

Transfer Pricing

Concepts and Issues

3rd July 2020

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The accompanying Discussion Paper may also be referred for clarity on the Concepts and Issues presented here.

Session Agenda

Tested Party incl.
Foreign Entity as
Tested Party

Deemed
International
Transaction

Value Chain
Analysis

Attribution of
Profit to PE

Cost
Contribution
Arrangements

Typical
Business
Models

APA & MAP

Management
Service Fees

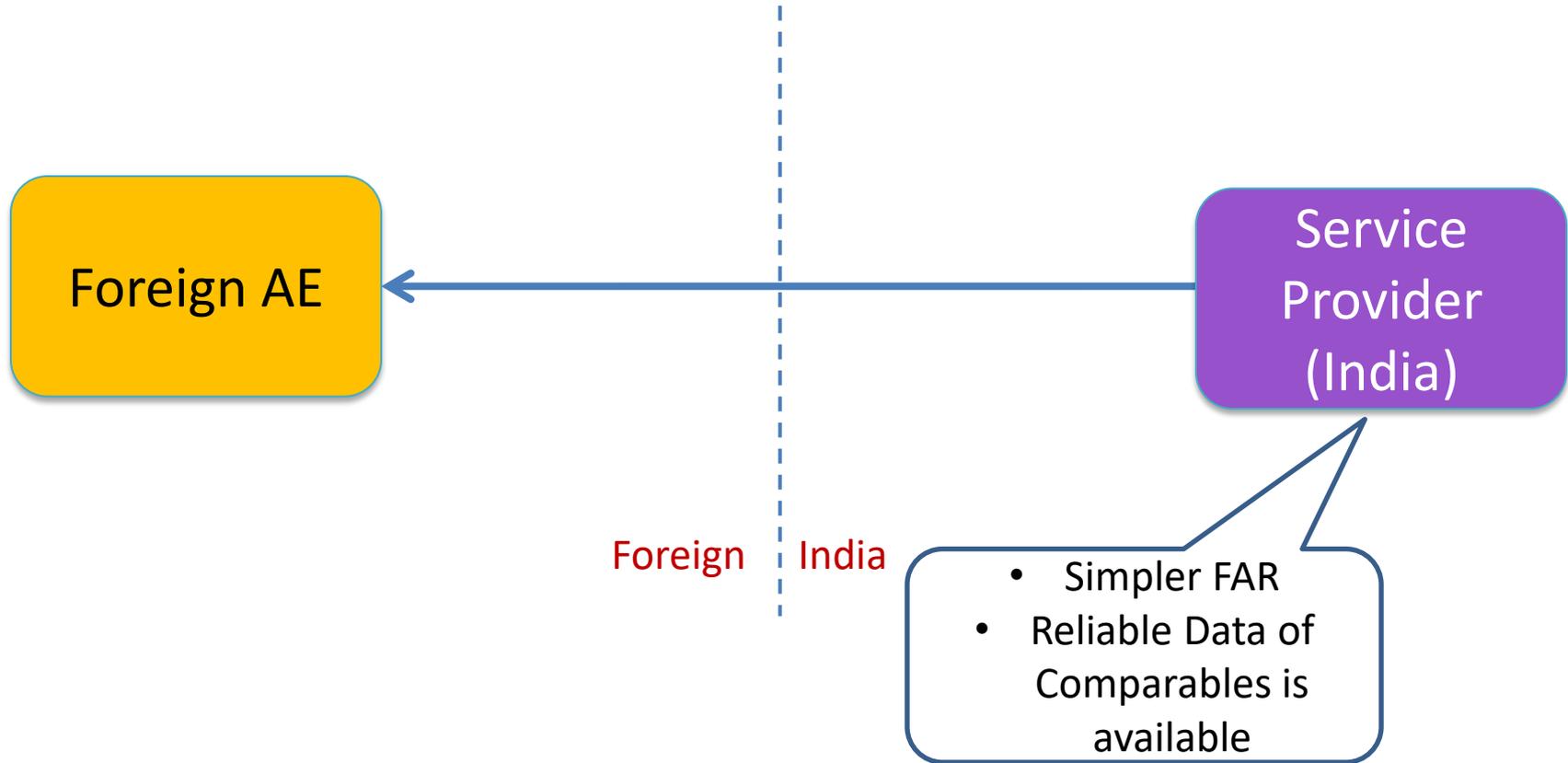
Safe Harbour
Rules

DEMPE
Concept of
Intangibles

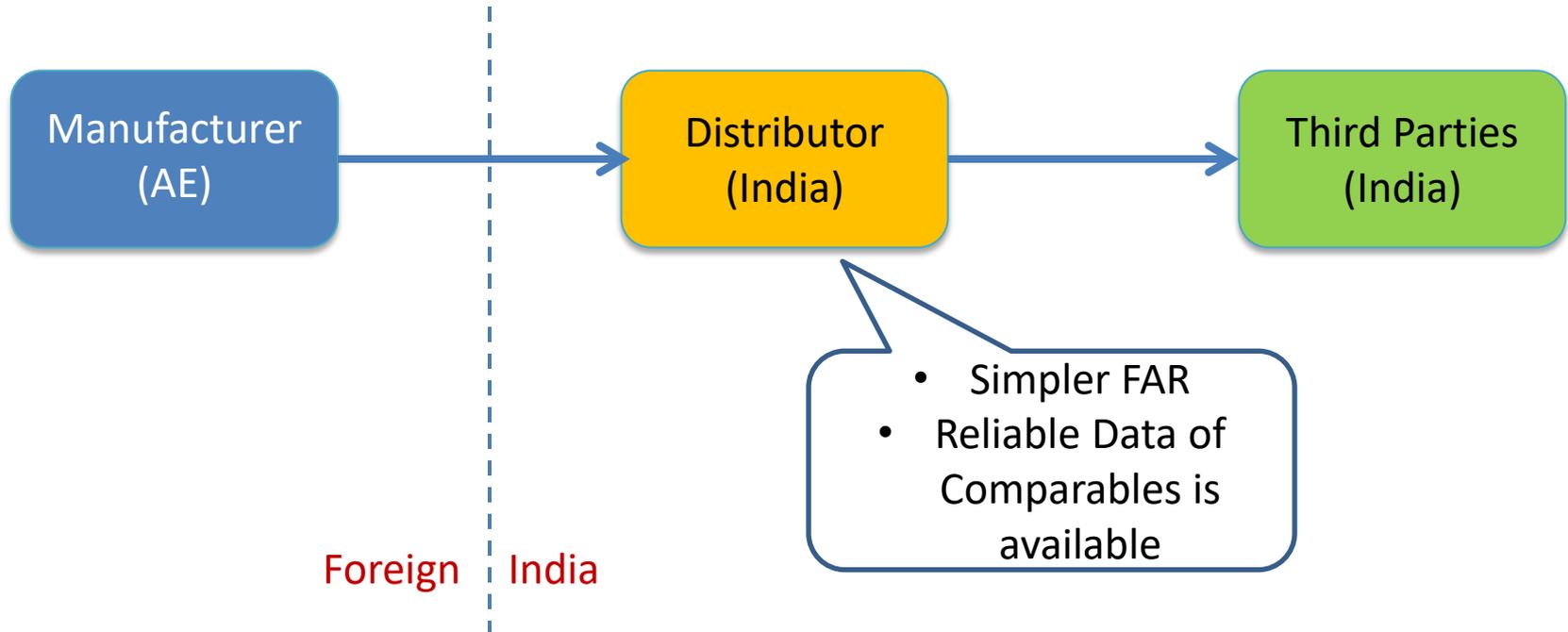
Tested Party

What is a Tested Party?

