



**WESTERN INDIA REGIONAL COUNCIL OF
THE INSTITUTE OF CHARTERED
ACCOUNTANTS OF INDIA**

Reference to and Proceedings before TPO, DRP and Valuation Officer

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The image shows a financial document with several tables and a line graph. The tables contain data related to interest rates, maturities, and current values. The line graph shows a share price trend over time, with labels for 'Share price' and 'One-day change'.

Current (%)	Maturity	Current	One-day change
6.700	Jan. 30, '18	1461	-286
5.875	May 10, '12	3820	-270
6.750	March 15, '12	786	-180
7.625	Nov. 30, '12	949	-131
5.750	Sept. 8, '11	953	-118
7.995	June 1, '36	787	-101
6.875	Feb. 1, '14	894	-101
5.500	Nov. 15, '12		

Share price graph showing trends for Oct., Nov., Dec., and Jan. The graph is labeled 'Share price' and 'One-day change'.



Current Transfer Pricing Landscape

Transfer Pricing in News... Winds of change...

THE  NEW
INDIAN EXPRESS

■ Vodafone Wins Rs 3,200-cr Transfer Pricing Case in HC

By PTI | Published: 10th October 2014 07:18 PM | Last Updated: 10th October 2014 07:18 PM

THE ECONOMIC TIMES

Government proposes separate unit for disposal of transfer pricing case

ET Bureau | Dec 18, 2014, 04:00AM IST

THE  HINDU
BusinessLine

Shell India wins 17,920-crore transfer pricing case

Business Standard

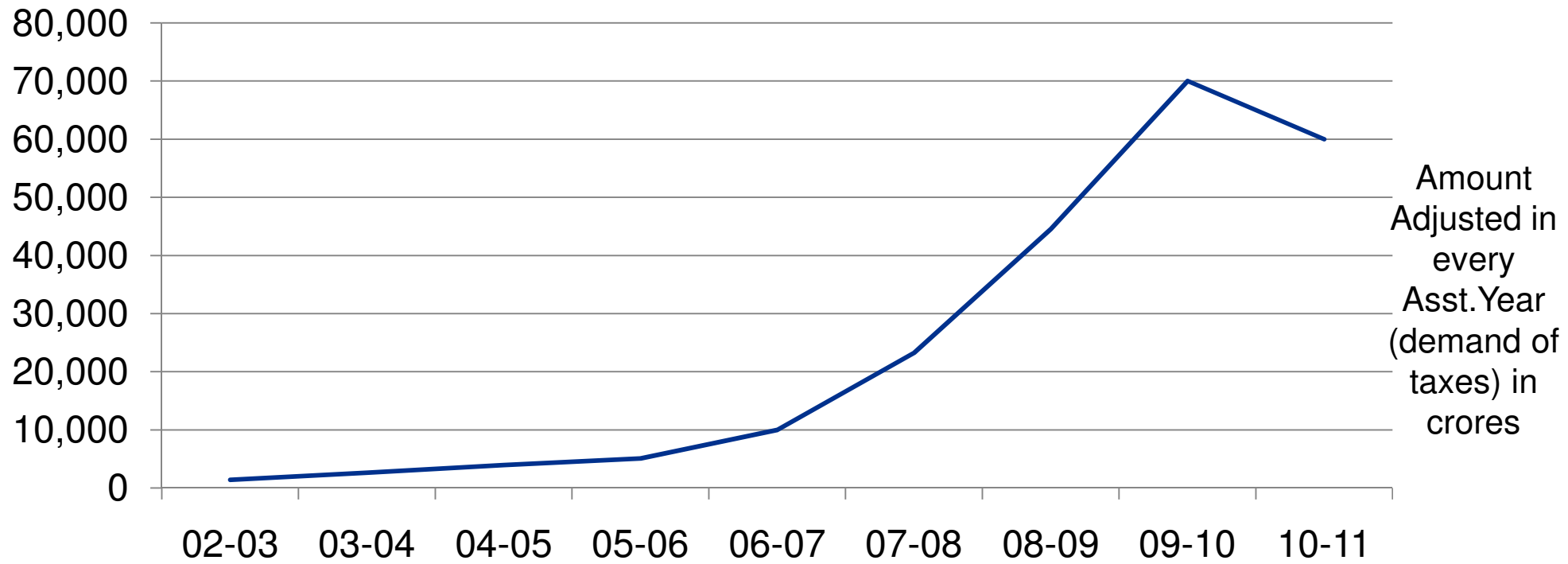
India signs first bilateral APA with Japanese company

Transfer Pricing Litigation Scenario in India

- Nine rounds of TP Audits completed- AY 2002-2003 to AY 2010-2011.

