



Benchmarking: Documentation & Certification

CA Jiger Saiya
24 June 2013

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TRANSFER PRICING BENCHMARKING

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TRANSFER PRICING BENCHMARKING

Purpose & Importance of Benchmarking Analysis

- Purpose of Benchmarking Analysis
 - To identify comparable transactions that are further used to assess whether the controlled transactions under review comply with the arm's length principle
- Importance of Benchmarking Analysis
 - Rule 10D necessitates maintenance of record of analysis performed to evaluate comparability of uncontrolled transactions
 - Forms part of Transfer Pricing Documentation which is the first line of defence for the taxpayer
- As per Rule 10B(2) comparability of international transaction shall be judged with reference to:
 - Specific characteristics of the transaction
 - Functions performed, Assets deployed, Risks assumed
 - Terms & conditions of the transaction and as prevailing in market

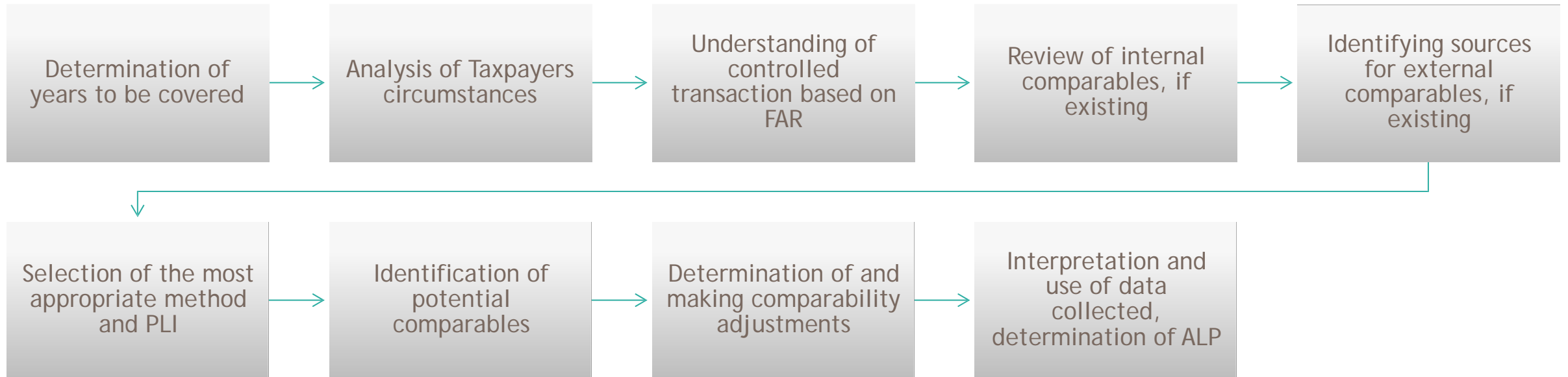
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Penalties

Section	Default	Penalty
271(1)(c)	Transfer Pricing Adjustment considered as concealment of income	100% to 300% of Tax on the Adjustment made
271G	Failure to furnish documentation	2% of Value of International Transactions and/or Specified Domestic Transactions
271BA	Failure to furnish Form 3CEB	INR 100,000
271AA	Failure to keep or maintain required documentation	2% of Value of International Transactions and/or Specified Domestic Transactions
	Failure to report required transactions	
	Furnish incorrect information or documentation	

TRANSFER PRICING BENCHMARKING

9 Step Process Recommended by OECD



TRANSFER PRICING DOCUMENTATION

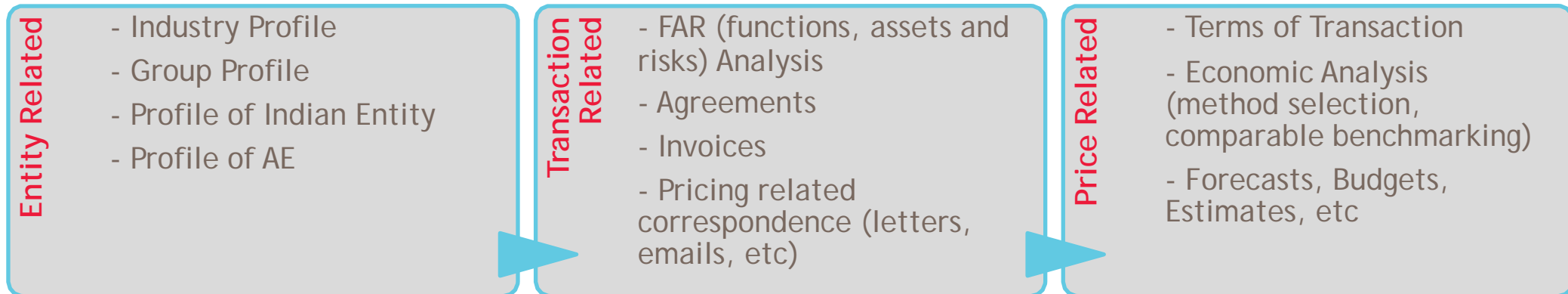
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Regulatory Requirement

- Section 92D of the IT Act r.w. Rule 10D of the IT Rules casts an obligation on the Taxpayer to maintain contemporaneous documentation with respect to the International Transactions and/or Specified Domestic Transactions:



- The said Rule exempts the Taxpayer from maintaining such documentation wherein the aggregate monetary value of International Transactions in a year as recorded in the books does not exceed Rs.1Cr.
- Section 92BA of the Income Tax Act exempts the taxpayer from any compliance with regards Specified Domestic Transactions where the aggregate value of such transactions do not exceed Rs. 5 Cr.
- Documentation is to be maintained for a period of 8 years from end of Assessment Year and ought to be produced before the Tax Office within 30/60 days from date of receipt of notice