Taxpayer Provides Services to AE

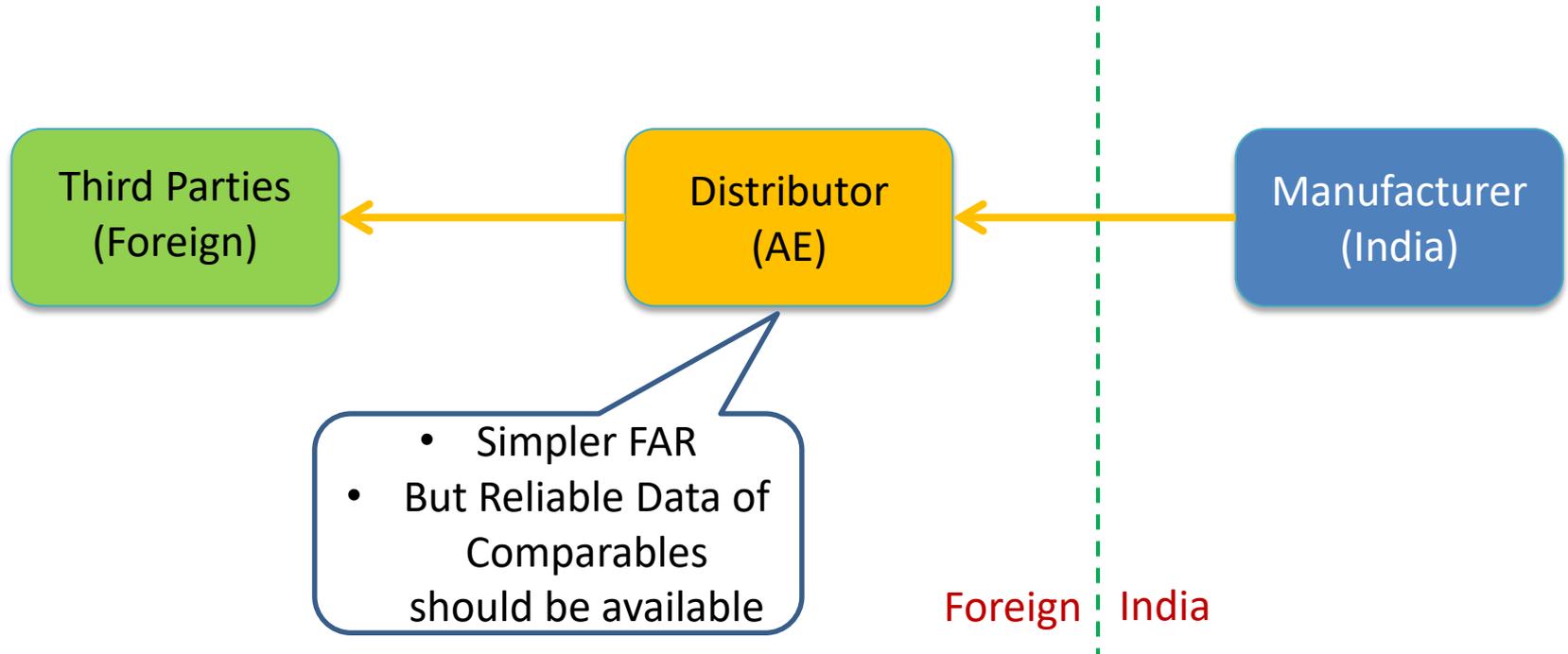


Taxpayer Sells Products Manufactured by AE



Foreign AE as the Tested Party

Taxpayer Manufactures; Sells Products to AE



Divergent Views of Tribunal

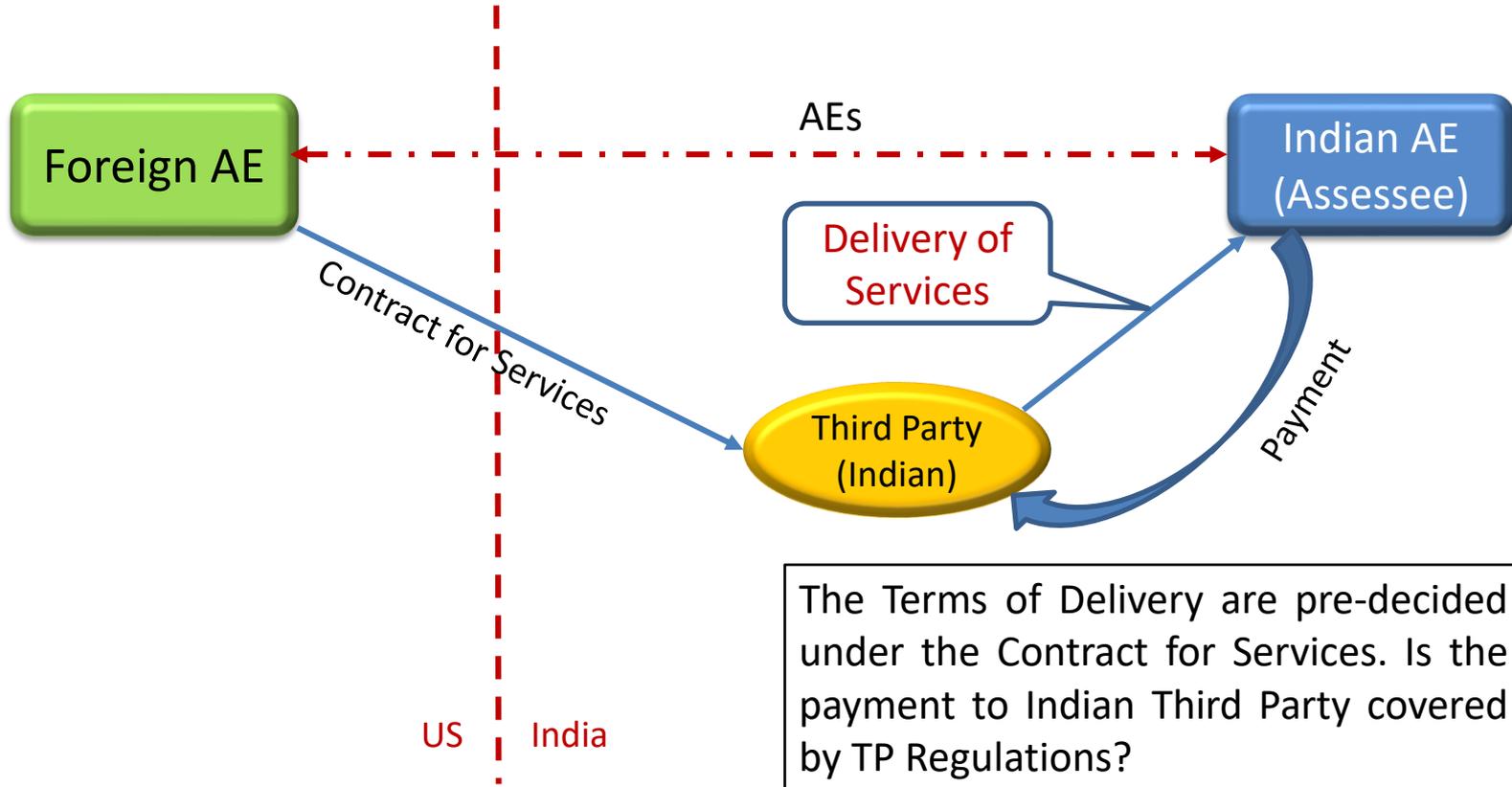
In 2019 Pune Tribunal adjudged that the concept of Foreign AE as tested party has no statutory sanction as per Indian TP regulation -

