

**TRANSFER PRICING IN INDIA
DOMESTIC TRANSACTION
AN ADDED DIMENSION**

For Jalandhar Branch Of

*NIRC Of
ICAI*

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Finance Minister's speech on the rationale for introducing Transfer Pricing Regulations

“The presence of multinational enterprises in India and their ability to allocate profits in different jurisdictions by controlling prices in intra-group transactions has made the issue of transfer pricing a matter of serious concern. I had set up an Expert Group in November 1999 to examine the detailed structure for transfer pricing legislation. Necessary legislative changes are being made in the Finance Bill based on these recommendations.”

- Mr Yashwant Sinha

Finance Minister, Government of India

February 28, 2001

Hon'ble SC in CIT vs. GlaxoSmithKline Asia (p) Ltd. (SLP 18121/2007) had observed

“The larger issue is whether Transfer Pricing Regulations should be limited to cross-border transactions or whether the Transfer Pricing Regulations to be extended to domestic transactions. In domestic transactions, the under-invoicing of sales and over-invoicing of expenses ordinarily will be revenue neutral in nature, except in two circumstances having tax arbitrage such as where one of the related entities is i) loss making or (ii) liable to pay tax at a lower rate and the profits are shifted to such entity.

The CBDT should examine whether Transfer Pricing Regulations can be applied to domestic transactions between related parties u/s 40A(2) by making amendments to the Act.

Genesis of Domestic TP regime

- Explanatory Memorandum to Finance Bill, 2012

“The application and extension of scope of transfer pricing regulations to domestic transactions would provide objectivity in determination of income from domestic related party transactions and determination of reasonableness of expenditure between related domestic parties. It will create legally enforceable obligation on assessee’s to maintain proper documentation. However, extending the transfer pricing requirements to all domestic transactions will lead to increase in compliance burden on all assessee’s which may not be desirable.”

Introduction to TP

- TP was earlier limited to 'International Transactions'
- The Finance Act 2012, extends the scope of TP provision to 'Specified Domestic Transactions' between related parties w.e.f. 1 April 2012
- The SC in the case of CIT vs Glaxo Smithkline Asia Pvt Ltd [2010-195Taxman 35 (SC)] recommended introduction of domestic TP provisions
- SDT previously reported/certified but onus on revenue authorities
- Obligation now on taxpayer to report/ document and substantiate the arm's length nature of such transactions
- Shift from generic FMV concept to focused ALP concept
- These new provisions would have ramifications across industries which benefit from the said preferential tax policies such as SEZ units, infrastructure developers or operators, telecom services, industrial park developers, power generation or transmission etc. Apart from this, business conglomerates having significant intra-group dealing would be largely impacted

Transfer Pricing Litigation status

S.No.	For A.Y.	No. of TP Audits done	No. of cases adj. made	Adjusted Case %	Adjustment made Rs. Crores
1	2002-03	1081	238	22	1373
2	2003-04	1501	345	23	2575
3	2004-05	1768	477	27	3861
4	2005-06	1479	370	25	4950
5	2006-07	1717	1019	59	9743
6	2007-08	2102	1089	52	24000
7	2008-09	2589	1343	52	44531
8	2009-10	3200	1600	50	70000

TP disputes/ litigation in India

- Seven rounds of TP assessments completed in 2011
- Aggregate TP adjustments in 2011 assessment cycle [FY 2007–08] → Rs 45,000 crore appx;
- *cumulative TP adjustments in first six assessment cycles → Rs 50,000 crore appx,*
- **Govt. Hopes to Raise 1 lakh cr by Taxing Cross-border Deals** about one-sixth of its total direct tax collection target
Acc To ET 12th April 2013
- India contributes > 70% litigation in TP globally (volume) at level of Tribunal/ Tax Courts or above → should taxpayers & Revenue continue to litigate ?

TP disputes/ litigation in India

- At least 1,500 transfer pricing disputes were in litigation in India as of February 2011, compared with fewer than six in the United States and none in Taiwan or Singapore (As per E&Y)
- Indian Tax Tribunals have decided > 470 TP cases in last 5 years; UK Tax Court has decided 1 TP case in last 5 years
- Generally two broad categories of TP litigation in India –
 - Pure comparability issue (IT & ITeS companies) → requires fundamental reforms in Indian TP regulations [“inter-quartile range” & “multiple year data” concepts]
 - Complex transactions on fundamentals of TP → requires significant improvement for all constituents [*taxpayers, to start with*]

Why Domestic Transfer Pricing?

- ▶ In order to check whether the Taxpayers carrying on business with related parties made excessive and unreasonable expenditure, provisions of section 40A(2) was introduced.
- ▶ Further, in order to check whether the profits of eligible units for availing the deduction under section 80A, 80IA, 10AA etc were not inflated, provisions were introduced in section 80A, 80IA, 10AA.
- ▶ However, there was no machinery in the Act to monitor/deal with the transactions with the related parties whether the same is valued at arm's length price or not.

Under the pre- amended provisions:

Section 40A(2) - Expenses or payments not deductible in certain circumstances.

The existing provisions of clause (a) of sub-section (2) of the aforesaid section 40A provides that

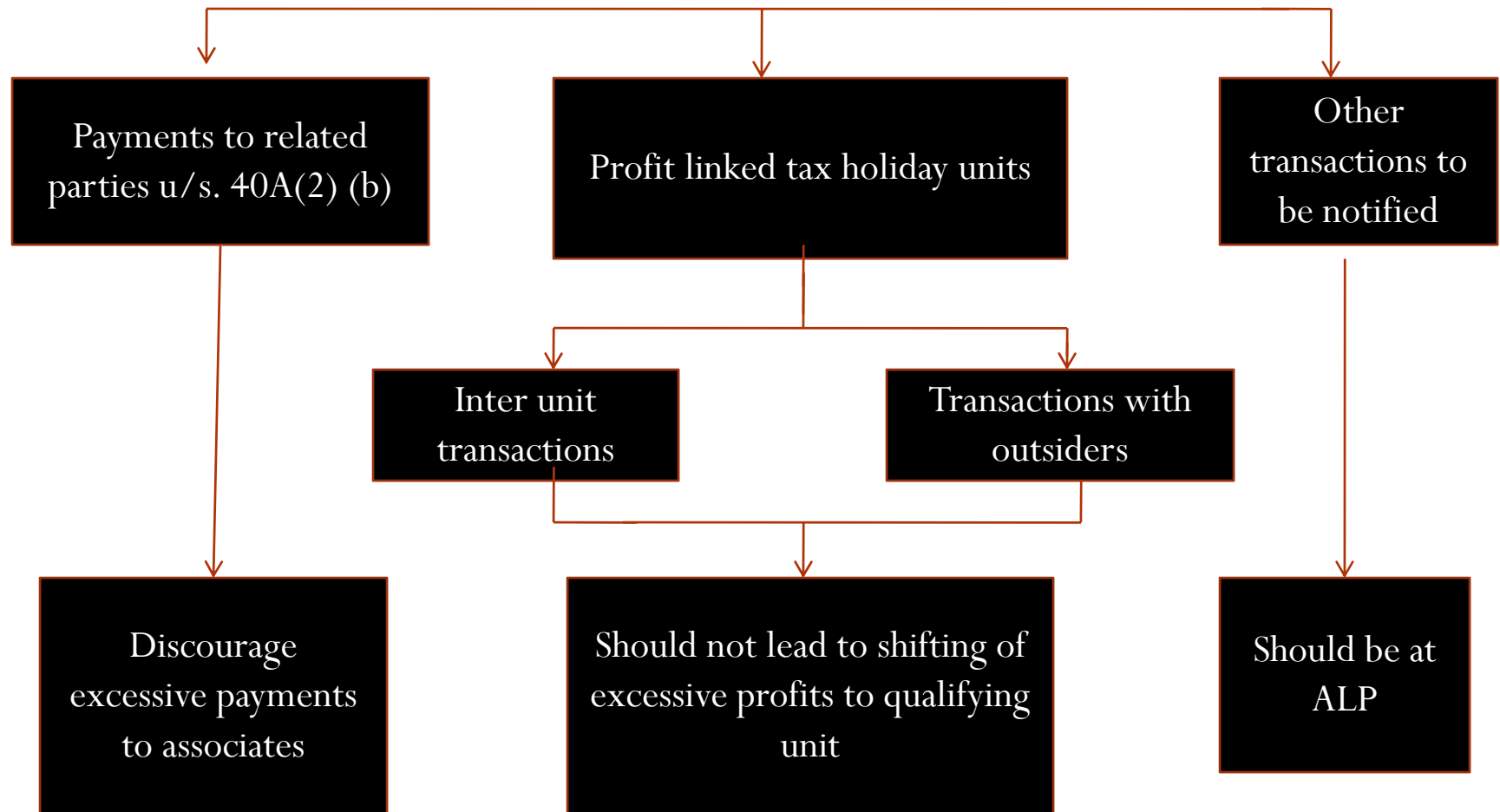
- ▶ where the assessee incurs any expenditure in respect of which payment has been or is to be made to any person referred to in clause (b) of the said section and
- ▶ the Assessing Officer is of the opinion that such expenditure is excessive or unreasonable having regard to fair market value of the goods, services or facilities
- ▶ for which the payment is made or the legitimate needs of the business or profession of the assessee or the benefit derived by or accruing to him there from, so much of expenditure as is so considered by him to be excessive or unreasonable shall not be allowed as deduction.