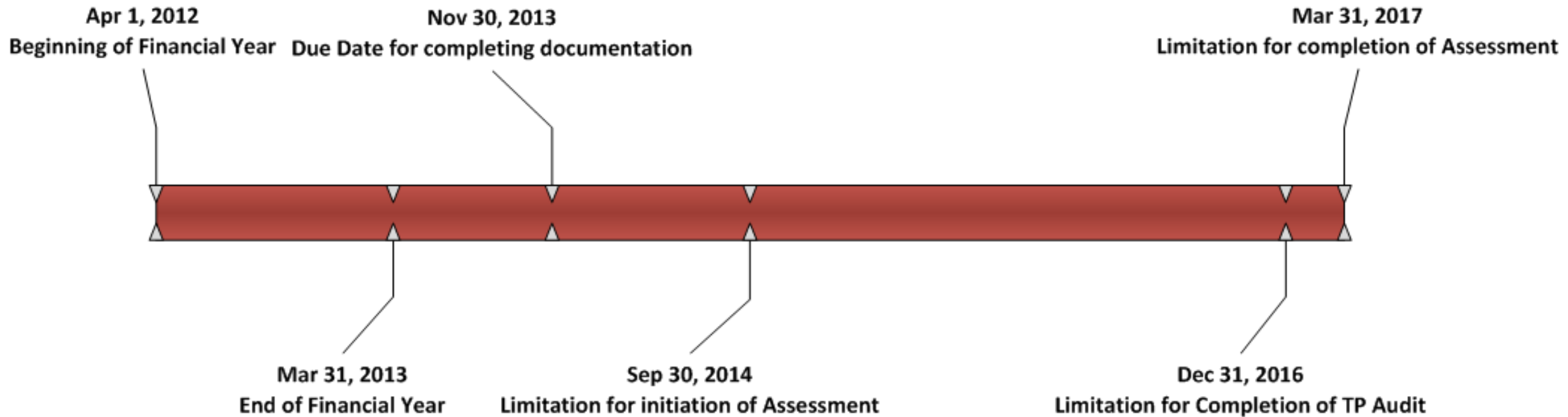
TRANSFER PRICING DOCUMENTATION

Contemporaneous Documentation

- Rule 10D(4) of IT Rules requires that the information & documentation specified under the Rule 10D should as far as possible be contemporaneous and should exist latest by the due date of filing of the Return of Income
- The word 'contemporaneous' has not been defined under the IT Act
- Random House Webster's Unabridged Dictionary defines the word Contemporaneous as "living or occurring during the same period of time", "Concurrent", "Consistent", "Simultaneous".
- From the above it can be inferred that the documentation should be present or should be created at the time the Taxpayer is entering into an International Transaction or Specified Domestic Transaction with an AE
- Contemporaneous Documentation Issues
 - Availability of data while entering into controlled transaction / due date of filing of Return of Income (Extended due date for Transfer Pricing Cases)
 - Use of earlier years data
 - Use of multiple years data
 - Updation of Databases - Fresh Search by TPO
 - Restatement of Financials
 - Difference in financial year