Particulars	Adjustments (in INR Cr)
AY 2002-2003	1,403
AY 2003-2004	2,631
AY 2004-2005	3,947
AY 2005-2006	5,060
AY 2006-2007	10,000
AY 2007-2008	23,237
AY 2008-2009	44,531
AY 2009-2010	70,016
AY 2010-2011	60,000

Yearly Trend of TP Adjustments



Amount Adjusted in every Asst. Year (demand of taxes) in crores

3/10/14

www.financialexpress.com/story-print/1232330

 **THE FINANCIAL EXPRESS**
Read to Lead

Print Close Window

Transfer pricing income adjustments decline 14% in 2013-14

Santosh Tiwari Posted online: Monday, Mar 10, 2014 at 0000 hrs

New Delhi : After a 54% jump in transfer pricing (TP) adjustments to R70,000 crore last year, additions to the income of companies conducting international transactions has dropped by over 14% to R60,000 crore in FY14.

**Reference and
proceedings before the
TPO and Valuation
Officer**

September 2014 – Scrutiny Guidelines

CBDT has laid down following procedure and criteria for manual selection of returns/cases for scrutiny during for Transfer pricing matters:

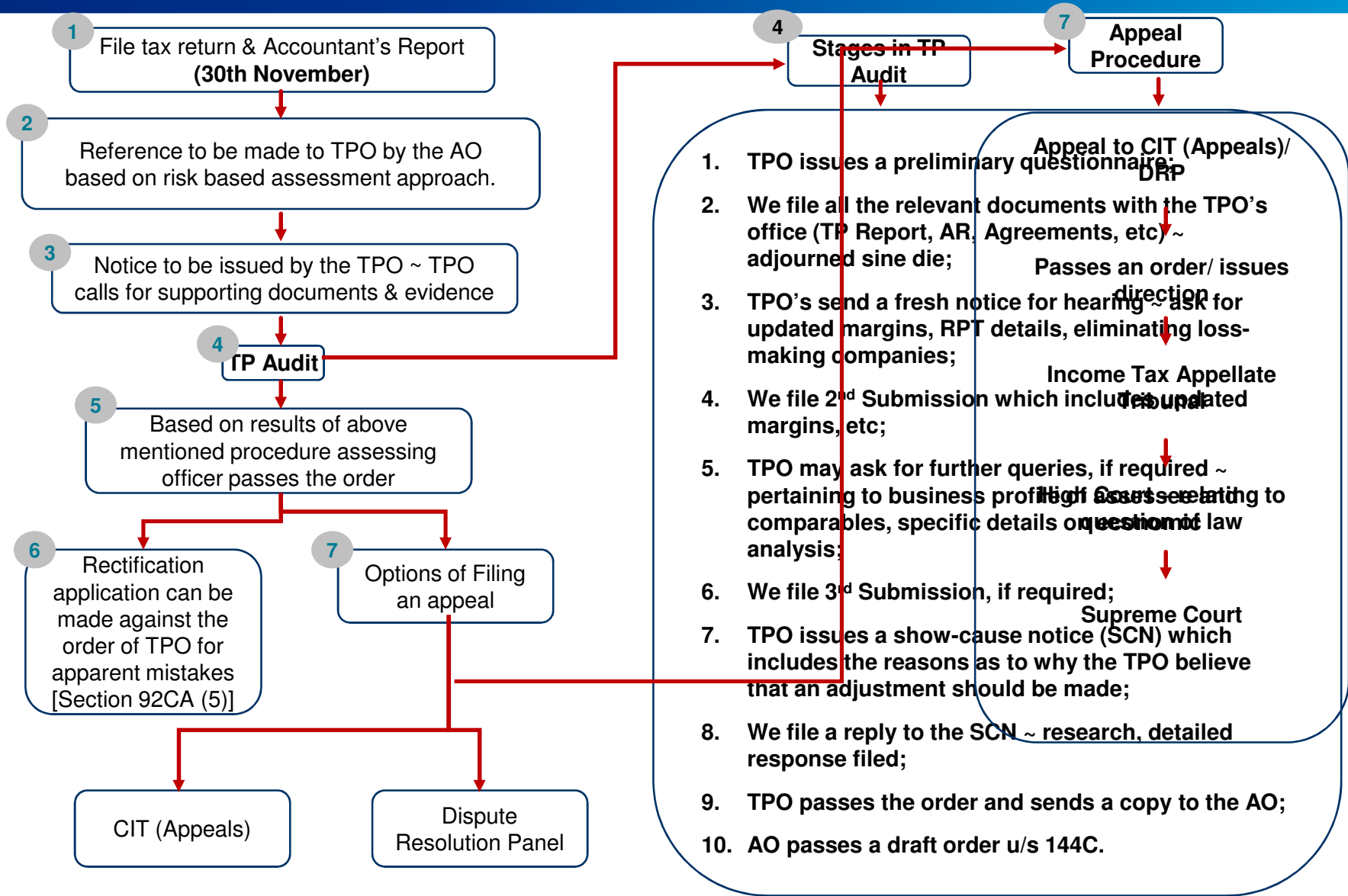
- **CBDT has dropped the Rs 15-crore threshold for referring cases for compulsory scrutiny. Instead, a risk-based approach is adopted to identify international transactions**
- **Cases involving addition in an earlier assessment year on the issue of transfer pricing in excess of Rs. 10 Crores or more which is confirmed in appeal or is pending before an appellate authority.**