Circular NO. 6-P, Dated 6-7-1968 and circular NO. 4-P[LXXVI-65], dated 7-6-1968

Relevant extracts of the Departmental Circular -

- ▶ It may be noted that the new provision is applicable to all categories of expenditure incurred in businesses and professions, including expenditure on purchase of raw materials, stores or goods, salaries to employees and also other expenditure on professional services, or by way of brokerage, commission, interest, etc.
- ▶ Where payment for any expenditure is found to have been made to a relative or associate concern falling within the specified categories, it will be necessary for the Income-tax Officer to scrutinise the reasonableness of the expenditure with reference to the criteria mentioned in the section.
- ▶ The Income-tax Officer is expected to exercise his judgment in a reasonable and fair manner. It should be borne in mind that the provision is meant to check evasion of tax through excessive or unreasonable payments to relatives and associate concerns and should not be applied in a manner which will cause hardship in *bona fide* cases.

Object of domestic TP



Intent of Indian TP Regulations (International transactions)

Situated out of
India

AE in Tax
Haven or
lower tax
jurisdiction

Shifting of Losses or expenditures

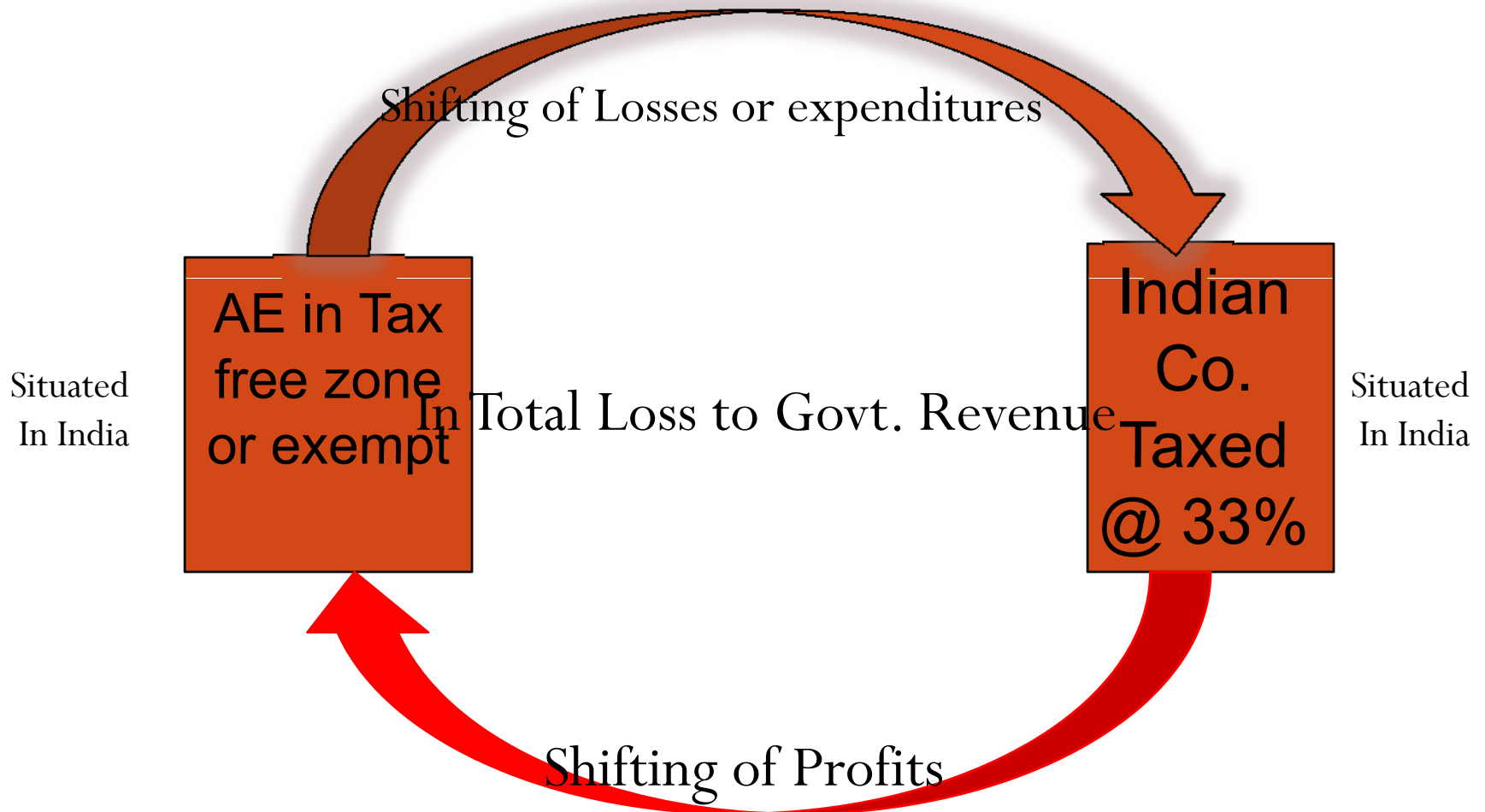
In Total Loss to Govt. Revenue

Indian
Co.
Taxed
@ 33%

Situated In India

Shifting of Profits

Intent of Indian TP Regulations (Domestic TP)



Domestic transactions - Transfer Pricing

- May lead to economic double taxation
- Inline with some tax jurisdictions like Australia, Thailand , Denmark etc.,
- Increase in compliance burden

ALP linked computation – S. 92(2A)

- ▶ Section 92(2A) “Any allowance for an expenditure or interest or allocation of any cost or expense or any income in relation to the specified domestic transaction shall be computed having regard to the arm's length price”
- ▶ In relation to Specified Domestic Transaction (SDT), the provision covers:
 - Allowance for an expense or interest
 - Allocation of cost or expense
 - Any income
- ▶ Cost contribution arrangements also covered [s.92(2)]
- ▶ The Chapter permits adjustment to income favorable to the revenue on item to item basis.
- ▶ The Chapter neither permit downward adjustment nor set-off of one item against another nor corresponding adjustment in hands of other party
- ▶ Allocation of cost or expense is not SDT in itself

Meaning of Specified Domestic Transaction – s. 92BA

► "Specified Domestic Transaction" means any transaction, not being an international transaction, namely:—

- i. any expenditure for which payment is to a person referred to in s.40A(2)(b);
- ii. any transaction referred to in s. 80A;
- iii. any transfer of goods or services referred to in s. 80-IA(8);
- iv. any business transacted between the assessee and other person under s. 80-IA(10);
- v. any transaction, under Chapter VI-A or s.10AA, if s. 80-IA(8) or s. 80-IA(10) is applicable; or
- vi. any other transaction as may be prescribed,
and the aggregate of such transactions entered into in the previous year exceeds
INR 5 Crores

