

Foreign IT firms use transfer-pricing provisions, double taxation treaties to minimise taxes in India

These are differences that are increasingly drawing the inquisitive and corrective eye of the income-tax department. In 2009-10, TCS, the largest home-grown IT company, recorded a net profit per employee of Rs 4.3 lakh. By comparison, Capgemini, a foreign IT firm with operations in India, recorded a net profit per employee of Rs 1.5 lakh -- about onethird of TCS.

The operations of Indian and foreign IT firms are now structured similarly, they fight for the same business, there is parity in their contract pricing and employee salaries, they follow the same tax rules. So, then, why are foreign IT firms reporting profitability numbers that are a fraction of their Indian peers? It's a question the IT department is beginning to evidently ask foreign IT firms with greater frequency -- and extract more tax revenues from them.

It's not just profits per employee. The differences are equally wide on every comparative financial metric: revenue per employee, operating profit margin, net profit margin...This, say tax experts, is the effect of 'transfer pricing' --or how a foreign parent with operations in many countries, including tax havens, prices its transactions with its Indian subsidiary, ostensibly to reduce its overall tax liability.

The basic premise of rules governing such related-party transactions is that the price at which the Indian subsidiary (say, IBM India) provides a service to its parent (say, IBM US) should be similar to what it would have charged a client.

Claiming that foreign IT firms don't always invoke this principle of pricing, the IT department is showing the transfer-pricing rules -- introduced in 2001 --to them. Cases of the department asking foreign IT companies to recalculate revenues are increasing. As is the quantum of adjustments on account of transfer pricing. The overall adjustment figure for all foreign companies operating in India, in both the IT sector and in non-ITsectors, hit a new high of Rs 22,800 crore in 2010-11.

Individual numbers for the IT sector are unavailable, but Rohan Phatarphekar, head of transfer pricing at KPMG, estimates that IT and ITES (IT-enabled services) companies accounted for "onethird to half " of these adjustments.

(Economic Times)