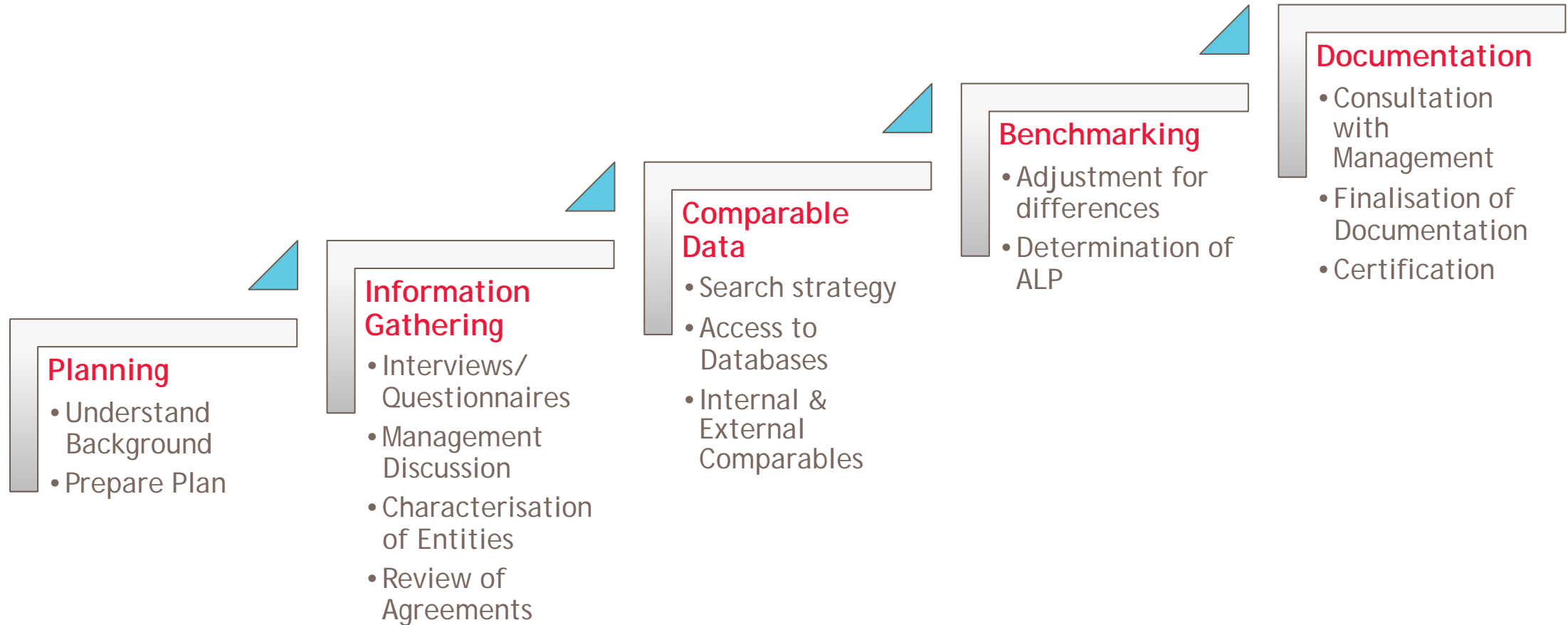
TRANSFER PRICING DOCUMENTATION

Transfer Pricing Timeline



TRANSFER PRICING DOCUMENTATION

Year End Documentation Process



TRANSFER PRICING DOCUMENTATION

Scope of Documentation

International Transaction / Specified Domestic Transaction

- Policy Documentation
- Transaction Documentation

Characterisation & Evaluation

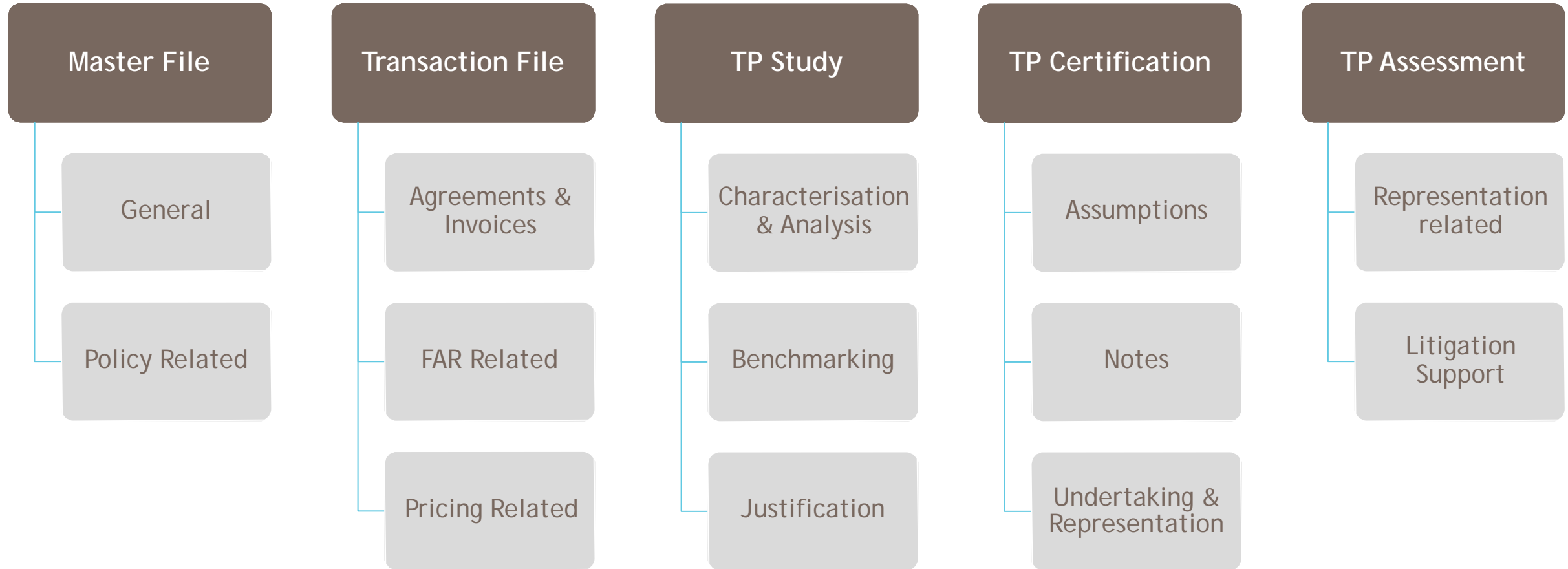
- Identification of Controlled Transactions & Associated Enterprises
- FAR Analysis of Controlled Transactions
- Selection of Tested Party
- Identification of Comparable Uncontrolled Transactions
- Selection of the Most Appropriate Method
- Economic & Functional Adjustments
- Determination of Arms Length Price

Transfer Pricing Assessment

- Justification
- Representation
- Litigation Support

TRANSFER PRICING DOCUMENTATION

Documentation Best Practices



TRANSFER PRICING DOCUMENTATION

Documentation Best Practices - Master File



Details / Information	Sources / Documentation
<ul style="list-style-type: none"> ▪ Ownership & Management structure ▪ Lines of business ▪ Key products dealt-in ▪ Business set-up ▪ Functional structure of Group Members ▪ Customer profile ▪ Key financial numbers 	<ul style="list-style-type: none"> ▪ Ownership & Management Chart ▪ Group Website ▪ Product brochures ▪ Management Discussion/ Representation ▪ Global Transfer Pricing documentation ▪ Consolidated financial statements

Details / Information	Sources / Documentation
<ul style="list-style-type: none"> ▪ Historical background ▪ Shareholding pattern ▪ Organisation structure ▪ Business model ▪ Key Business segments ▪ Key Products and their applications ▪ Industry classification ▪ Customer profile ▪ Physical / Functional set-up ▪ Employee profile ▪ Research & Development activity ▪ Key financial numbers 	<ul style="list-style-type: none"> ▪ Business Profile or Brochure ▪ Statutory Records/ Registers ▪ Information / Reports filed with external agencies ▪ Taxpayer Website ▪ Product Brochures ▪ Historical Annual Reports ▪ Books of Accounts ▪ Management Discussion/ Representation ▪ Registrations & Applications



TRANSFER PRICING DOCUMENTATION

Documentation Best Practices - Master File



Details / Information	Sources / Documentation
<ul style="list-style-type: none"> ▪ Identification of Associated Enterprise(s) ▪ Relationship with the Taxpayer ▪ Business activity ▪ Physical / Functional set-up ▪ Key financial numbers 	<ul style="list-style-type: none"> ▪ Group Holding Structure ▪ Management Discussion / Representation ▪ Website of Associated Enterprise(s) ▪ Annual Report of Associated Enterprise(s)