- *Bekaert Industries Private Limited [TS-347-ITAT-2019(PUN)-TP]*
- *Carraro India Private Limited [TS-124-ITAT-2019(PUN)-TP]*

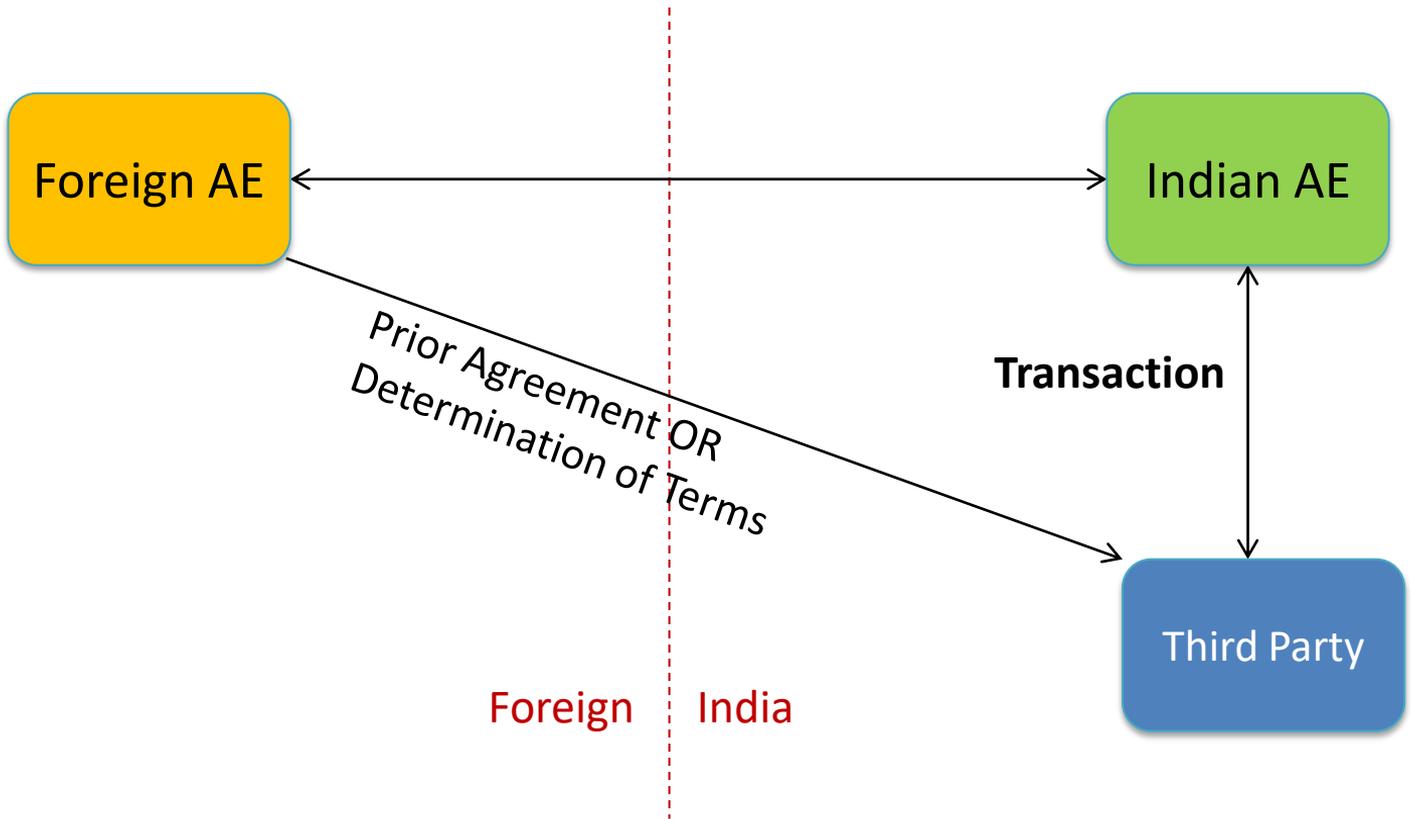
Deemed International Transaction

Sec. 92B (2)

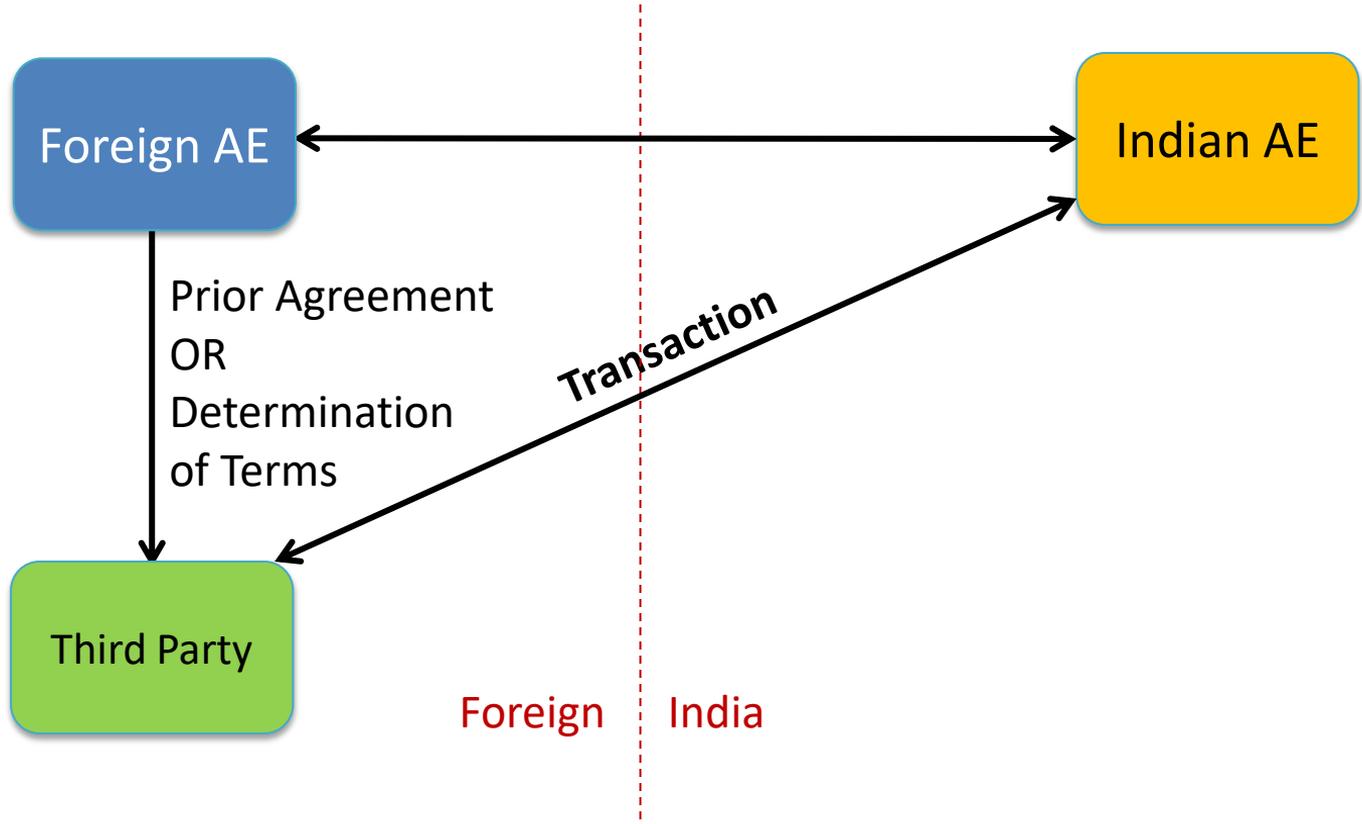
Is this Transaction Covered by TP Regulations?