Meaning of Specified Domestic Transaction

- Applicability

Transaction covered under Section	Applicability
clause (b) of sub section (2) of Section 40	Any expenditure
Sub section (6) of 80A	Computing Section (Determination of ALP)
Sub section (8) of Section 80IA Profit based deduction	Any transfer of goods or services within units – <u>Intra Units</u>
Sub section (10) of Section 80IA Profit based deduction	Any business transacted within <u>closely connected entities</u>
Chapter VIA or Section 10AA Profit based deduction	Any transaction
In any of the section	Any other transactions as may be prescribed

Section	Tax Payers covered	Applicability of TP provisions on SDT aggregating a value of more than INR50 million
40A(2)	Substantial Interested Parties	Expenses or payment made or to be made.
80A(6)	Enterprise claiming profit linked deductions from total income under chapter VI-A	Intra Transfer of goods and services and within the closed connected entities. (i.e. eligible business to non eligible business)
80IA Sub Section (8) And (10)	<ul style="list-style-type: none"> ➤ Infrastructure developers ➤ Telecommunications service providers ➤ Developers of Industrial parks ➤ Producers or distributors of power <p>An enterprise with an eligible business and close connection with any other person</p>	<p>The goods and services of an eligible business transferred to any other business carried on by the same taxpayer and vice-a-versa, are to meet the arm's length test. (sub section 8) Intra Unit Transfer</p> <p>a business transacted between a taxpayer carrying on an eligible business transact with a close connection, which results in more than ordinary profits to the business, is to meet the arm's length test. (sub section 10)</p>

Section	Tax Payers covered	Applicability of TP provisions on SDT aggregating a value of more than INR50 million
80-IAB	<p>Developers of SEZs</p> <ul style="list-style-type: none"> ➤ Small Scale industry engaged in operating Cold storage plant ➤ Industrial undertaking in industrially backward state as mentioned in VIII Schedule (ex : Jammu and Kashmir) <ul style="list-style-type: none"> ▪ Multiplex theaters and convention centers ▪ Company carrying on scientific research and development ▪ Eligible housing projects ▪ Eligible hospitals 	<p>The goods and services of an eligible business transferred to any other business carried on by the same taxpayer and vice-a-versa, are to meet the arm's length test. (sub section 8) Intra Unit Transfer</p> <p>a business transacted between a taxpayer carrying on an eligible business transact with a close connection, which results in more than ordinary profits to the business, is to meet the arm's length test. (sub section 10)</p>
80-IC / 80-IE	<p>Persons with units in specified states / north-eastern states claiming deduction</p>	
80-ID	<p>Hotels located in districts with World Heritage sites</p>	
10AA	<p>Persons with income from SEZ units</p>	

Section 92BA Analysed.....

For the purpose of sec. 92, 92C, 92D and 92E

Section	Relevance with provisions of Sec 92BA
92 : Computation of income having regard to ALP	✓
92A : Meaning of AE	✗
92B : Meaning of International transaction	✗
92C : Methods of computation of ALP	✓
92CA: Reference to TPO	✓
92CB : Safe harbour rules	✗
92CC : Advance Pricing agreement	✗
92CD : Effect of TP agreement	✗
92D : Maintenance of information and documents	✓
92E : CA's Report	✓
92F : Definitions: Accountant, ALP, Enterprise, PE, Specified date, Transaction*	✗

*** Sec 92F – Definitions does not define terms relevant for domestic TP transactions**

Domestic transactions -Transfer Pricing

- S.10AA
- S.40A(2)(b) – FMV vs. ALP
- S.80A - Scope of deductions & FMV for inter business transfers
- S.80IA (8) – Eligible business Vs. Other business
- S. 80IA (10) - Eligible assessee Vs. Other person
- S.80IAB(3), 80IB(13),80IC (7), 80ID (5), 80IE (6)

Domestic transactions-Transfer Pricing

- S.92C – computation of ALP – methodologies- also apply to SDT.
- S.92CA (1)(2)&(3)- reference , service of notice & order to be made by TPO
- S.92D – documentation – maintenance & production
- S.92E – report from an accountant –new form notified

Domestic transactions -Transfer Pricing

Corresponding Amendments :

➤ S. 40A(2) – Proviso inserted to provide for ALP in cl(a) :

“ Provided that no disallowance, on account of any expenditure being excessive or unreasonable having regard to the fair market value, shall be made in respect of a specified domestic transaction referred to in S.92BA, if such transaction is at arm’s length price as defined in cl.(ii) of S.92F”

- FMV different from ALP?

➤ In cl (b) (iv) , after the words “ or any relative of such director, partner or member”, the words “or any other company carrying on business or profession in which the first mentioned company has substantial interest” shall be inserted.

Domestic transactions -Transfer Pricing

Corresponding Amendments :

➤ S. 80A – Cl (iii) to Explanation inserted :

“in relation to any goods or services sold, supplied or acquired means the arm’s length price as defined in cl.(ii) of S.92F of such goods or services, if it is a specified domestic transaction referred to in S.92BA”

is ALP synonymous with Market value ?

➤ S. 80-IA – Explanation substituted in Ss(8) :

Market Value , in relation to any goods or services means –

- i. *the price that such goods or services would ordinarily fetch in the open market: or*
- ii. *the arm’s length price as defined in cl(ii) of S.92F, where the transfer of such goods or services is a specified domestic transaction referred to in S.92BA*

Domestic transactions -Transfer Pricing

Corresponding Amendments :

➤ In S.80 IA(10) - Proviso inserted :

“Provided that in case the aforesaid arrangement involves a specified transaction referred to in S.92BA, the amount of profits from such transaction shall be determined having regard to arm’s length price as defined in clause (ii) of S. 92F”

not clear whether ALP and FMV are the same.

Related Party coverage of s. 40A(2)(b) relationship

- Relationship can exist any time during the year

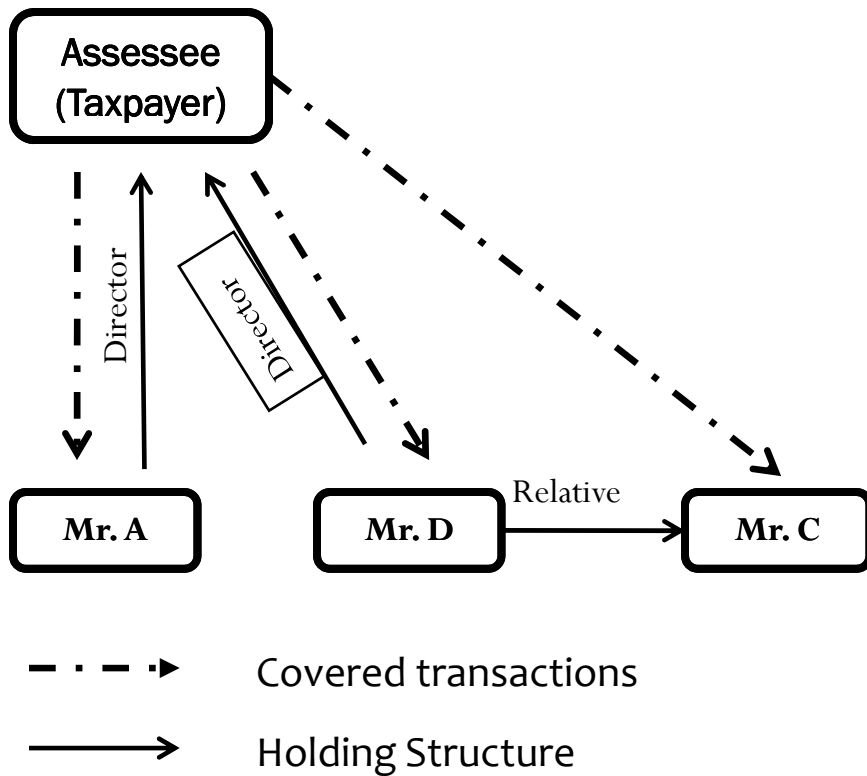
Taxpayer	Illustrative Relation coverage
Individual	<ul style="list-style-type: none">▶ Relatives (2(41) "relative", in relation to an individual, means the husband, wife, brother or sister or any lineal ascendant or descendant of that individual)▶ Firm in which he is partner▶ Company in which he is director /has more than 20% shareholding
Firm	<ul style="list-style-type: none">▶ Partners/ relatives▶ Company/ firm in which partner / relative has substantial interest (>20%)
Company	<ul style="list-style-type: none">▶ Director/ relatives▶ Company/firms in which director / relatives have substantial interest (> 20%)▶ Parent (> 20%)▶ Sister subsidiary (common parent holding > 20%)