Details / Information	Sources / Documentation
<ul style="list-style-type: none"> ▪ Global Scenario ▪ Indian Scenario ▪ Industry constituents ▪ Key Value Drivers & Weights thereof ▪ Internal / External dependence ▪ Market Size/ Market Share ▪ Regulatory Framework ▪ SWOT Analysis 	<ul style="list-style-type: none"> ▪ Authentic Internal / External Sources ▪ Publications from Industry Associations ▪ Analysts Reports ▪ Reports of Research Agencies ▪ Government Body / Ministry Report ▪ Offer Document / Annual Report of Peers ▪ Local/ International Publications ▪ Published Reports ▪ Industry Magazines



TRANSFER PRICING DOCUMENTATION

Documentation Best Practices - Transaction File



Details / Information	Sources / Documentation
<ul style="list-style-type: none"> Complete list of International/ Specified Domestic Transactions Quantity, Quality & Price Related Information Terms of Transactions Pricing Methodology Characterisation of Transactions Margin Workings 	<ul style="list-style-type: none"> Agreements / Arrangements Invoices / Debit Notes / Credit Notes Supporting Documents Relevant Entity / Group Policies Management Discussion / Representation Books of Accounts Disclosures in Financial Statements

Details / Information	Sources / Documentation
<ul style="list-style-type: none"> Functions Performed Assets Deployed Risks Assumed 	<ul style="list-style-type: none"> Agreements / Arrangements Management Discussion / Representation

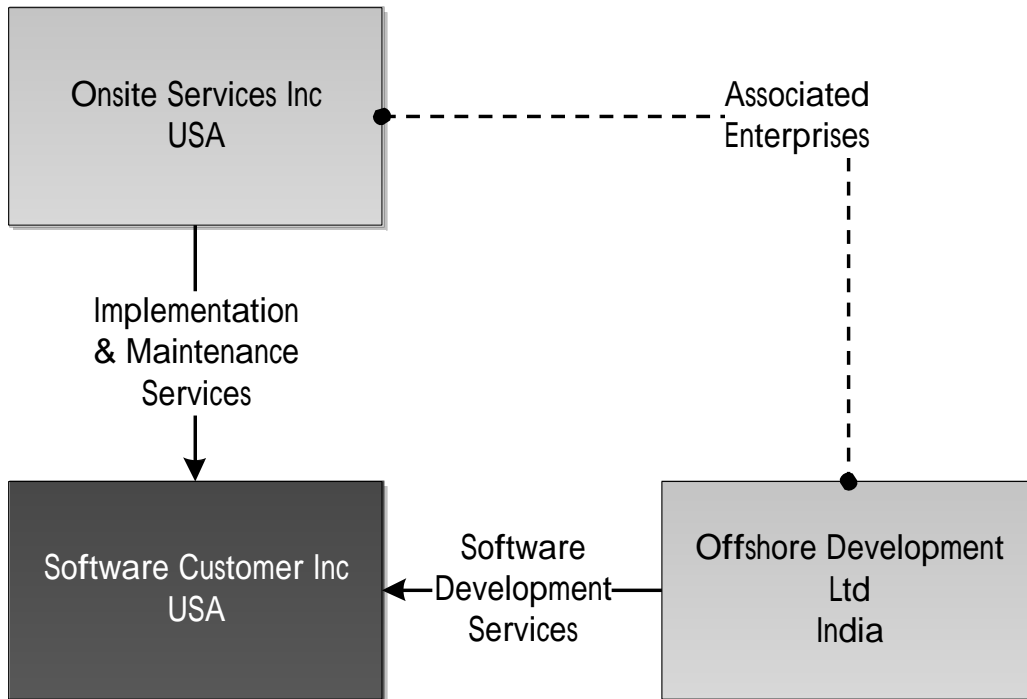


Details / Information	Sources / Documentation
<ul style="list-style-type: none"> Identification of Comparable Uncontrolled Transaction (Internal / External) Quantity, Quality & Price related info Terms of Transactions Margin Workings Selection of Comparable Entities Basis and Process of selection FAR profile of Comparable Entities 	<ul style="list-style-type: none"> Internal / External Sources Agreements / Arrangements Industry / Company Reports Specific Benchmarking Annual Reports of Comparable Entities Expert Analysis Competition Information Management Discussion / Representation

TRANSFER PRICING DOCUMENTATION

Case Studies

Deemed International Transaction



Likely Issue

- TPO may consider the transactions as Deemed International Transactions as per 92B(2)

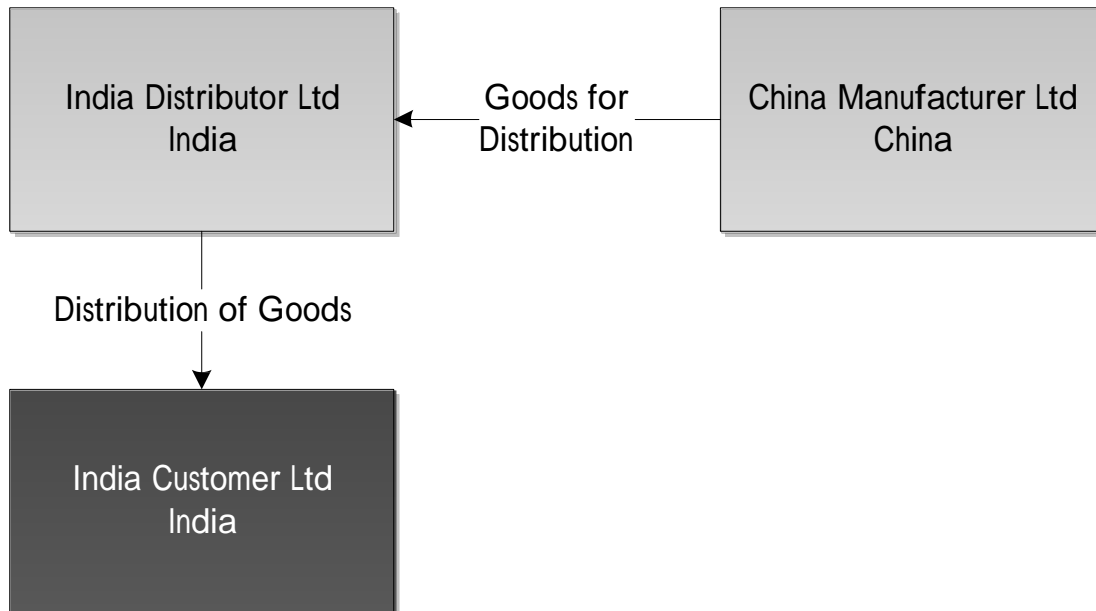
Recommended Documentation

- Clear & Distinct Agreements
- Distinct FAR & supporting documents
- Demonstration of independence of services
- Demonstration of absence of inter-connection