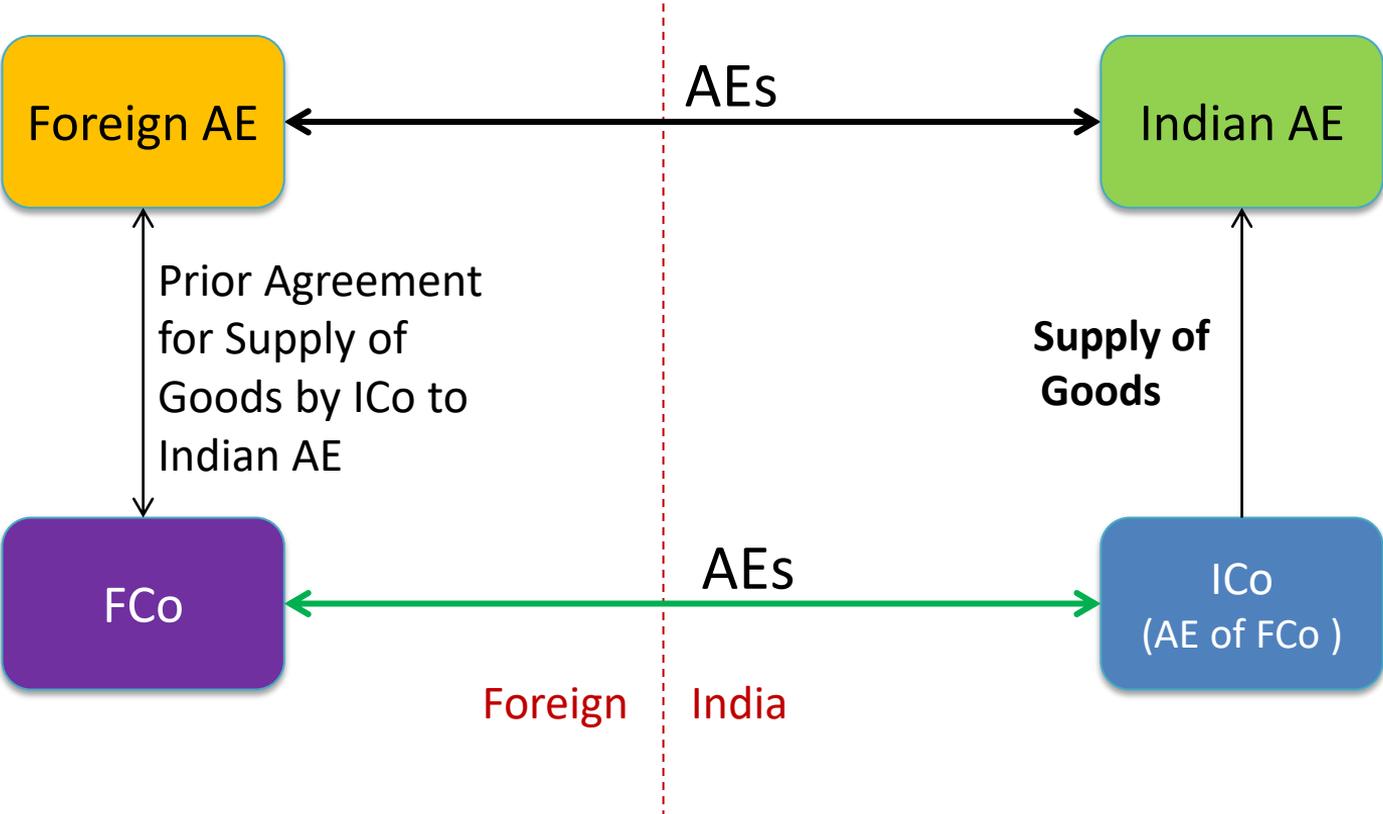
Sec. 92B (2): Deemed International Transaction



Sec. 92B (2): Deemed International Transaction

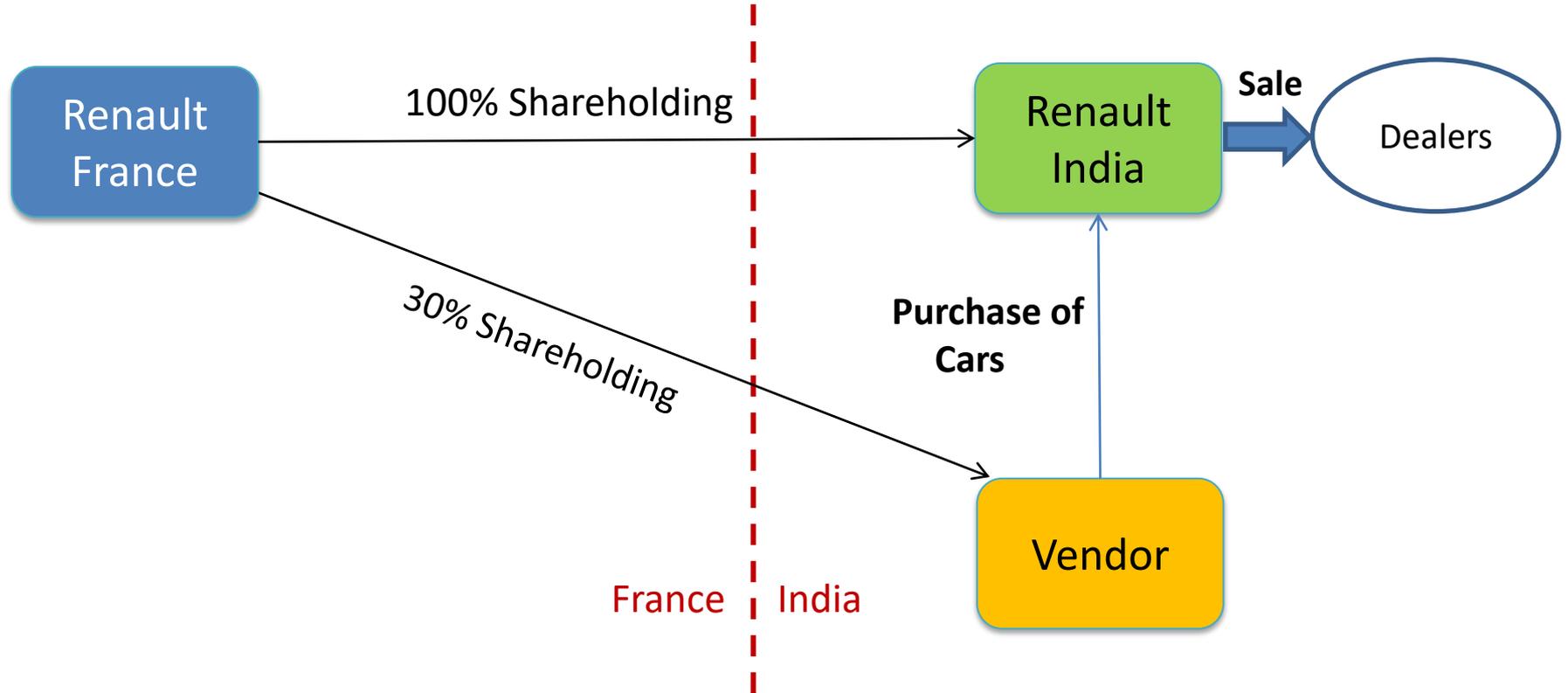


Sec. 92B (2): Deemed International Transaction



Renault India P Ltd v. DCIT

ITA No.1078/Mds/2017, ITAT Chennai



Cost Contribution Arrangements

- Contribution
- Expected Benefit

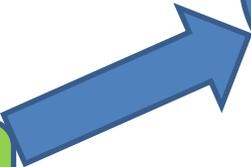
AE 1



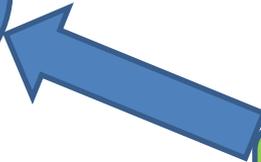
CCA

A contractual arrangement between AEs to share the costs and risks of Developing, Producing or Obtaining Assets, Services or Rights, and to define the interests of each Participant in those Assets, Services or Rights