Either AO can do the transfer pricing assessment or can refer the computation to the TPO

Reference to Transfer Pricing Officer

- S 92CA (1) – if AO considers it necessary or expedient so to do, he may refer the computation of arm's length price to the TPO with the previous approval of the Commissioner – prima facia view
 - S. 92CA (2) TPO to serve notice on the Assessee requiring him to produce evidence in relation to arm's length price computed
 - S. 92CA(2A) and (2B) – TPO can *suo motto* take cognizance of the transaction not reported by the Assessee or nor referred by the AO
 - S 92CA(3) provides that the TPO after taking into account the material available with him shall, by an order in writing, determine the arm's length price in accordance with s 92C(3).
 - S 92CA(3A) Time limit for passing an order - 60 days prior to the date of limitation referred in S. 153.
 - S. 92CA(4) Provides that on receipt of the order of the TPO, the AO shall proceed to compute the total income of the assessee in conformity with the ALP as determined by the TPO.
 - S. 92CA(5) and (6) refers to rectification for mistake apparent from record in TPO's Order
 - S. 92CA(7) exercise of power specified under
 - 131(1) - Power regarding discovery, production of evidence, etc.
 - 133(6) - May require any person to furnish information or
 - 133A - Power of Survey
-

Audit Process



Reference to Valuation Officer - Statutory provisions

- Pursuant to the Supreme Court's direction in case of CIT, Delhi v. Bharti Cellular Ltd. [2010] 193 Taxman 97 (SC)
 - *"We are directing CBDT to issue directions to all its Officers, that in such cases, the Department need not proceed only by the contracts placed before the officers. With the emergence of our country as one of the BRIC countries and with the technological advancement matters such as present one will keep on recurring and hence time has come when Department should examine technical experts so that the matters could be disposed of expeditiously and further it would enable the appellate Forums, including this Court, to decide legal issues based on the factual foundation. We do not know the constraints of the Department but time has come when the Department should understand that when the case involves revenue running into crores, technical evidence would help the Tribunals and courts to decide matters expeditiously based on factual foundation."*
 - **CBDT issued INSTRUCTION No. 5/2011-** The AO/TPO should frame assessments only after **taking opinion of technical/ valuation experts and bringing on record technical evidence in cases involving complex issues of technical nature and substantial revenue**
 - **S. 50C** – AO may refer the valuation of the capital asset to a Valuation Officer, if the taxpayer claims that stamp duty valuation is higher than the fair market value (FMV) and such valuation has not been disputed
 - **S. 55A** – With a view to ascertaining the FMV of a capital asset, the AO may refer the valuation of capital asset to a Valuation Officer, if AO is of opinion that having regard to the nature of the asset and other relevant circumstances, it is necessary so to do
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Reference to Valuation Officer - Statutory provisions