Definition of Relatives

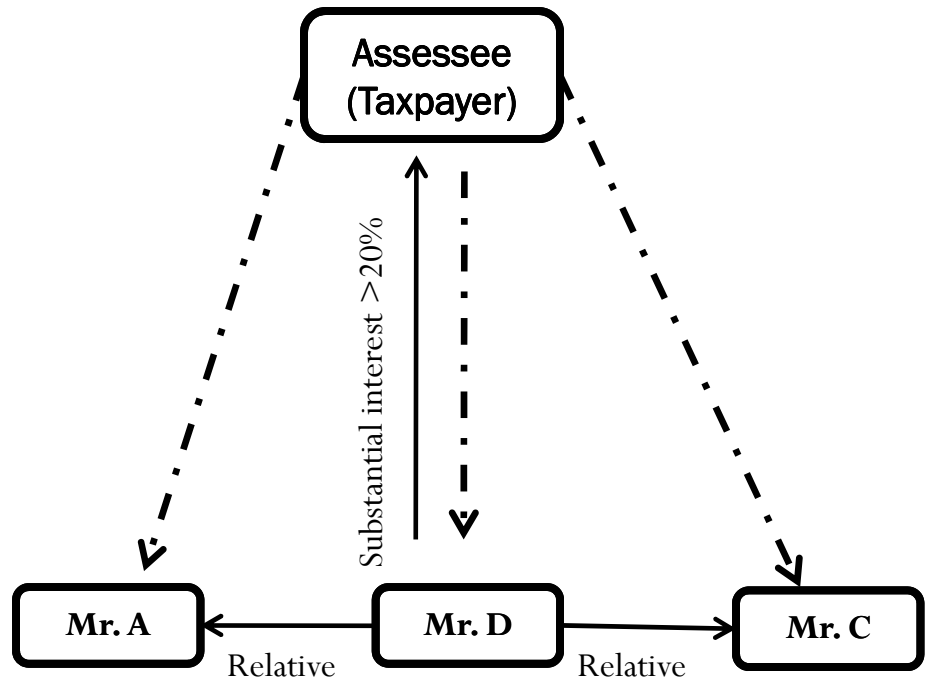
- **Section 2(41)** defines relative in relation to an individual to mean:
 - Husband;
 - Wife;
 - Brother;
 - Sister; or
 - any lineal ascendant or descendant;

Type of transactions covered (illustrations for payments made by a Company) ...

Case 1 - Director or any relative of the Director of the taxpayer – Section 40A(2)(b)(ii)



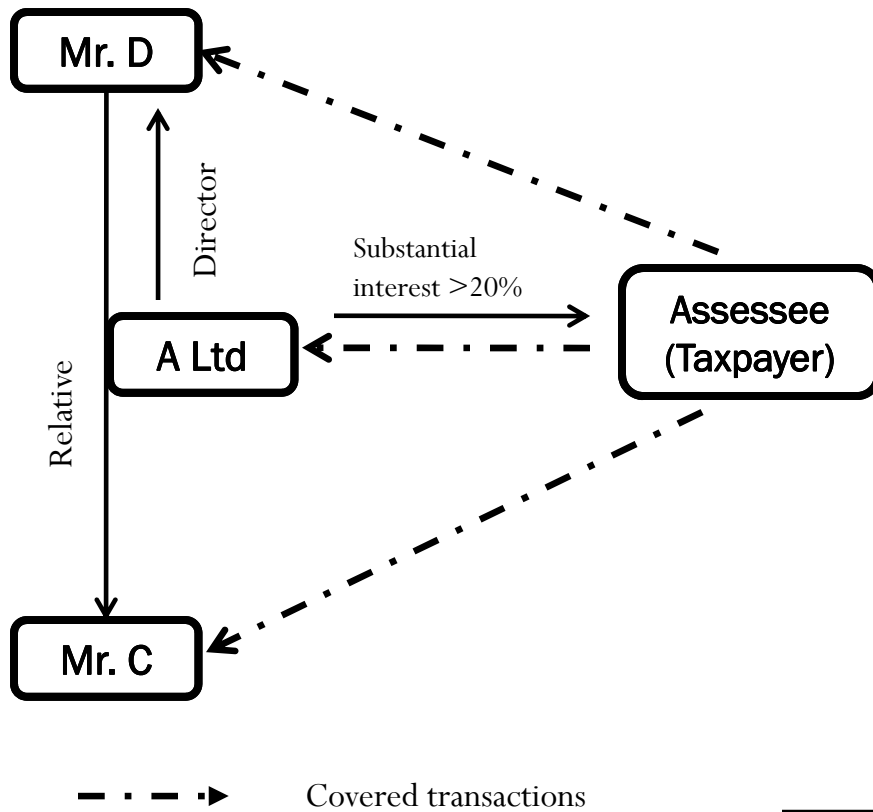
Case 2 - To an individual who has substantial interest in the business or profession of the taxpayer or relative of such individual – Section 40A(2)(b)(iii)



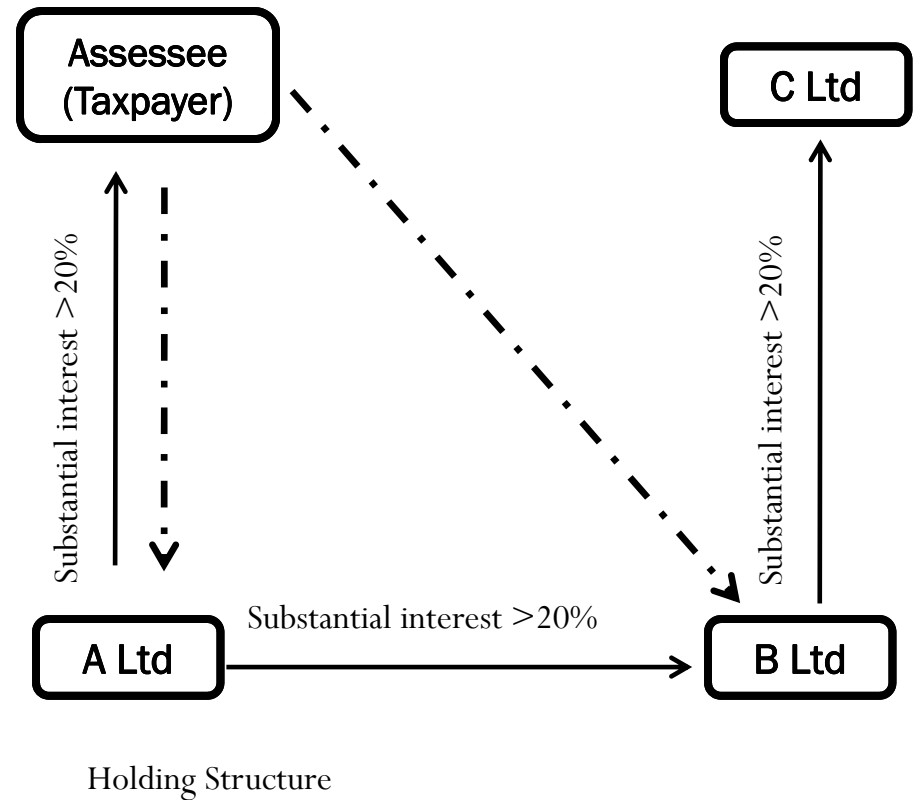
Type of transactions covered (illustrations for payments made by a Company)

...