AE 3



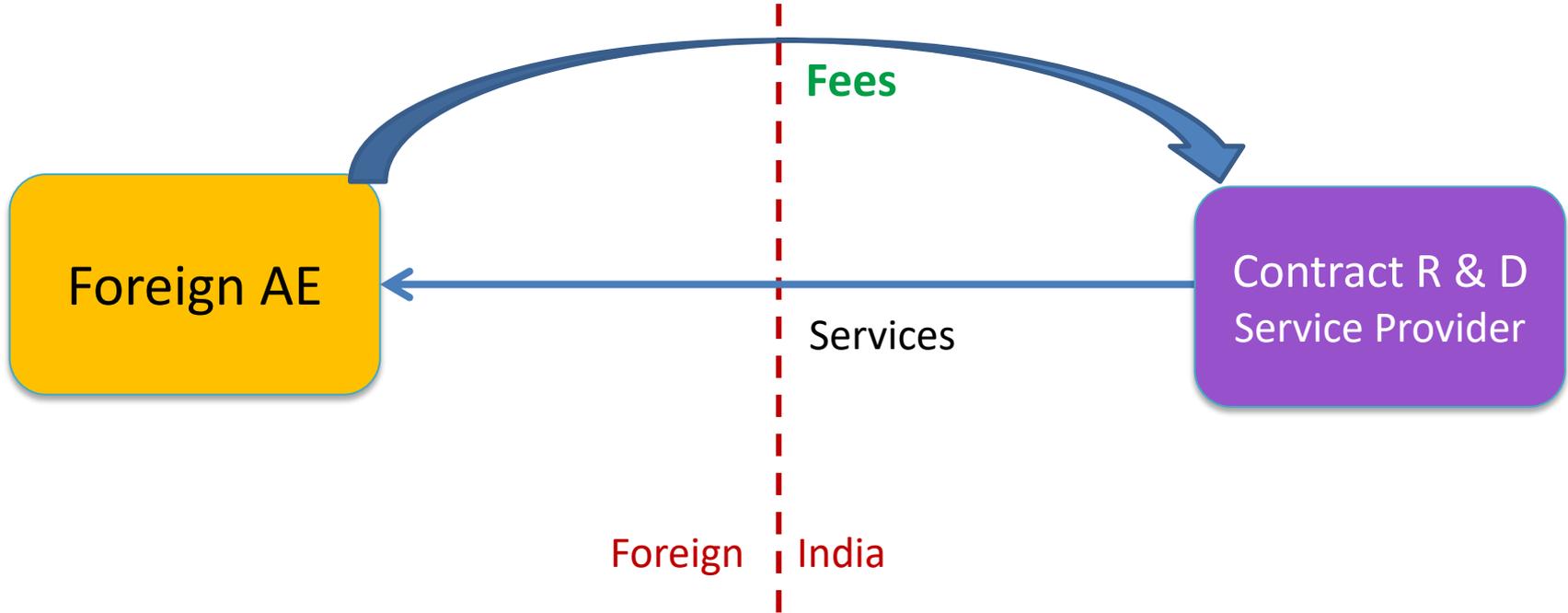
AE 2



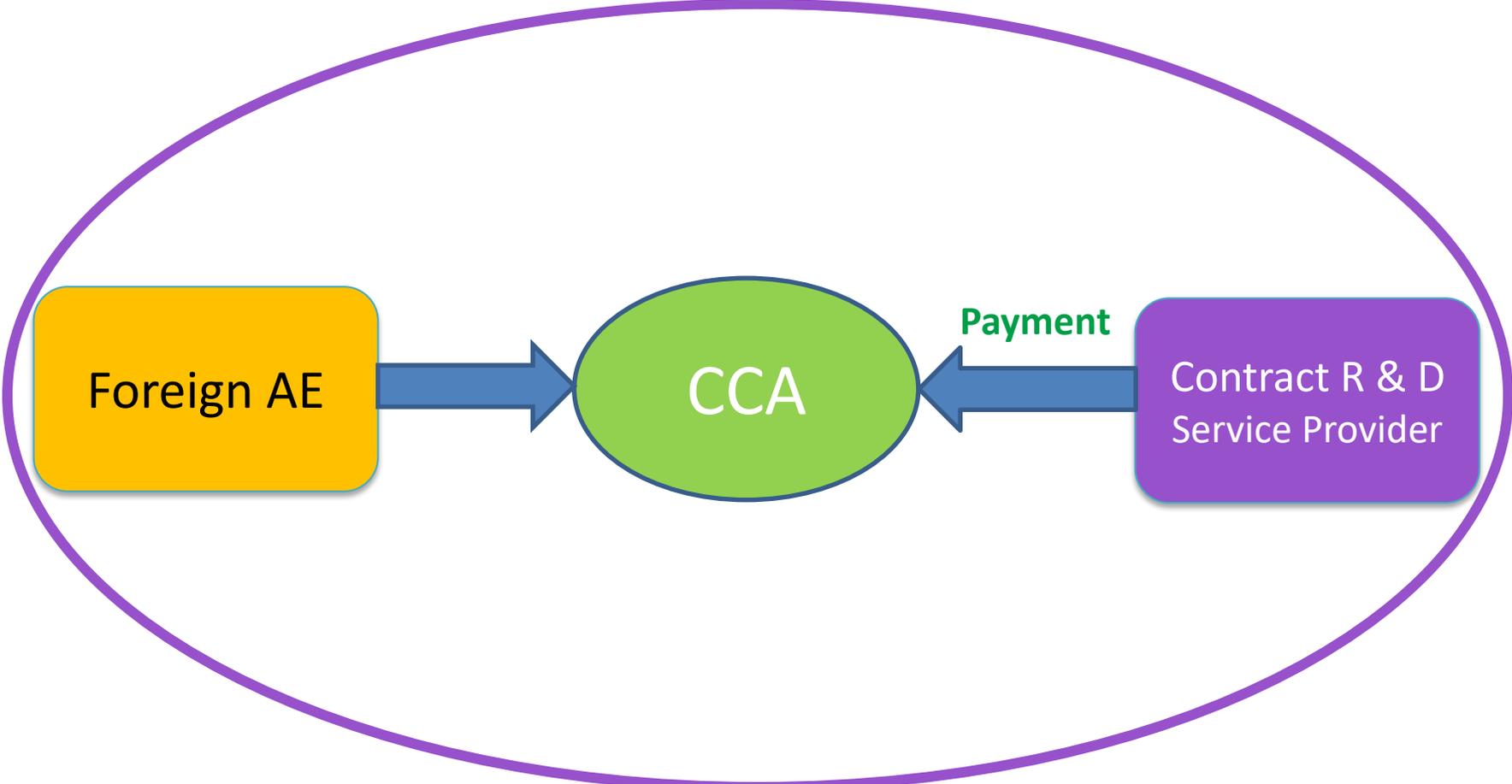
- Contribution
- Expected Benefit

- Contribution
- Expected Benefit

Taxpayer Provides Contract R & D Services to AE

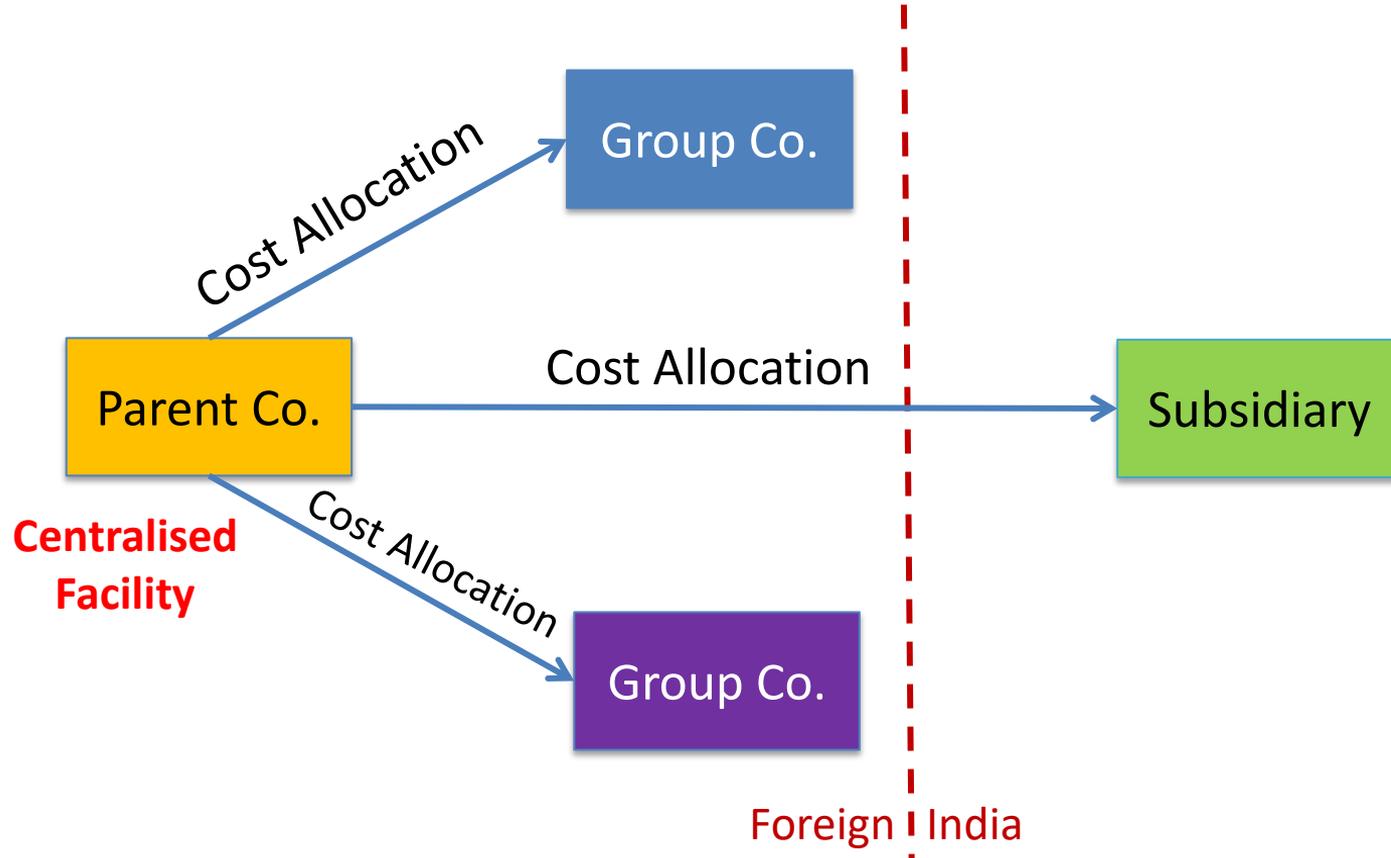


Taxpayer Joins AE in a Cost Contribution Arrangement



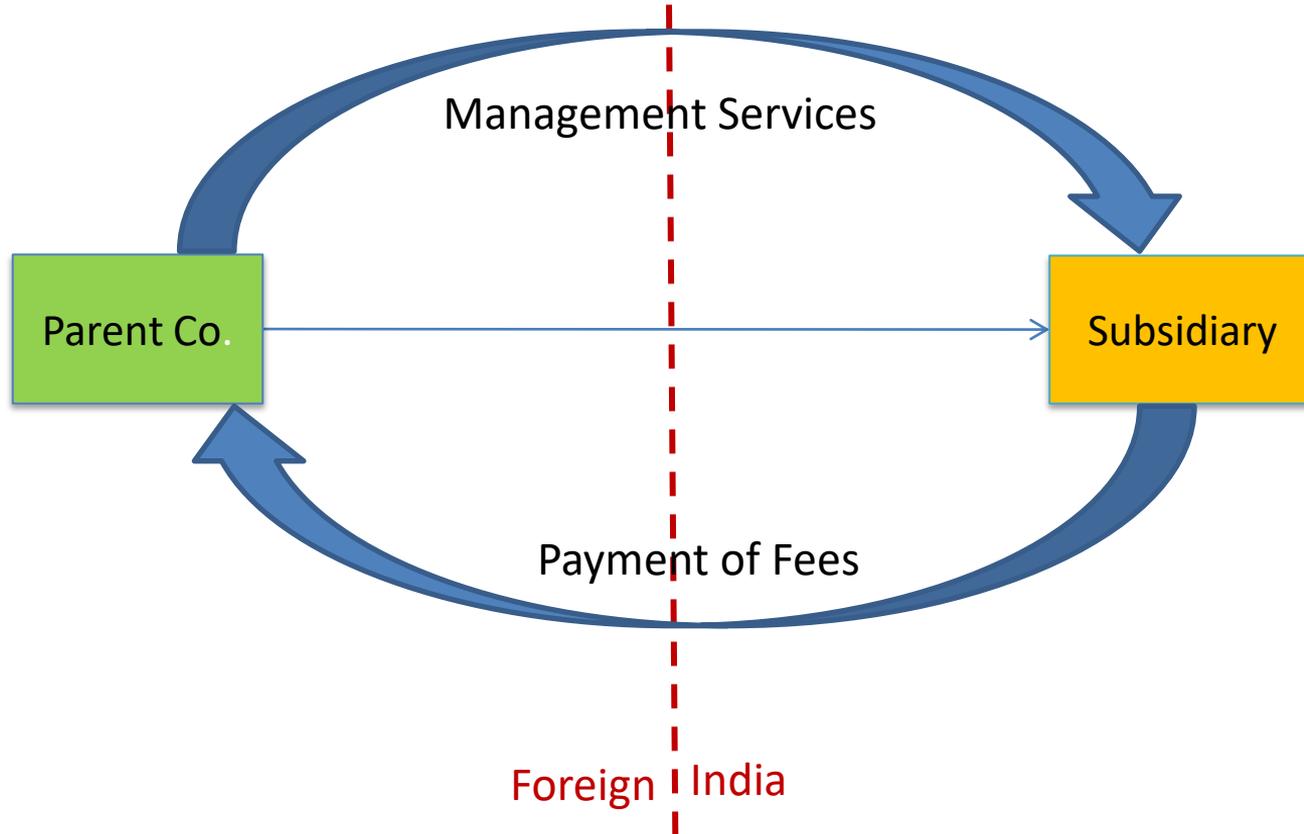
Cost Sharing Arrangements

Cost Sharing Arrangement



Management Service Fees

Management Service Fees



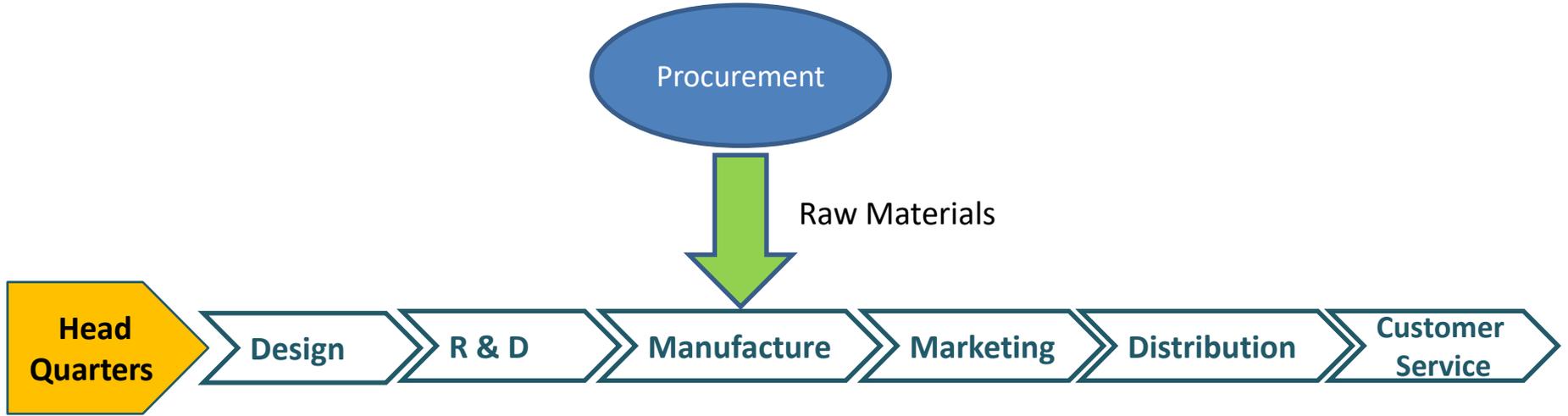