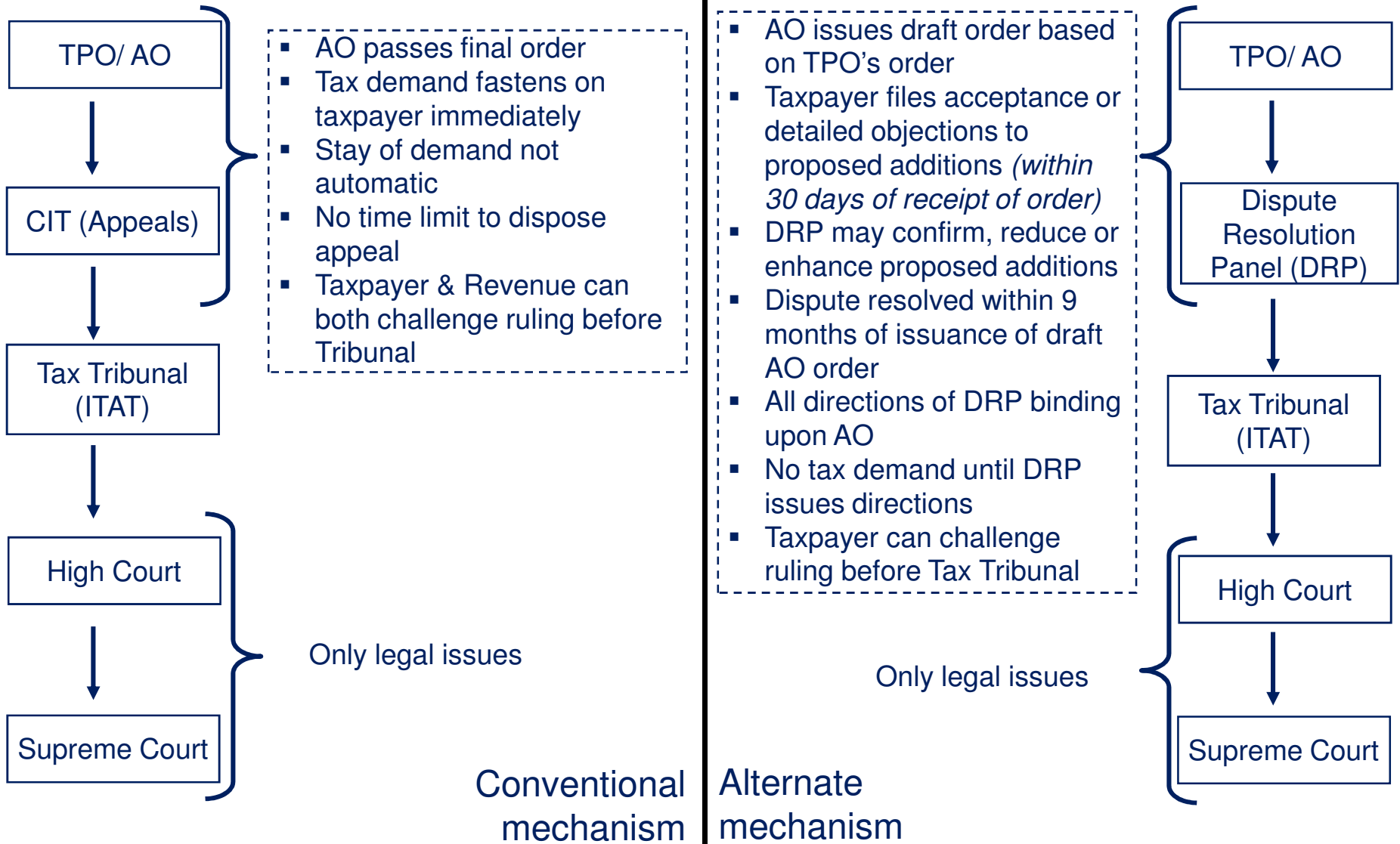
- **S. 142A** – For the purposes of assessment or reassessment, AO may make a reference to a Valuation Officer to estimate the value, including FMV, of any asset, property or investment whether or not he is satisfied about the correctness or completeness of the accounts of the taxpayer
- **S 269L** - For the purpose of initiating proceedings for the “acquisition of any immovable property” (by Central Government) under certain circumstances (tax evasion or concealment of income), the competent authority (Jt. Commissioner) may require a Valuation Officer to determine the FMV of such property

Reference to Valuation Officer – Procedural aspects (section 16A of the Wealth Tax Act, 1957)

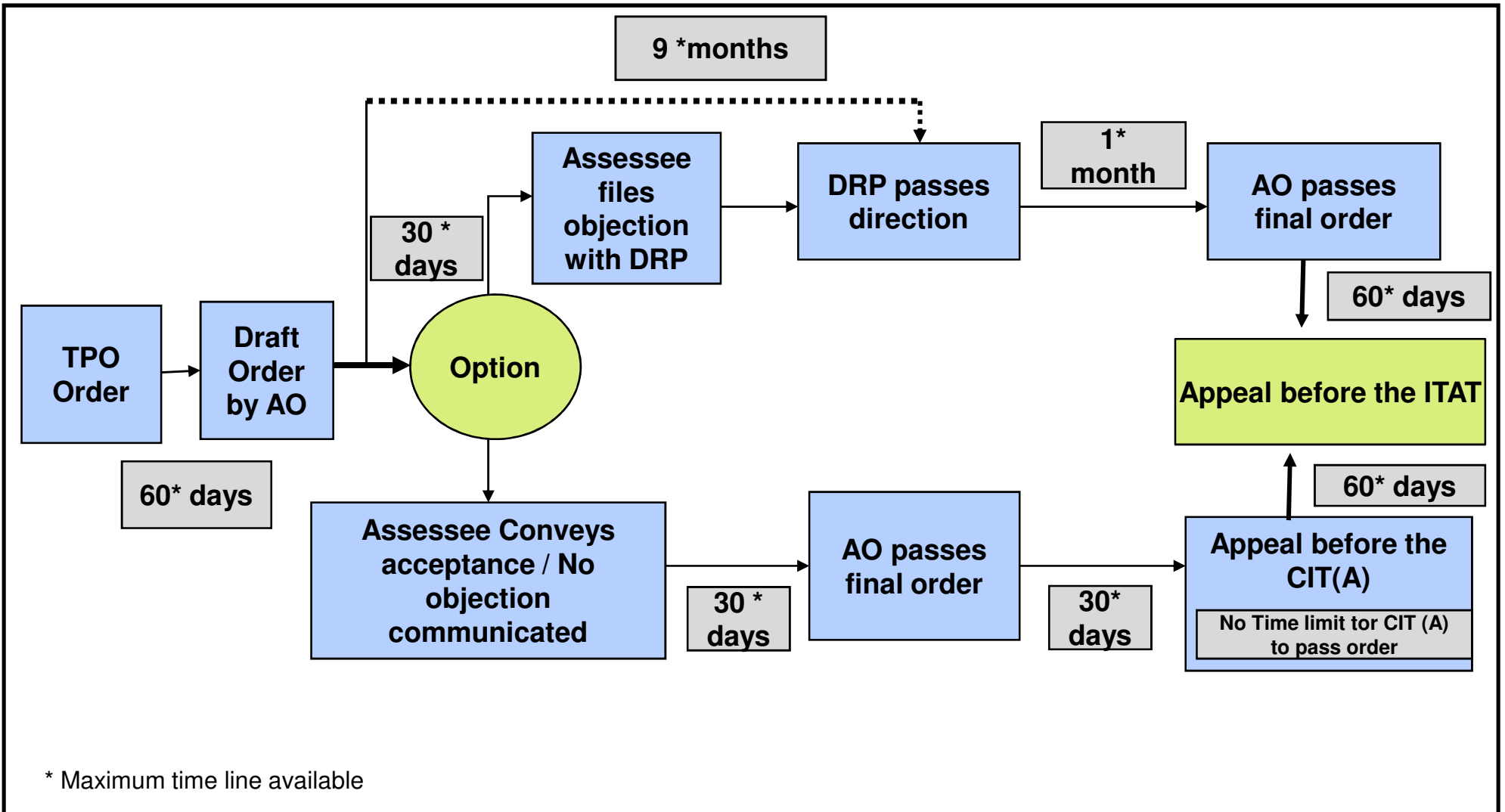
- VO may serve a notice on the taxpayer requiring him to furnish the accounts, records and other relevant documents for the purpose of valuation.
 - If the VO is satisfied that the value declared by the taxpayer is correct, then he shall pass an order in writing and send a copy of his order to the AO and the taxpayer.
 - If not, he shall serve a notice on the taxpayer intimating the value which he proposes to estimate and give an opportunity to state his objections. After hearing the taxpayer’s contentions and other evidences as may be produced by him, the VO shall pass an order estimating the value of the asset and send a copy of his order to the AO and the taxpayer.
 - On receipt of order from the VO, the AO shall proceed to complete the assessment (in relation to the valuation of the asset), in conformity with the order of the VO
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**Reference and
proceedings before the
DRP**