Case 3 – To a Company having substantial interest in the business of the taxpayer or any director of such company or relative of the director – Section 40A(2)(b)(iv)

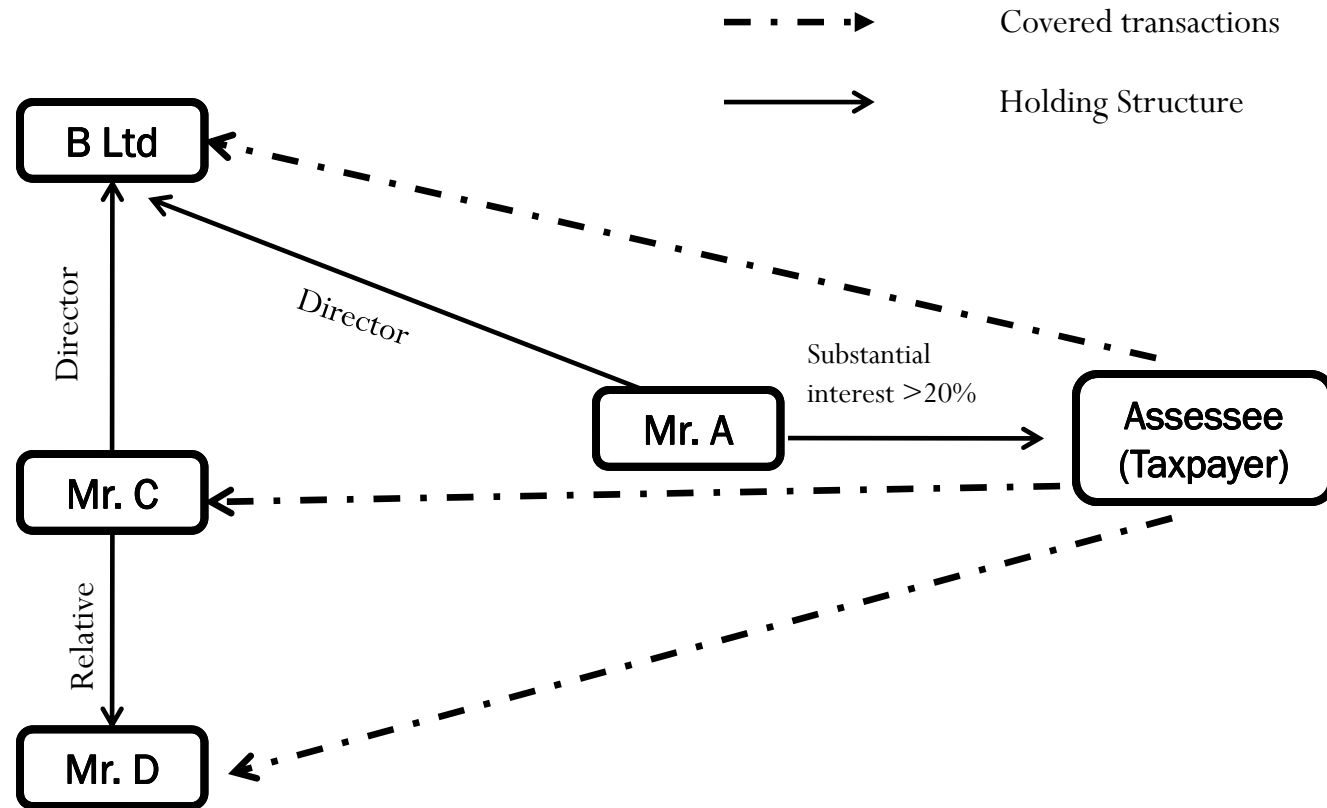


Case 4 – Any other company carrying on business in which the first mentioned company has substantial interest – Section 40A(2)(b)(iv)



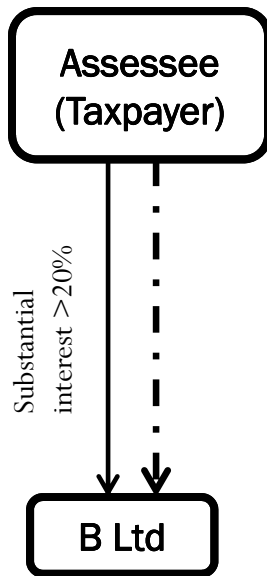
Type of transactions covered (illustrations for payments made by a Company) ...

Case 5 – To a Company of which a director has a substantial interest in the business of the taxpayer or any director of such company or relative of the director – Section 40A(2)(b)(v)



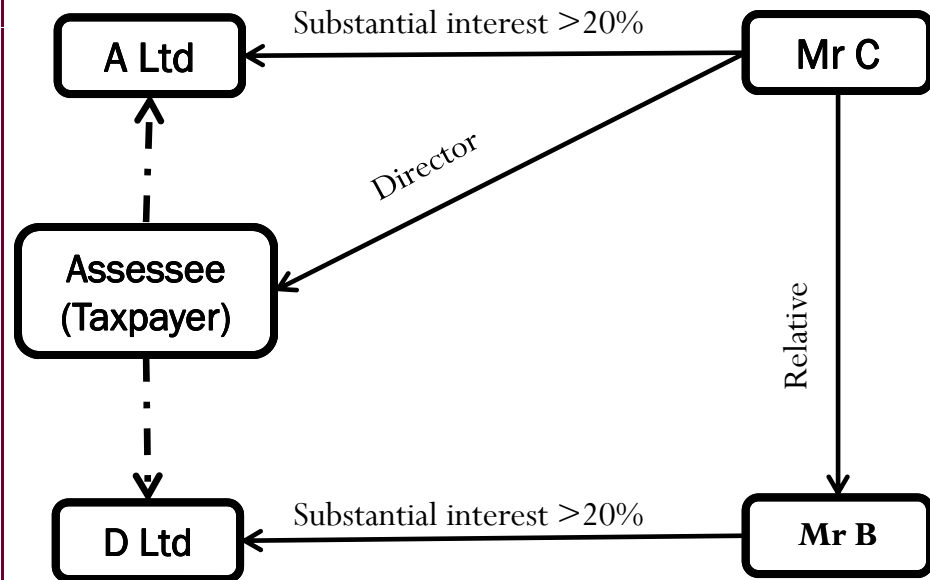
Type of transactions covered (illustrations for payments made by a Company)...

Case 6 – To a Company in which the taxpayer has substantial interest in the business of the company – Section 40A(2)(b)(vi)(B)



---> Covered transactions
—> Holding Structure

Case 7 – Any director or relative of the director of taxpayer having substantial interest in that person– Section 40A(2)(b)(vi)(B)