Maintain Robust Documentation

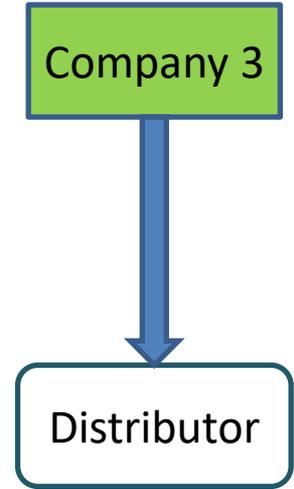
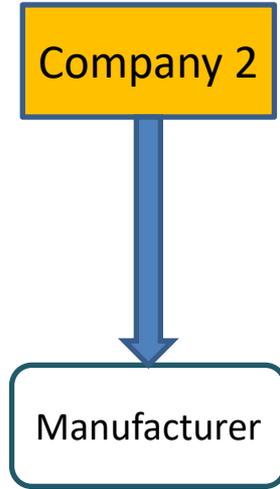
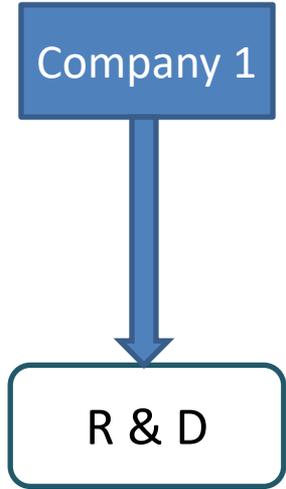
- Agreements
- Evidence of the AE's Capabilities, Cost Centre, Infrastructure, etc.
- Proof that Services were rendered by the AE
- Proof that the services were received by the Taxpayer Entity

Management Service Fees - Important High Court Cases

- ❑ Knorr-Bremse India (P) Ltd vs ACIT 63 taxmann.com 186 (Punjab & Haryana HC)