Conventional v. Alternate Mechanisms



DRP Process



DRP Mechanism – Key Aspects ... (1/2)

- Introduced by Finance (No.2) Act, 2009 w.e.f 1 April 2009 . Alternative dispute resolution mechanism for “Eligible Assessee”:
 - **Foreign company** - Transfer pricing adjustment not necessary
 - **Any other person** – If variation in pursuance to order issued by transfer pricing officer
- Objections to be filed against entire Draft Order – both transfer pricing as well as non transfer pricing (i.e. general tax issues)
- Additional evidence (not submitted to the AO) to be filed through a separate application stating the reasons for filing such additional evidence
- No payment of tax till AO issues the Final Order in pursuance of DRP directions

DRP – Powers and Duties

DRP has powers as are vested in a 'Court' under Code of Civil Procedure, 1908

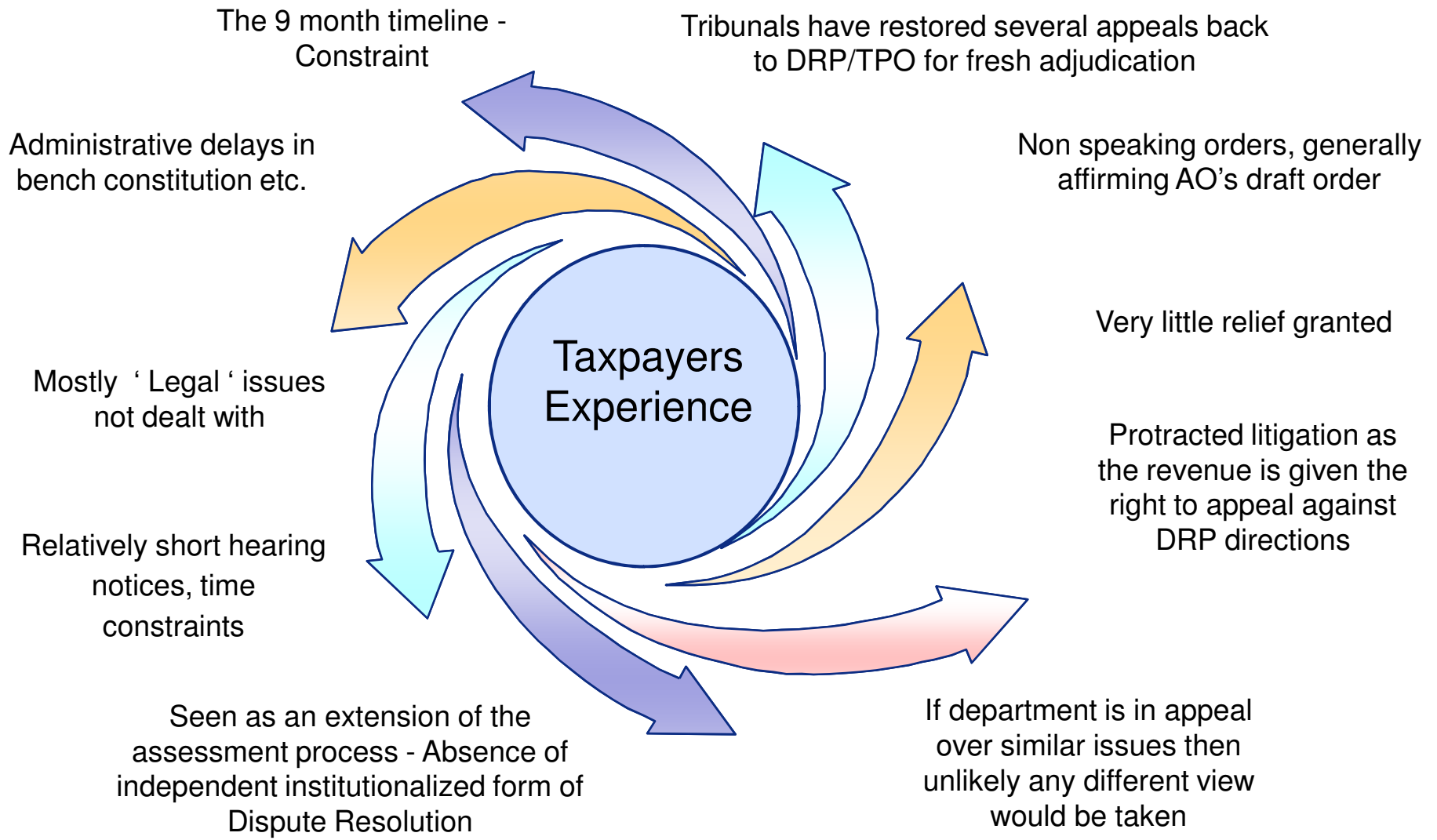
DRP issues directions to confirm, reduce or enhance proposed variation