TRANSFER PRICING DOCUMENTATION

Case Studies

Limited Risk Distributor



Likely Issue

- Indian limited risk distributor treated as full fledged reseller
- Adjustment made for low margins

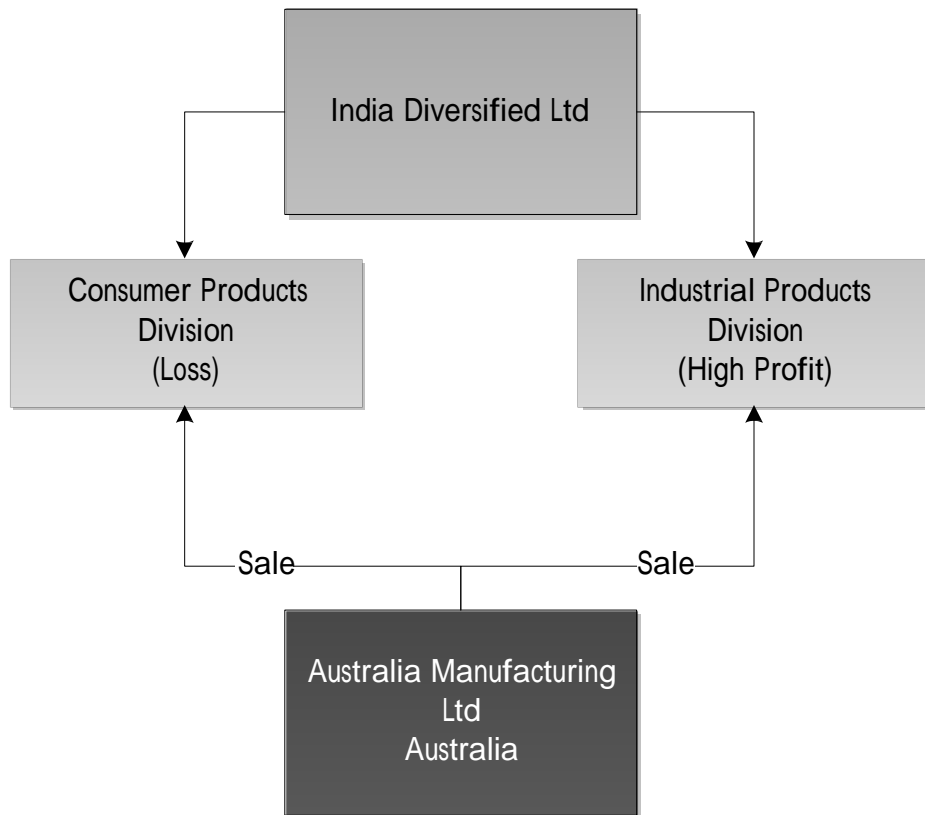
Recommended Documentation

- Clearly spelt out Distribution Agreement
- Demonstrative FAR
- Historical or subsequent demonstration of risks like Bad Debt, Quality, etc
- Indenting & Stocking procedures & documents

TRANSFER PRICING DOCUMENTATION

Case Studies

Aggregation of Similar Transactions



Likely Issue

- Due to loss in the Consumer Product Division TPO may make adjustment to International Transactions therein although consolidated profitability may be high

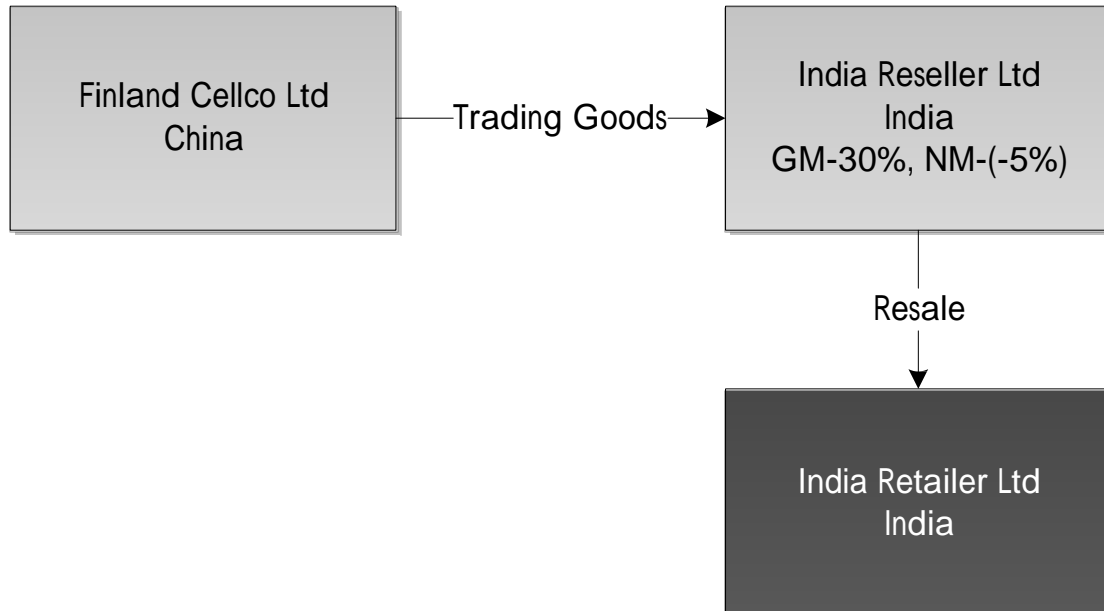
Recommended Documentation

- FAR of divisions is same
- Products economics & Business strategies for both divisions identical
- Cost structure similarity should be documented