- ❑ CIT vs Cushman and Wakefield (P) Ltd [2014] 46 taxmann.com 317 (Delhi HC)
- ❑ CIT vs EKL Appliances Ltd [2012] 24 taxmann.com 199 (Delhi HC)

Value Chain Analysis



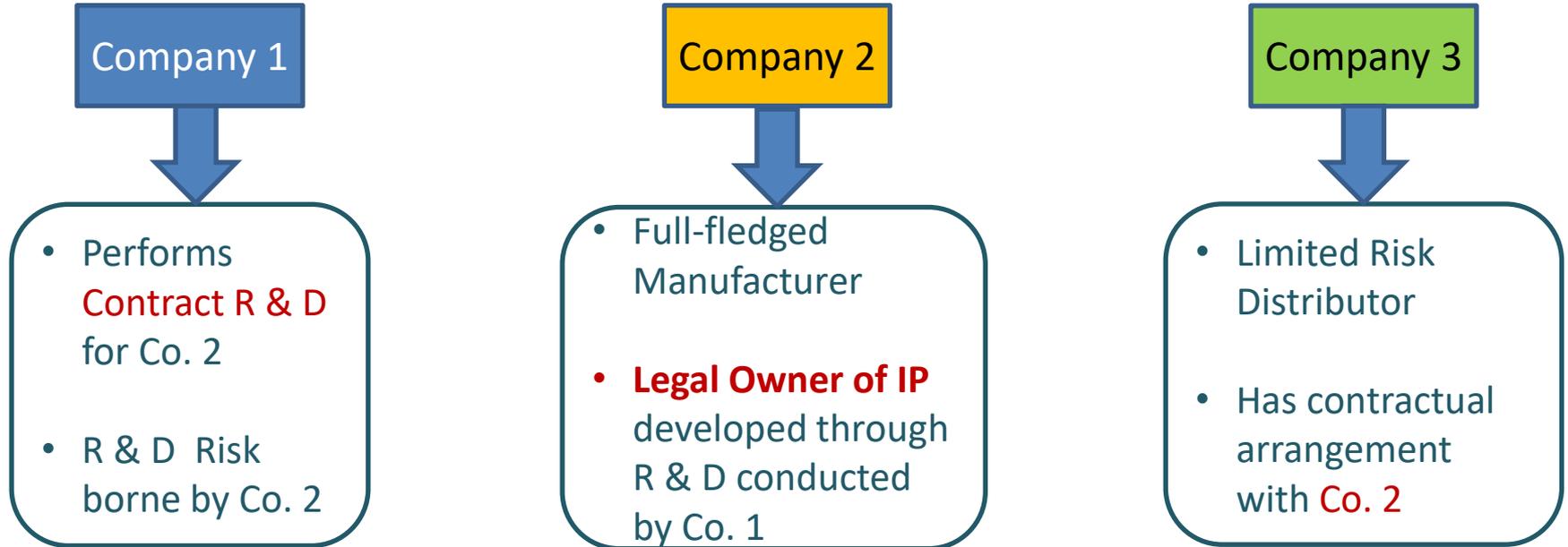


Scenario 1



Company 1 is the Legal Owner of the Intangible Property of the MNC, and bears substantial risks associated with R & D, Manufacturing and Sales

Scenario 2



Company 2 is the Legal Owner of the Intangible Property of the MNC, and bears substantial risks associated with R & D, Manufacturing and Sales