To issue directions within nine months from end of month in which draft order is forwarded to taxpayer

DRP cannot set aside proposed variation – Must give final directions to AO on the issue

DRP may not condone delay - No provisions in Sec144C / DRP rules to condone delay in filling of objections

Taxpayers Experience



Recent Change in DRP constitution

- CBDT revises Disputes Resolution Panel (DRP) rules w.e.f. 1 January 2015,
- DRP to be set-up 3 headquarters at Delhi Mumbai & Bangalore;
- Each DRP Headquarter to have jurisdiction over multiple states as follows:

Headquarters	Jurisdiction
2 Panel at Delhi	Delhi, Rajasthan, Himachal Pradesh, Jammu and Kashmir, Uttar Pradesh, West Bengal, Bihar, Odisha, North-east states, etc.
2 Panel at Mumbai	Maharashtra, Gujarat, Madhya Pradesh, Chhattisgarh, etc.
1 Panel at Bangalore	Karnataka, Tamil Nadu, Andhra Pradesh, Telangana, Kerala, Goa, etc.

- Rules also prescribed for transferring the case from one jurisdiction to another

Reference to DRP vs CIT(A) - A Comparative

Key	DRP	CIT(A)
Constitution	Collegium of three officers of the CIT rank	Only one CIT
Application Process	If the taxpayer chooses this route, he is required to lodge objections within 1 month from receipt of Draft Order	Should file Appeal within 30 days from the receipt of Final AO Order
Time limit	Only 9 months from the date of Draft Order to examine the case, hold hearings and pass directions	No time limit
Demand	No demand till disposal of the matter	Significant portion of demand is required to be paid unless stayed
Pros	Fast track route to the ITAT	Detailed hearings may be granted to the Assessee to represent their case
Form	Form 35A – specific format to be followed for submission	Form 35
Further Appeal	Both taxpayer as well as AO can appeal to ITAT	

Key Triggers – Transfer Pricing Litigation

Key Triggers and Contributors for Transfer Pricing Litigation

Key Triggers for Aggressive Audits

- Consistent losses / low margins of the assessee attributable to inter-company transactions
- Significant changes in profitability of the assessee and its AEs
- High Royalty / Technical fee payouts, Cost recharges, Management Fees, Cost allocations
- Net losses incurred by routine distributors
- Low mark-ups for services
- Application of Ratio's such as ROCE / Berry ratio / cash profit instead of net margins
- Significant Advertisement and marketing spends by manufacturing / distribution companies
- Use of foreign comparables