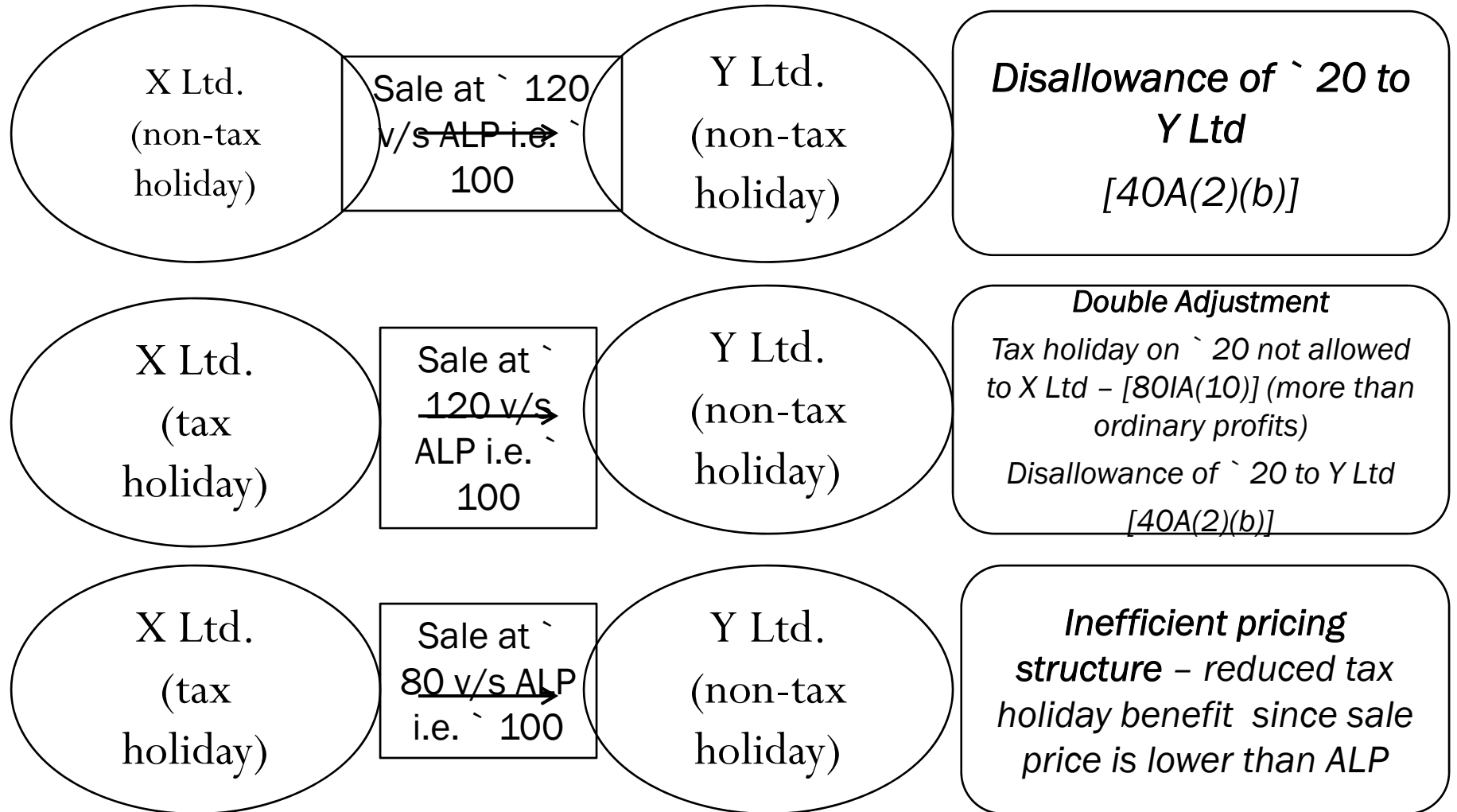
Scope of s. 40A(2)(b)

- ▶ Domestic TP applies to expenditure for which payment is made or is to be made to a person referred to in s. 40A(2)(b)
 - ▶ Coverage is wide; conceptually different from AS-18
- ▶ Applies to transactions on or after 1 April 2012
 - ▶ Will not apply on basis of payment on or after 1 April 2012
- ▶ Applies to ‘payment’ which results in ‘expenditure’
 - ▶ Arguably includes constructive payment
 - ▶ Dividends/DDT not covered since not an expenditure
 - ▶ Payment of loan or share capital is not an expenditure
- ▶ —Payment should be to independent entity; Inter unit transaction of same taxpayer not covered

S. 40A(2)(b) – controversial transactions

- ▶ Inter-linking of S.40A(2) (a) and S.40A(2)(b)
- ▶ Benchmarking of remuneration
 - ▶ Remuneration to partners regulated by s.40(b)
 - ▶ Directors remuneration regulated under Company Law (1968 Circular 6-P)
- ▶ Payment to related parties covered under non-business heads
 - ▶ Interest payment to related party claimed as deduction u/s 57 ; s.58 (2) extends s. 40(A)(2) to Income from other sources.
 - ▶ Cost of capital asset acquired from related party
 - ▶ Payments for capital assets under business head
 - ▶ Depreciation claimed u/s. 32
 - ▶ Full deduction claimed u/s. 35(1)(iv)

Tax burden, if transaction not at ALP



Section 80IA (8) & 80IA (10) – Deduction in respect of profits and gains from industrial undertaking or enterprise engaged in infrastructure development, etc.

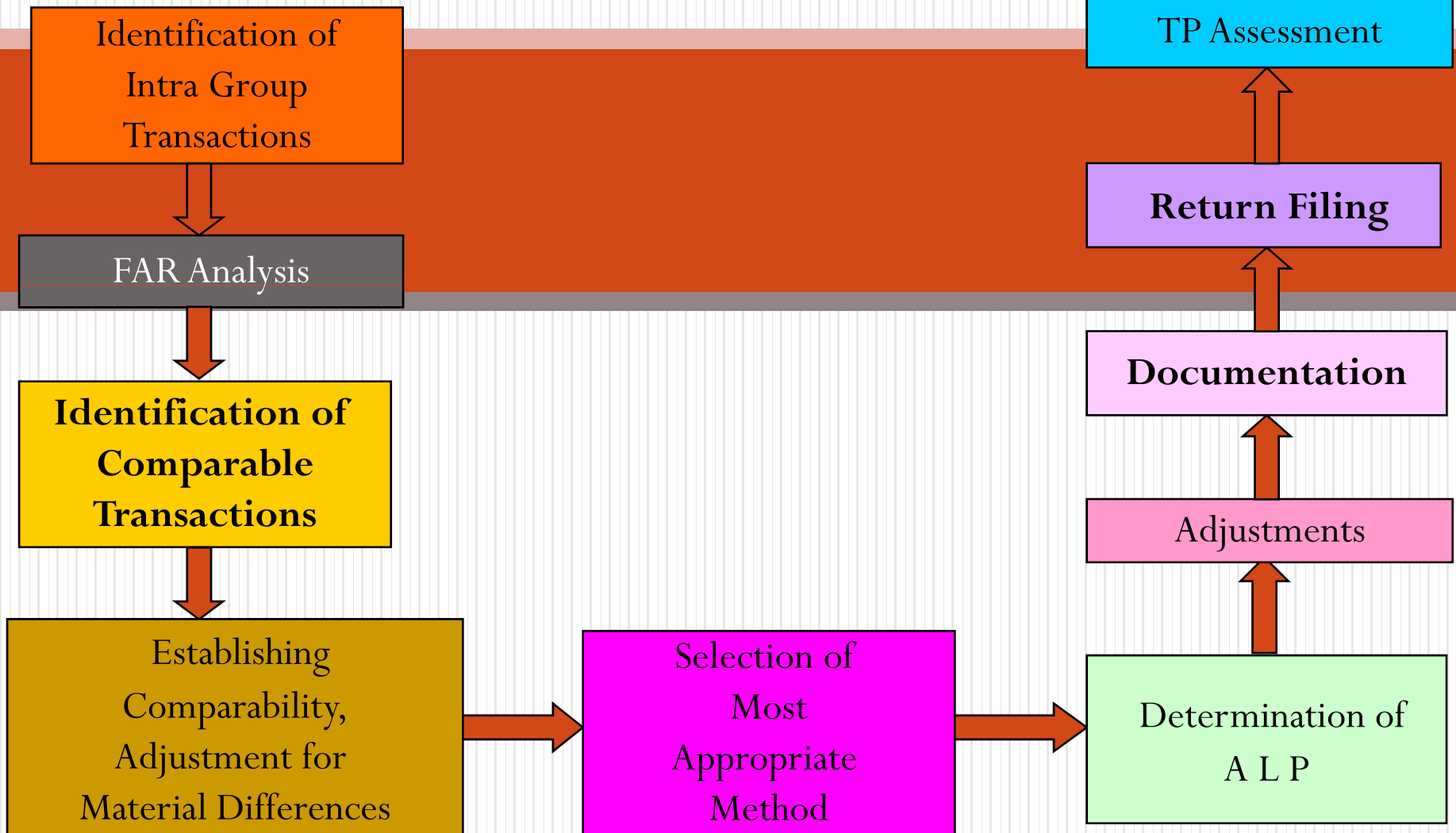
80IA (8)	80IA (10)
Inter-unit transaction of goods or services	<ul style="list-style-type: none"> • Business transacted with any person generates more than ordinary profits • Owing to either close connection or any other reason
Applicable where transfer is not at market value	Applicable to tax holiday units earning more than ordinary profit
Onus on tax payer	<ul style="list-style-type: none"> • Primary onus on taxpayer • Onus on tax authorities as well

- No guidance on the meaning of close connection
- To align ordinary profits with arm’s length price. For example:

ALP of 5 comparable companies OP/TC	Mark-up of the tax holiday entity OP/TC
Arithmetic mean = 15%	30%