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Case Studies

Resale of Traded Goods



Likely Issue

- In case of lower Net Margins, TPO may apply TNMM to make adjustment for lower margins

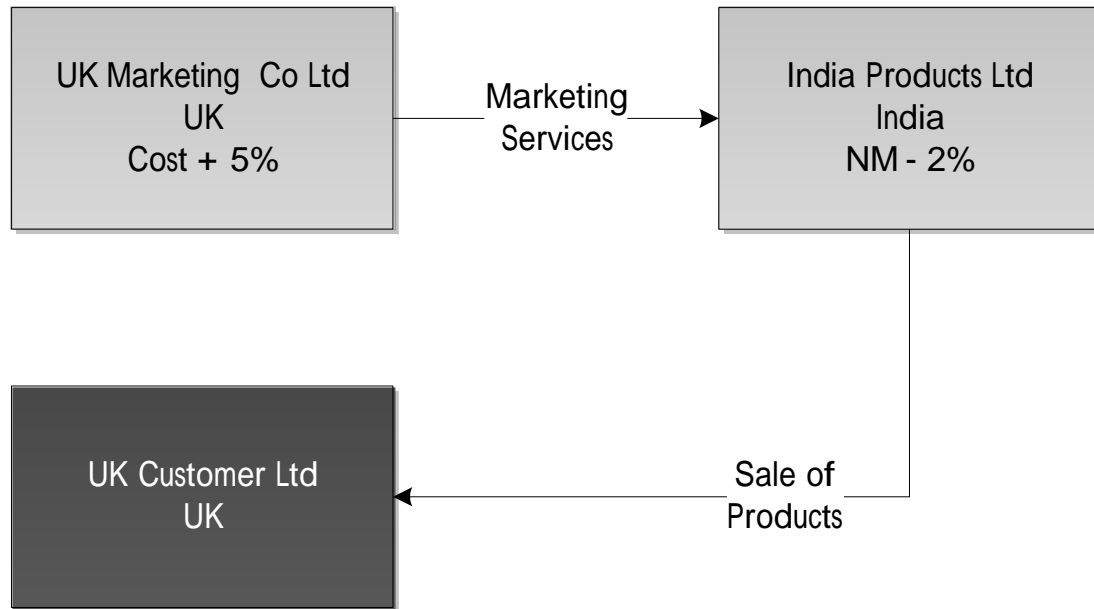
Recommended Documentation

- Well documented FAR to demonstrate Resale functions & risks
- In order to apply RPM, Inventory books and Invoice to demonstrate Gross Margins
- Gross Margin data for Internal Comparables
- Gross Margin data for External Comparables

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Case Studies

Marketing Services Arrangement



Likely Issue

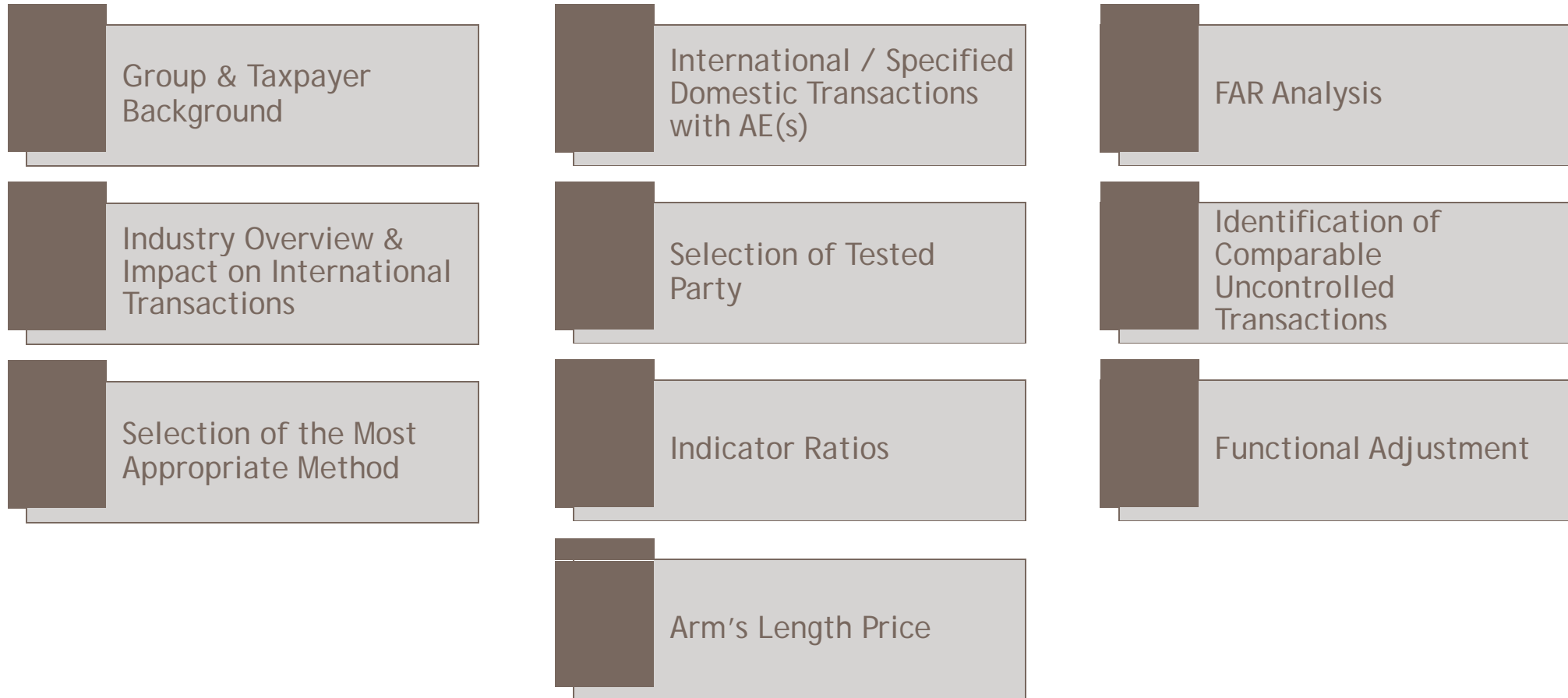
- In case Indian Entity is selected as Tested Party adjustment could be made by TPO on account of lower net margins