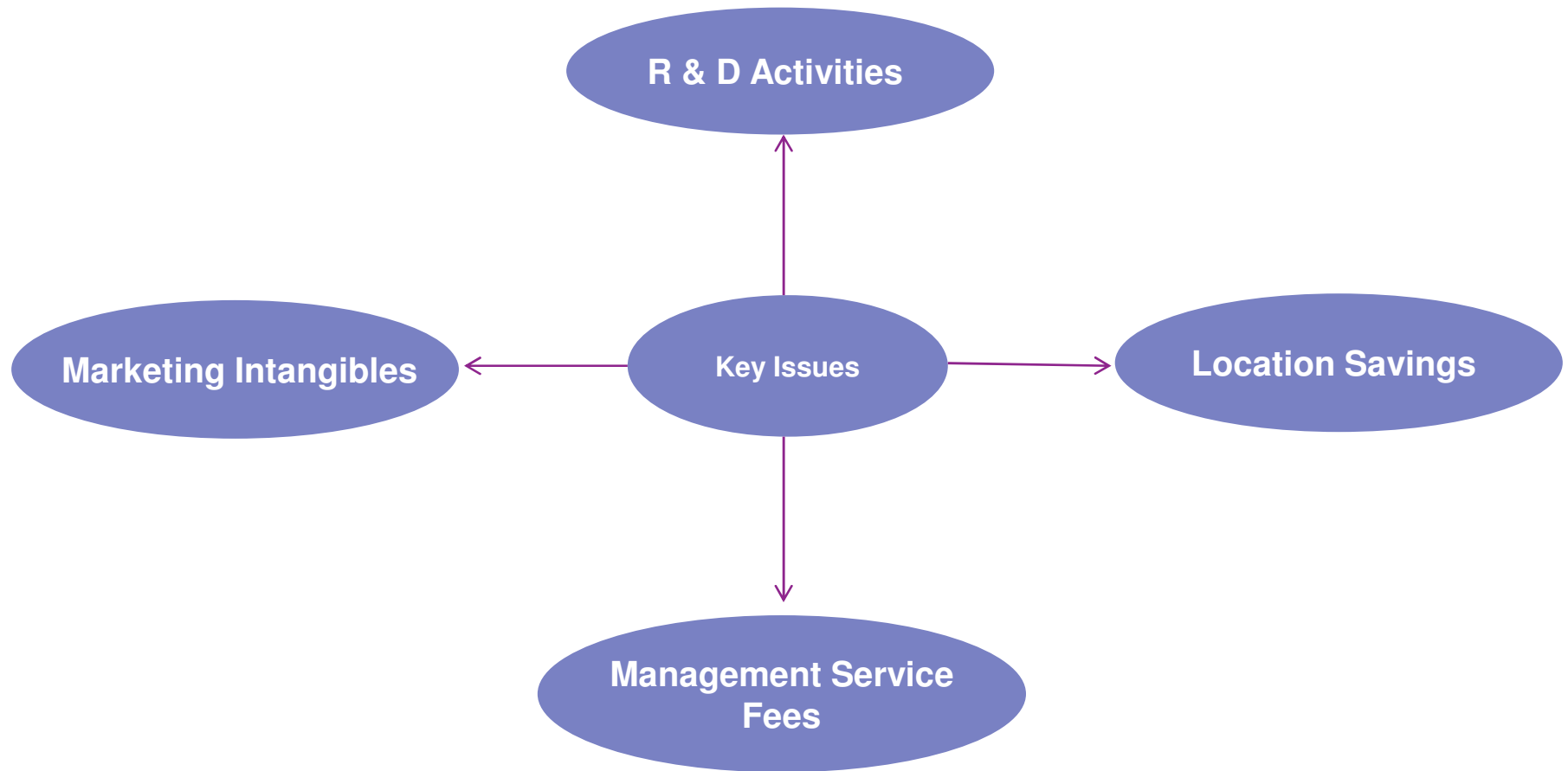
Contributors to Aggressive Audits:

- Mounting fiscal demand on Government
- Need to Preserve tax base
- Constant competitive pressure to restructure business operations efficiently
- Unprecedented sharing of information between revenue authorities

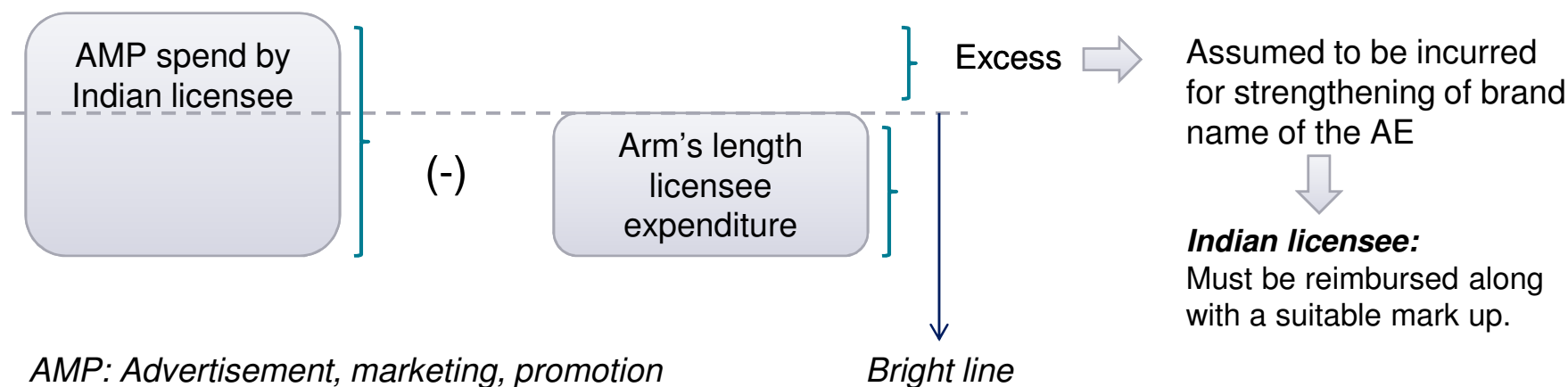
*Substantial increase in transfer pricing audits and disputes across the Globe ,
India is no exception....*

