the project location of XYZ.

Case Study I

Facts:-

ABC France Project Office ("PO")

ABC France has set up a project office in India. ABC France has entered into contract with XYZ for setting up fired heaters in India.

ABC India

ABC India is a 100% subsidiary of ABC France.

ABC France has sub-contracted portion of EPC services to ABC India.

Other Facts:-

- **The contract received by ABC France is split into offshore and onsite components.**
- **The offshore services and supply of equipment is performed by ABC France.**
- **The onsite services and supply of equipment is done by ABC France PO.**
- **ABC France PO subcontracts the engineering portion of the project work received from XYZ to ABC India**

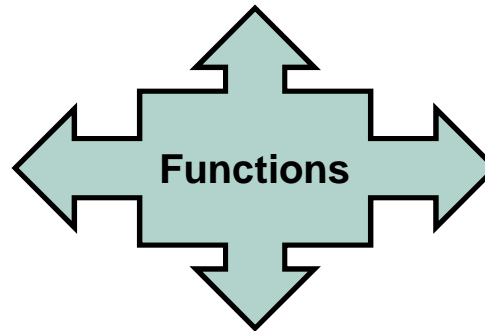
Case Study I

Functions of XYZ

- Exploration & production of crude oil & gas
- Refining of oil
- Pipeline
- Transportation
- Marketing of petroleum products and natural gas

Functions of ABC India

- Support for Preparation of Proposal
- Detailed Engineering
- Project execution support
- Engineering and related services to Heurtey PO
- Supply of required equipments



Functions of ABC France

- Development of fired heaters, cracking furnaces and reformers
- Prefabrication services
- Process and Detailed Engineering designs
- Entire Project Execution
- Procurement of equipments
- Construction

Functions of ABC France – Project Office

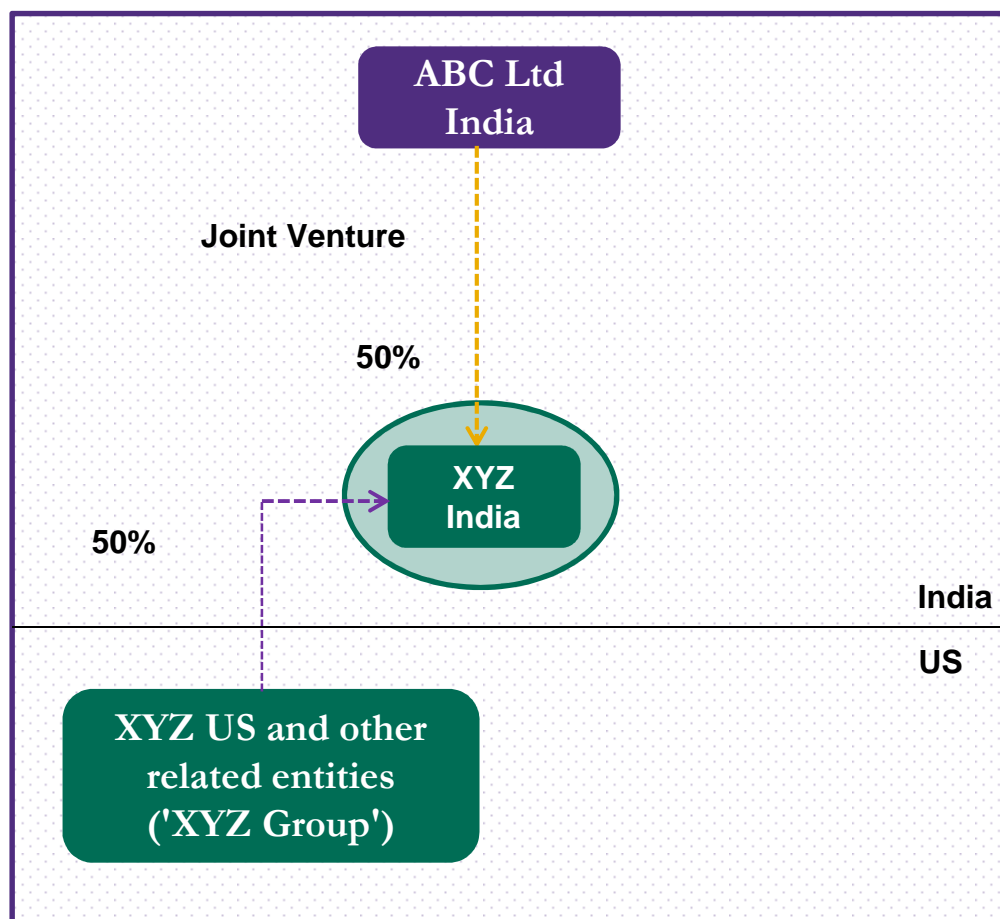
- Construction of fired heaters
- Front ending and contracting

Case Study I

Challenges in proving Arm's Length

1. Calculation of the fee for inter-company engineering services
2. Issues on comparables
3. Establishing arm's length compensation for EPC services
4. Losses incurred in project office
5. Transactions between the Indian subsidiary and project office

Case Study II – Gas Industry



Facts:-

XYZ US:

XYZ US along with other affiliated entities owns portfolio of products, services, solutions, providing atmospheric gases, process and speciality gases, performance, materials, equipment and services. XYZ owns related technology intangibles.

XYZ India:

XYZ India is a 50:50 joint venture between ABC and XYZ US based in US. XYZ India is engaged in commissioning, installation, construction and procurement contracts in India. XYZ India is engaged in operating gas commissioning plants for industrial use in India. These gases usually are Hydrogen, Carbon-Dioxide, Argon, Helium, Nitrogen, Oxygen.

Case Study II

International Transactions

Critical Factors

- ⇒ XYZ India purchases gases from XYZ Group
- ⇒ XYZ India purchases gas plant and equipments from XYZ Group
- ⇒ XYZ India provides advances for equipments and plants
- ⇒ XYZ India purchases capital equipments for facilitating purchases from AE as well as from third parties
- ⇒ Profitability comparison of individual plants for purchase of plants from related parties and third parties
- ⇒ Profitability comparison at cash level profits and net level profits w.r.t to capital investments in plants. Also profitability comparison w.r.t to comparable companies in India.

Comparability factors

Actuals

Projections

Capacity of plant

Nature of plant

Commissioning Periods

Thank you