- OP/ TC of 30% considered to be at arm’s length by the TPO
- Under 801A(10) the AO states that the profits are more than ordinary
- Solution: Defend price or evaluate alternate methods (other than profit based)
- Impact of non-charging of services/ costs to tax holiday undertaking

Transfer Pricing Process



Arm's length price

➤ S. 92 F (ii)

“arm's length price” means a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions”

Fair Market Value vs. Arm's Length Price

- Domestic Transfer Pricing usher shift from generic 'Fair Market Value' concept to Arm's Length Pricing

Characteristic	Fair Market Value	Arm's Length Pricing
Definition	The price which goods or services would have fetched or cost in the open market	A price which is applied in a transaction in uncontrolled conditions
Computation Mechanism	No specific mechanism provided in law	Most appropriate method out of six prescribed methods
Transaction Value	Any market pricing point can be treated as fair market value	Arithmetic mean of comparable prices treated as arm's length price
Sample Size	One comparable may be sufficient to establish fair market value	Require bigger sample size for establishing arm's length
Deviation	No deviation permitted from fair market value	Deviation of plus / minus three percent is permitted

Transfer Pricing Documentation

Transfer Pricing Documentation - Overview

- ➔ Transfer Pricing (“TP”) regulations were introduced in India w.e.f. financial years beginning from April 1, 2001.
- ➔ The regulations require extensive TP documentation to be maintained by taxpayer undertaking international transactions with overseas group affiliates (“AEs”).
- ➔ The contemporaneous TP documentation is required to be maintained on or before the due date of filing the corporate income tax return, i.e. on or before 30th November every year in respect of the tax year.
- ➔ The detailed list of documents to be maintained as a part of TP documentation is provided in Rule 10D of the Income Tax Rules, 1962 (“Rules”)

Rule 10D Documentation

Entity related



- ✓ Profile of industry
- ✓ Profile of group
- ✓ Profile of Indian entity
- ✓ Profile of AEs

Price related



- ✓ Transaction terms
- ✓ Functional analysis (functions, assets and risks)
- ✓ Economic analysis (method selection, comparable benchmarking)
- ✓ Forecasts, budgets, estimates

Transaction related



- ✓ Agreements
- ✓ Invoices
- ✓ Pricing related correspondence (letters, emails, fax, etc)

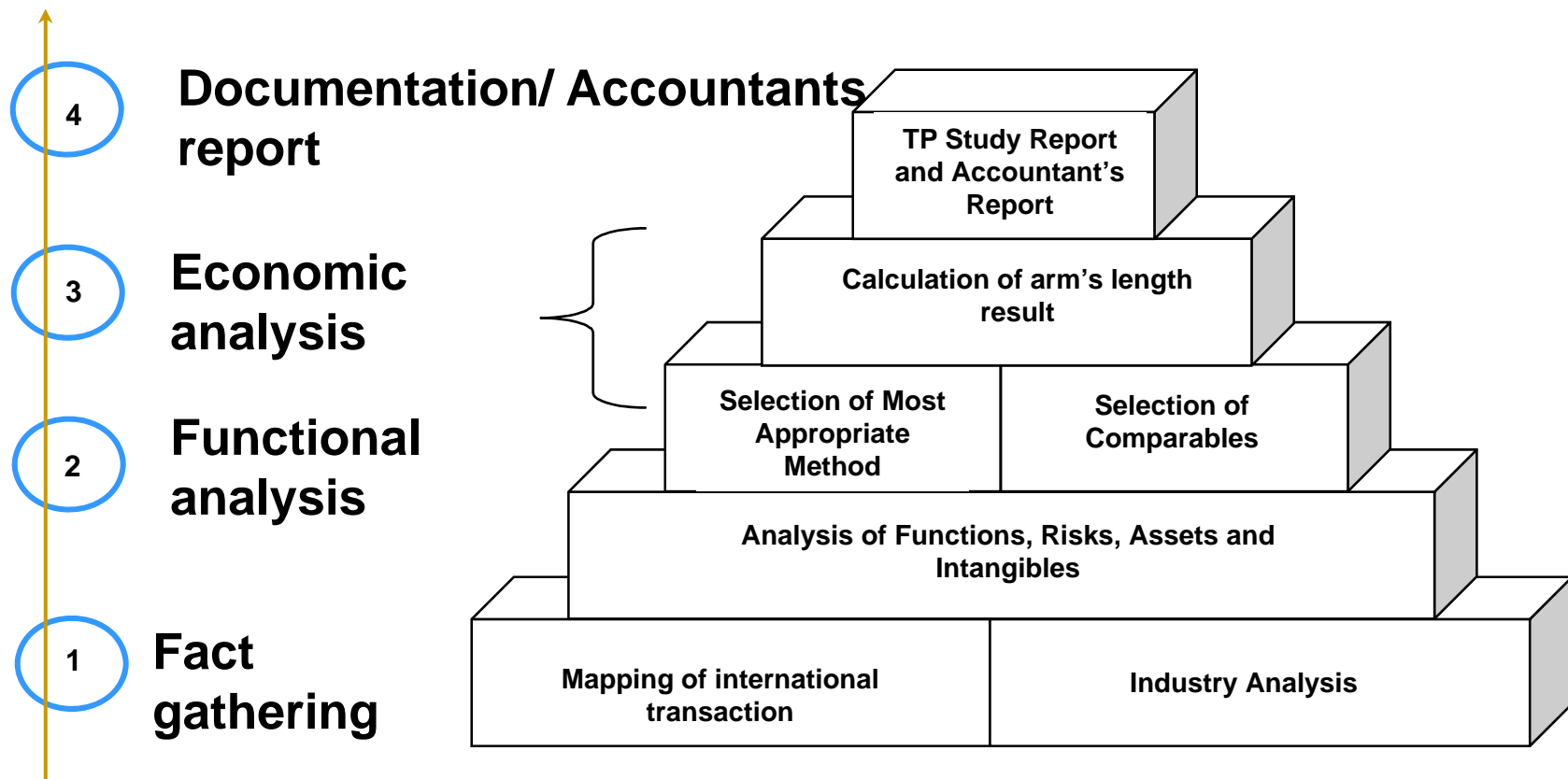
Contemporaneous documentation requirement

Documentation to be retained for 9 years from financial year

Documentation is not required to be maintained if the *aggregate value* of all international transactions does not exceed *one crore rupees*

Documentation – Rule 10D

The approach for TP documentation may be summarised in the following phases of work:





TP Study Report and Accountant's Report

Fact gathering

Mapping of international transaction or SDT

- ➔ Applicability of TP regulations to the entity and its international transactions with its AEs.
- ➔ Keeping the legislative provisions in perspective, the following details about the AEs need to be documented:
 - ✓ Name and address of AEs.
 - ✓ Legal status.
 - ✓ Country of tax residence.
 - ✓ Ownership linkages.
 - ✓ Broad description of the business of the AEs.

Industry Analysis

- ➔ Understand industry dynamics in which entity operates
 - ✓ Industry analysis examines industry trends, risks and overall environment, in which the entity/ the group operates.
- ➔ Generally, the following information should be documented about the industry:
 - ✓ Industry structure (including the Legal environment of the industry);
 - ✓ Key players;
 - ✓ Key value drivers/ inhibitors of the industry;
 - ✓ Trends in profitability, turnover, market share, etc.;
 - ✓ Future outlook; and
 - ✓ Other important details, if any.

Functional analysis

Functional Analysis

➔ The functional analysis includes:

- ✓ Overview of the entity and the group to which it belongs.
- ✓ Analysis of functions performed by the entity and its AEs.
- ✓ Analysis of risks assumed by the entity and its AEs.
- ✓ Analysis of the intangibles owned by the entity and its AEs.
- ✓ Description of the assets utilised by the entity.

➔ The functional analysis is primarily based on the interviews with the entity's personnel.

- ✓ Information can also be gathered from portals of the entity, internet, intranet, entity brochures and audit documents.