Recommended Documentation

- Well documented FAR to demonstrate FAR of UK entity are simpler and do not require adjustment & hence can be selected as Tested party
- Complete details of the Search for Comparables and availability of such data
- Reference can be drawn to US Regulations & OECD Guidelines for use

TRANSFER PRICING DOCUMENTATION

Documentation Best Practices - Transfer Pricing Study



DATABASES USED FOR BENCHMARKING

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DATABASES USED FOR BENCHMARKING

Domestic Databases

- Prowess
 - By Centre for Monitoring Indian Economy (CMIE)
 - prowess.cmie.com
- Capitaline
 - By Capital Markets Publishers P Ltd (Publisher of Capital Market Magazine)
 - www.capitaline.com
- Ace TP
 - By Accord Infotech P Ltd
 - www.acetp.com

DATABASES USED FOR BENCHMARKING

International Databases

- Amadeus
 - By Bureau Van Dijk
 - Data of European Companies
 - www.bvdinfo.com
- USTransferPricing.com
 - By Global Business Information Strategies, Inc.
 - Data of US Companies
 - www.ustransferpricing.com
- Transfer Pricing Analytics
 - By Edgarstat LLC
 - Entities listed on major stock exchanges
 - www.edgarstat.com
- OneSource Transfer Pricing
 - By Thomson Reuters
 - Global listed & unlisted entities
 - onesource.thomsonreuters.com
- RoyaltyStat
 - By RoyaltyStat LLC
 - Royalty Rates, Global Company information
 - www.royaltstat.com

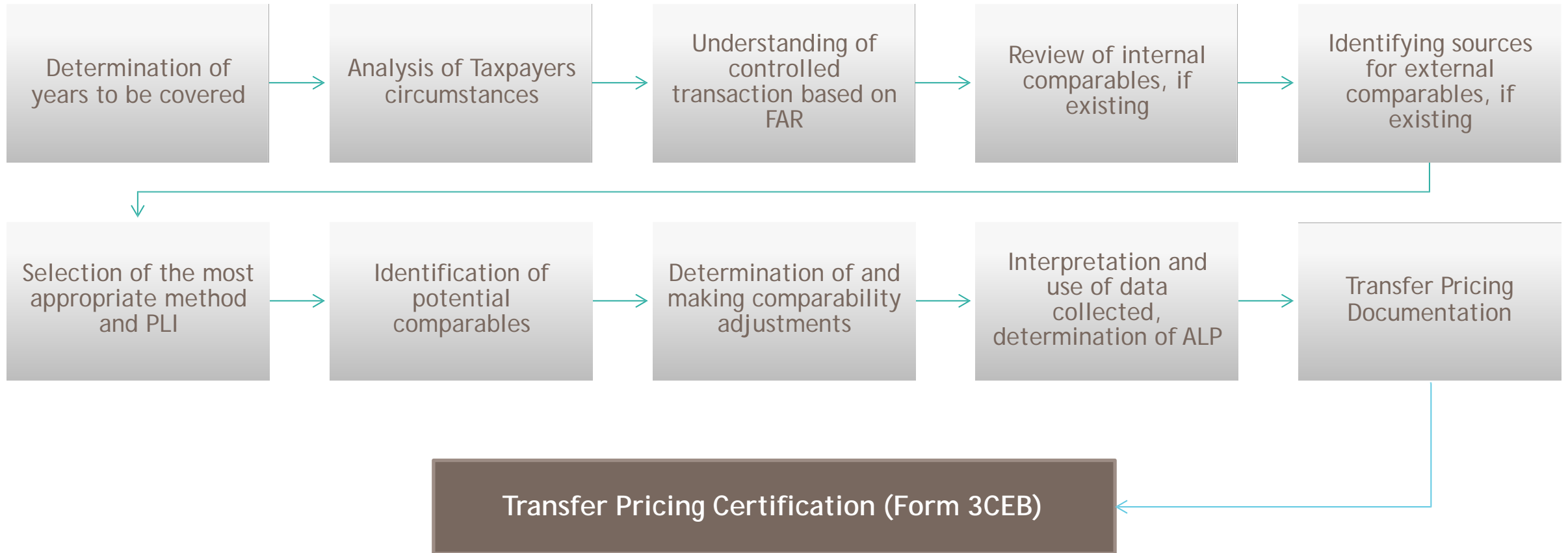
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TRANSFER PRICING CERTIFICATION

The Process



TRANSFER PRICING CERTIFICATION

Form No 3CEB

- Section 92E of the Income Tax Act requires every person who has entered into an international transaction or a specified domestic transaction to obtain a report from an accountant
- Rule 10E prescribes the requisite report to be furnished in Form No. 3CEB

Form No 3CEB

Examination of accounts & records

Maintenance of prescribed information & documents

Factual accuracy of contents mentioned in annexure to form 3CEB

Annexure to Form No 3CEB

Part A: General Information

Part B: International Transactions

Part C: Specified Domestic Transactions

- While certifying in the Report consider the following
 - Make appropriate disclosure of judicial pronouncement relied upon
 - Follow Accounting Standard, ICAI Guidance Notes & Standards on Auditing issued by ICAI
 - Obtain written representation for positions and assumptions

TRANSFER PRICING CERTIFICATION

Annexure to Form 3CEB

Part A - General Information

1. Name of the assessee
2. Address
3. Permanent account number
4. Nature of business or activities of the assessee (for business codes refer ITR 6)
5. Status
6. Previous year ended
7. Assessment year
8. Aggregate value of international transactions as per books of accounts
9. Aggregate value of specified domestic transactions as per books of accounts