Emerging Transfer Pricing Issues

Key Emerging Issues in Transfer Pricing Audits



Marketing Intangibles: General Concept



Revenue's Approach

Application of 'Bright line' test	Treating excess as expense incurred for creation of intangible	Deeming a service fee	Royalty payment also challenged	Application of Profit Split Method
Use of comparables selected under TNMM?	Application of CUP while determining the excess percentage	Adding a profit mark-up in addition		Apportionment of global profits to India for brand /marketing intangible creation

Marketing Intangibles

- Ownership of intangibles – Legal vs. Economic
- Excess Advertisement Marketing and Promotion (AMP) expenses incurred by a brand licensee is an international transaction – Delhi ITAT Special Bench ruling – **LG Electronics India Pvt. Ltd.**
- AMP spends to satisfy the ‘bright line’ test - Identification of expenses “in connection with sales” as against “for promotion of sales”
- Revenue expects Mark-up on AMP expenses in excess of bright line – in some cases have also considered global profit split
- India’s position in the UN TP manual – Primarily based on AMP expense by no risk or limited risk distributors working on cost plus model – they should incur only routine AMP expenses
- Recent Delhi Tribunal ruling in the case of **BMW India Private Limited** drew a distinction in the facts from that of LG India’s case and held that premium profits earned by distributor are adequate compensation for excessive AMP, and deletes adjustment

R&D Activities – new administrative guidance

Circular No. 2 / 3 (dt. 26/3/2013)
 Application of Profit Split Method ('PSM')
 Conditions relevant to identify Contract
 R&D with insignificant risk

Circular No. 6 (dt. 29/6/2013)
 Circular No. 2 on PSM rescinded
 Circular No. 3 on contract R&D amended
 and reissued

**R&D activities
 In India**

Conditions for characterisation

Parameters

Functions

Funding/ Assets

Supervision &
 Control

Risk Profile

Outcome of
 Research

Outside India

Economically "Significant"

Source of funds/ capital
 Significant assets/ intangibles

Strategic decisions for Core
 Functions & Monitoring

Significant Risks

Legal & economic owner of
 resultant IP

In India

Economically
 "Insignificant"

No economically significant
 assets or intangibles

Operate under Guidance

No significant risks

No ownership of resultant
 IP

Primary Coverage - Indian Captives engaged in Research and Development Activities

Location Savings

- Refers to Cost Savings due to relocation of business from 'high cost' location to 'low cost' location and 'Location Specific Advantages' (e.g. skilled manpower, large customer base, superior network etc) enjoyed by growing economies like India
- Quantification and allocation of Location Savings is subject matter of controversy
 - UN and OECD Manual: Depends on functional analysis and bargaining power of the parties
- Indian Revenue authorities believe Profit Split Method ('PSM') may be used to allocate Location Savings
- Location Savings considered through applications of higher mark-up in low cost countries
- GAP Ruling- geographical comparability considers Location Savings
- No Location Savings where location's benefits are actually shifted to customers

Management service fees

- ✓ Payment towards management fees is generally towards services such as Planning & Coordination, Budgetary Control, Financial advice, Accounting, Auditing, Legal services, Computer services, Financial services, Management and administrative services, Purchasing, marketing and distribution, Human resource services etc.
- ✓ Management fee charged by AEs are investigated in great detail by the Revenue department
- ✓ Robust / exhaustive documentation requirement demanded to substantiate the total receipt of services and benefits received . In absence of substantial documentation demonstrating the services received such allocations are disallowed completely or determined at a substantially lower amount
- ✓ Revenue also enquire into whether a similar charge is levied on other group entities and rates thereof are also called for and examined
- ✓ Typical mindset of the Revenue is that management charge are used for profit repatriation.



Key Points for success in Transfer Pricing audits in India



- Detailed Functions-Assets-Risks analysis
- Proactive Planning
- Agreements / contracts should exist for transactions between Associated Enterprises
- Price setting mechanisms to be documented
- Localization of Global Transfer Pricing policies
- Documentation should completely describe search methodology, basis for inclusion / exclusion of comparables, etc.
- Substantiate business, economic and commercial rationale
- Maintain detailed cost-benefit analysis with respect to cross charges (intra-group services)
- Strategizing and providing appropriate information during the audit

Thank You

Bhavesh Dedhia

Director - Global Transfer Pricing Services