Functional Analysis

- ➔ Interview with the entity's personnel, would generally include:
 - ✓ Discussing the organisation structure and operating procedures.
 - ✓ Identifying all international transactions including deemed international transactions.
 - ✓ Functions performed, risks assumed and assets utilised by each entity involved in the transaction.
 - ✓ Identifying pricing strategies.
 - ✓ TP methodology adopted by the group and its implementation in the entity's operations.
 - ✓ Identifying internal / external comparable data.
 - ✓ If losses are incurred, then reasons for the same.

Functional analysis

Functional department	Personnel
R&D / Product Development	Chief Engineer, Head of R&D, or Product Development
Manufacturing	Plant Manager, Product Manager, Process or Production Engineer, Purchasing Manager, Quality Control Manager
Sales, Marketing, & Distribution	Export Sales Manager, Domestic Sales Manager, Intercompany Sales Manager, Marketing Manager, Advertising Manager, Warehouse Manager, Distribution Manager
Administrative/Central Services	Tax Manager, Treasurer, Controller, MIS Manager, Director of Planning, Staff Attorney

Economic analysis

Economic Analysis

➤ Economic Analysis involves:

- ✓ Determination of method to be applied and reasons for rejection of other methods.
- ✓ Description of the databases used in the analysis (e.g., Prowess, CapitaLine, etc) and search methodology used.
- ✓ Description of the financial analysis undertaken including descriptions of the comparables and adjustments to data.
- ✓ Determination of the arm's-length price.
- ✓ Adjustment to the arm's length price / tested party price to make them comparable:
 - Capacity utilisation
 - Working capital
 - Marketing
- ✓ Conclusion on whether the transaction meets the arm's length test.

**Economic analysis –
Selection of Most
Appropriate Method**

Transfer Pricing Methods

OECD Transfer Pricing Methods

Traditional Transaction Methods

Comparable
Uncontrolled
Price

Resale Price
Method

Cost Plus
Method

Transactional Profit Methods

Profit Split
Method

Transactional
Net Margin
Method

Other
Method

1. OECD: traditional methods preferred to transactional methods (in 2010 Guidelines OECD doesn't define)
2. Indian rules confirm OECD approach
3. Any other method prescribed by the Central Board of Direct Taxes- as of now introduced

Comparables

- ➔ All methods require comparables.
- ➔ Transfer price is set/ defended using data from comparable companies.
- ➔ Comparable company should be independent and similar to the entity.
- ➔ Following factors are generally used in judging comparability (Rule 10C(2)):
 - ✓ nature of transactions undertaken (i.e type of good, service etc.)
 - ✓ company functions
 - ✓ risks assumed
 - ✓ contractual terms (i.e similar credit terms)
 - ✓ economic and market conditions

Key requirements of Indian TP Regulations

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Key requirements of Indian TP Regulations

- Computation of Arm's length price by applying the 'most appropriate' method out of:
 - Comparable Uncontrolled Price (CUP)
 - Resale Price Method (RPM)
 - Cost Plus Method (CPM)
 - Transaction Net Margin Method (TNMM)
 - Profit Split Method (PSM)
 - Other Method
- Mandatory contemporaneous documentation requirements
- Documentation requirements
 - The statute requires information / documents in relation to an international transaction to be: :
 - kept and maintained in by every person
 - List of documents prescribed in Rule 10D
 - kept and maintained for a prescribed time – 8 years
 - furnished within 30 / 60 days of Revenue's request.
- Stringent Penal Consequences on Non-compliance / TP adjustments

Section 92C mechanism of determining the "arm's length" price

- **Comparable uncontrolled price method;**
 - Comparison of price charged or paid for property transferred or services provided in a comparable uncontrolled transaction.
 - Used mainly in respect of transfer of goods, provision of services, intangibles, loans, provision of finance.

Section 92C mechanism of determining the "arm's length" price

- **Resale-price method;**
 - Considers the price at which property purchased or services obtained by the enterprise from an AE is resold or are provided to an unrelated enterprise.
 - Used mainly in case of distribution of finished goods or other goods involving no or little value addition

Section 92C mechanism of determining the "arm's length" price

- **Cost plus method or cost-price method;**
 - Considers direct and indirect costs of production incurred by an enterprise in respect of property transferred or services provided and an appropriate mark-up.
 - Used mainly in respect of provision of services, joint facility arrangements, transfer of semi finished goods, long-term buying and selling arrangements

Section 92C mechanism of determining the "arm's length" price

- Profit-split method;
 - Considers combined net profit of the AEs arising from the international transaction and its split amongst them.
 - Used mainly in respect of transactions involving integrated services provided by more than one enterprise, transfer of unique intangibles, multiple inter-related transactions, which cannot be separately evaluated

Section 92C mechanism of determining the "arm's length" price

- Transactional net margin method.
 - Considers net profit margin realised by the enterprise from an international transaction entered into with an AE.
 - Used in respect of transactions for provision of services, distribution of finished products where resale price method cannot be adequately applied, transfer of semi-finished goods

Other method

- Other Method would provide flexibility in establishing ALP, particularly in cases where the application of the five specific methods is not possible due to reasons such as difficulties in obtaining comparable data due to uniqueness of transactions such as intangibles or business transfers, transfer of unlisted shares, sale of fixed assets, revenue allocation/splitting, guarantees provided and received, etc. However, it would be necessary to justify and document reasons for rejection of all other five methods while selecting the ‘Other Method’ as the most appropriate method.

PENAL PROVISIONS

- **Section 271(1)(c)**
- As per Explanation 7 to section 271(1)(c)
- where in case of an assessee who has entered into an international or Domestic transaction any amount is added or disallowed in computing the total income under section 92C(4)
- then the amount so added or disallowed shall be deemed to represent the income in respect of which particulars have been concealed or inaccurate particulars have been furnished
- unless the assessee proves to the satisfaction of the Assessing Officer or the Commissioner (Appeals) or the Commissioner that the price charged or paid in such transaction was computed in accordance with the provisions contained in section 92C and in the manner prescribed under that section, in good faith and with due diligence.
- The amount of penalty provided for is not less than the amount of tax sought to be evaded; and,
- not more than three times the amount of tax sought to be evaded, by reason of the concealment as aforesaid.

PENAL PROVISIONS

- **Section 271AA**
- If the assessee fails to keep and maintain the prescribed information and documents, or fails to report any RPT, penalty equal to 2% **of the value of each international transaction or SDT** may be leviable.

PENAL PROVISIONS

- **Section 271BA**
- Failure to furnish the accountant's report may attract penalty of Rs. 1,00,000/- .
- **Section 271G**
- Failure to furnish the required information and documents may attract penalty of 2% of the value of the International Transaction OR SDT for each failure.

Issues

- Whether payment for capital expenditure Or expenditure capitalized is also covered ?
- Whether the provisions will apply in case the payer's income is chargeable to tax under the head 'Income from other sources', because section 58(2) says –The provisions of section 40A shall, so far as may be, apply in computing the income chargeable under the head “Income from other sources” as they apply in computing the income chargeable under the head “Profits and gains of business or profession” ?

- Whether new provision applies to -
 - Public Charitable Trust paying remuneration to related persons.
 - Co-operative Societies
 - Social Clubs having a business undertaking
- Transfer pricing provisions are not applicable in case where income is not chargeable to tax at all.

- Correlative adjustments - if excessive or unreasonable expenses are disallowed in the hands of tax payer at time of the assessment then corresponding adjustment to the income of the recipient will not be allowed in the hands of recipient of income. Hence, it would lead to double taxation in India.

Challenges

Type of payments/ transactions	Challenges
<ul style="list-style-type: none"> • Salary and Bonuses paid to the partners • Remuneration paid to the Directors • Transfer of land • Joint Development agreements • Project management fees • Allocation of expenses between the same taxpayer having an eligible unit and non-eligible unit • Definition of Related Party 	<ul style="list-style-type: none"> • Benchmarking? • Whether the limit as mentioned in section 40 (b) would be the ALP? • Benchmarking? • Whether the limit as mentioned in Schedule XIII would be the ALP? • Whether the rates mentioned in the ready reckoner be considered as ALP? • Benchmarking? • Benchmarking? • Whether these allocation would be SDT – Sec 80-IA(10)? • Directly v/s Indirectly

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