TRANSFER PRICING CERTIFICATION

Annexure to Form 3CEB

Part B - International Transactions

10. List of associated enterprises with whom the assessee has entered into international transactions
11. transactions of tangible property
 - A. Purchase / sale of raw material, consumables or any other supplies for assembling / processing / manufacturing of goods / articles from / to associated enterprises
 - B. Purchase / sale of traded / finished goods
 - C. Purchase / sale of any other tangible movable / immovable property or lease of such property
12. Transactions of intangible property (purchase / sale / use of intangible property such as know-how, patents, copyrights, licenses, etc.)
13. Service transactions
14. Lending or borrowing of money (any type of advance payments, deferred payments, receivable, non-convertible preference shares/ debentures or any other debt arising during the course of business)



TRANSFER PRICING CERTIFICATION

Annexure to Form 3CEB

Part B - International Transactions

16. Transactions in the nature of guarantee
17. International transaction of purchase or sale of marketable securities, issue and buyback of equity shares, optionally convertible/ partially convertible/ compulsorily convertible debentures/ preference shares
18. Mutual agreement or arrangement
19. International transactions arising out of/ being part of business restructuring or reorganizations
20. Any other transaction
21. Deemed international transaction

TRANSFER PRICING CERTIFICATION

Annexure to Form 3CEB

Part C - Specified Domestic Transactions

21. List of associated enterprises with whom the assessee has entered into specified domestic transactions
 - Name, Address and PAN of the associated enterprise
 - Relationship with associated enterprise
 - Brief description of the business of associated enterprise
22. Transactions in the nature of payment for any expenditure to persons referred to in section 40A(2)(b)
23. Transfer or acquisition of any goods or services to/from eligible business of the same assessee
24. Any business transacted by an eligible business
25. Any other transaction

TRANSFER PRICING CERTIFICATION

Annexure to Form 3CEB

Information required regarding international transactions

- Name and Address of AE
- Description of Transaction
- Total Amount paid / received or payable / receivable
 - As per books of accounts
 - As per Arm's length price as computed by the assessee
- Method used for determining ALP
- Additional information for goods
 - Quantity
- Additional information for finance transactions
 - Currency of loan

TRANSFER PRICING CERTIFICATION

Check Points for the TP Auditor and Taxpayer

Coverage of Relationships

- Check for completeness and correctness
- Check points
 - Previous year's form 3CEB
 - Financial Statements
 - Notes to Accounts - AS 18 disclosures
 - Form 3CD - Sec. 40A(2)(b) disclosures
 - Cost Audit Report of the company
 - Company / group website
 - Register under Section 301 of Companies Act
 - Management discussion and representation
 - Relevant Income tax forms
 - Shareholding pattern as per Members Register and Annual Return

Coverage of Transactions

- Reconciliation with disclosures
 - Notes to Accounts [AS-18]
 - Tax Audit Report [Section 40A(2)(b)]
 - Cost Audit Report
 - Register under Section 301 of Companies Act
- Ledger scrutiny
 - Ledger of Party Concerned
 - Transaction Ledger
- Reconciliation with amounts as per Financial Statements
- Management discussion and representation
- Details of foreign exchange transactions as provided in the audited accounts

TRANSFER PRICING CERTIFICATION

Roles and Responsibilities

Taxpayer

- Recognition of parties and transactions where transfer pricing applies
- Determination of the most appropriate transfer pricing methodology
 - Recognizing comparable transactions / entities, as much as is relevant from TP perspective
 - Providing relevant industry-level and market-level information, such as key markets, major customers, competitors etc.
 - Providing insight into price-setting mechanism
- Determination of Arm's Length Price
- Compilation of relevant documents as proof of Arm's Length Price on real time basis
- Maintenance of transfer pricing documentation (as per section 92D r.w. Rule 10D)

Auditor

- Independence in Audit work
- Clearly defined Scope of examination
 - Importance of signed engagement Letter
- Management Representation Letter
- Communication with outgoing auditor
- Adherence to Code of Conduct
- Adherence to Guidance Note
- Quality control and peer review
- Timely issuance of the Accountant's Report (Form 3CEB) to client
- Maintenance of client file and documentation
- Disclaimer in Documentation

TRANSFER PRICING CERTIFICATION

Practical Issues

- Availability of contemporaneous data
- Comparability differences
 - Cyclical Issues
 - Geographical differences
 - Quantity differences
 - Differences in terms of transaction
 - Currency of transactions
- Aggregation or standalone evaluation of transactions
- Lack of clarity regarding nature of transaction
 - Services v Cost allocation
 - Mutual agreement v Business restructuring
- Lack of Information available with client
 - Lack of records maintained
 - Transactions undertaken in absence of agreements
 - Confidential Agreements
- Reliance on previous year's benchmarking and analysis



TRANSFER PRICING BENCHMARKING

What When Benchmarking Is Not Feasible

- Exhaust all possible sources of benchmarking & documents
- Demonstrate due diligence
- Reliance on International Guidance
- Reliance on Expert Opinions
- Documentation for inter-company negotiations
- Documenting complete transactional profile
- Next best possible comparable (Lateral Comparable)
- Earlier/subsequent year's benchmark
- Group level transfer pricing policies
- Industry best practices
- Compile robust documentation for each stage





KEY TAKEAWAYS

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KEY TAKEAWAYS

Mitigate Transfer Pricing Risks

- Expanded coverage
 - Expanded definition of AE and Enterprise
 - Capital transactions covered
 - Deemed international transactions
 - Specified domestic transactions
 - Business Restructuring
- No provision for revision of Form 3CEB
- Increased penalty exposure
- Importance of
 - Management Representation Letter and its coverage
 - Disclaimers in Documentation
- **DOCUMENTATION IS THE KEY**



THANK YOU

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