Scenario 3

Company 1

- Performs **Contract R & D** for Co. 3
- R & D Risk borne by Co. 3

Company 2

- Limited Risk Contract Manufacturer
- Has contractual arrangement with Co. 3

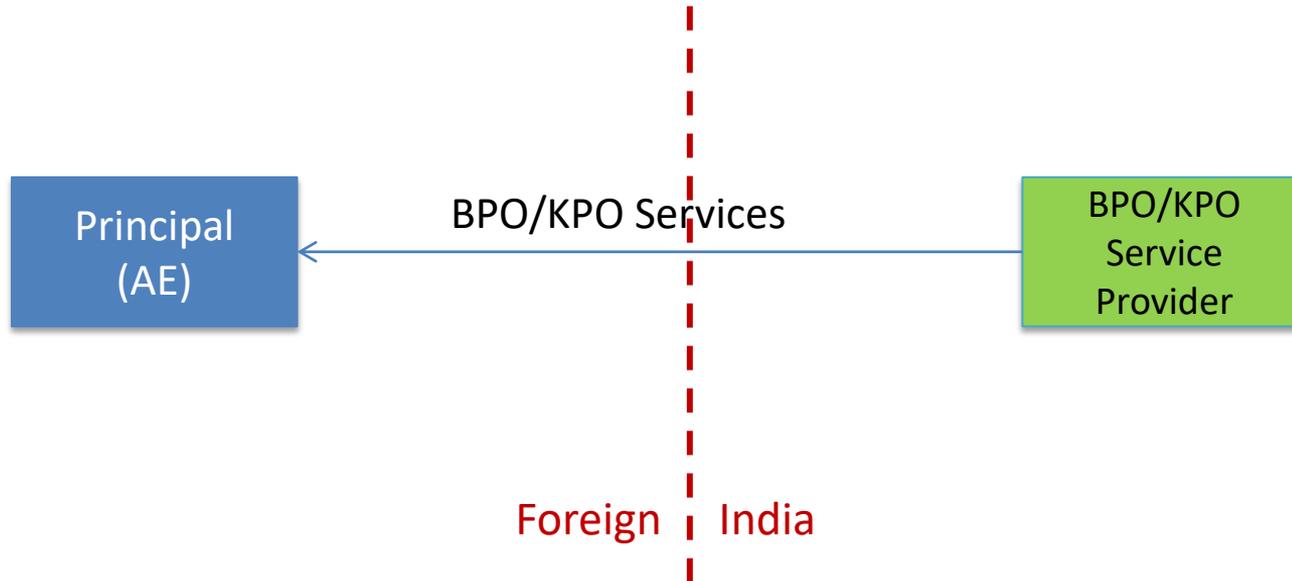
Company 3

- Entrepreneur
- Risk bearing Distributor
- **Legal Owner of IP** developed through R & D conducted by Co. 1

Company 3 is the Legal Owner of the Intangible Property of the MNC, and bears substantial risks associated with R & D, Manufacturing and Sales

Typical Business Models

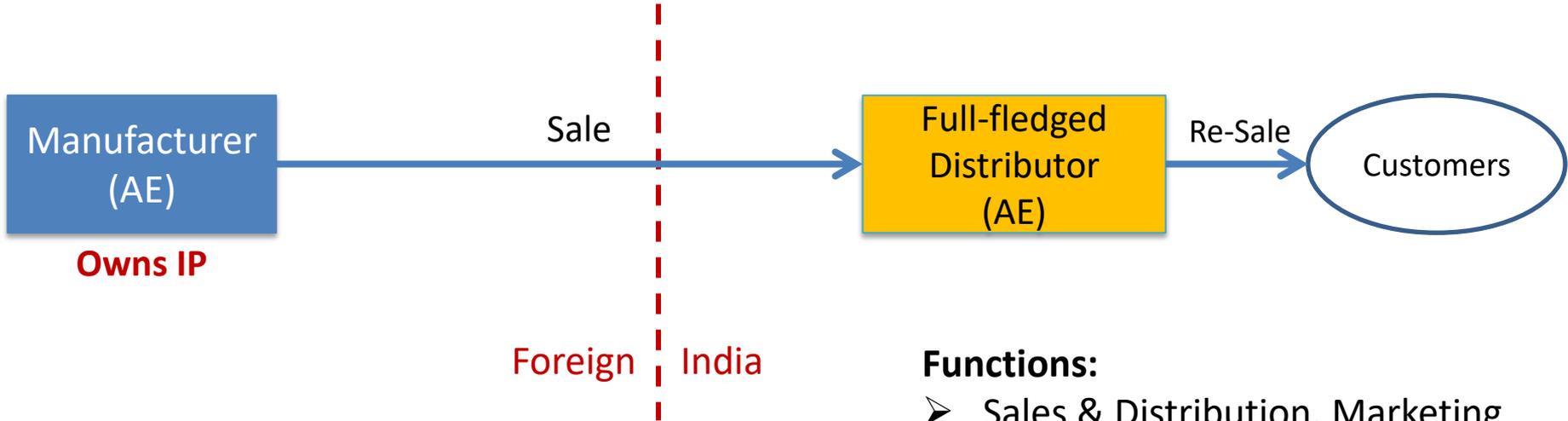
Captive Service Provider



Decision of Special Bench of ITAT in

Maersk Global Centres (India) Pvt Ltd vs ACIT reported in [2014] 43 taxmann.com 100 (ITAT Mumbai) (SB)

Full-fledged Distributors



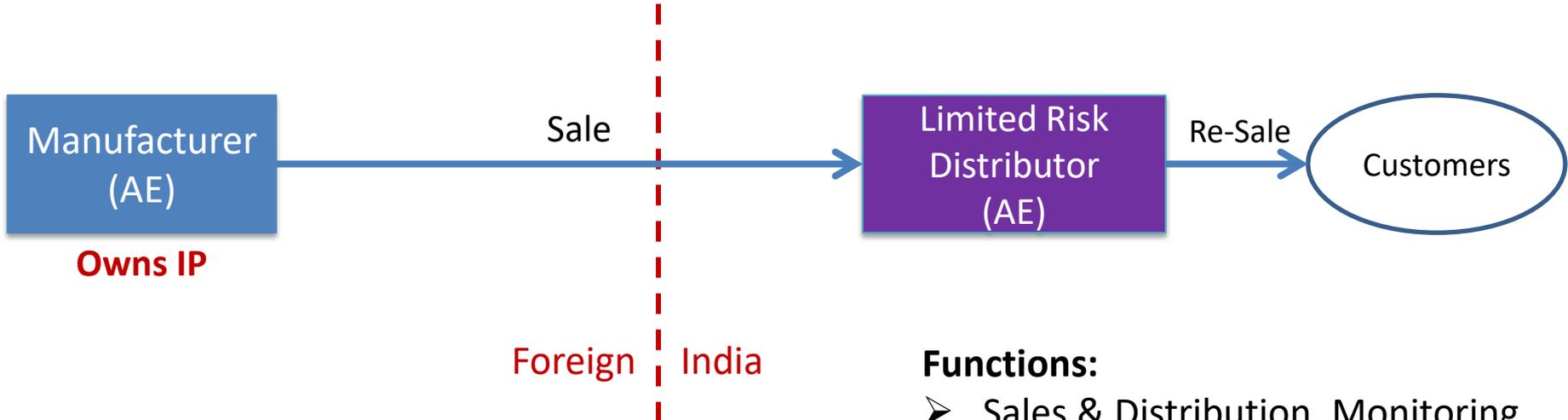
Functions:

- Sales & Distribution, Marketing

Risks:

- Market Risk, Inventory Risks, Credit Risks

Limited Risk Distributors



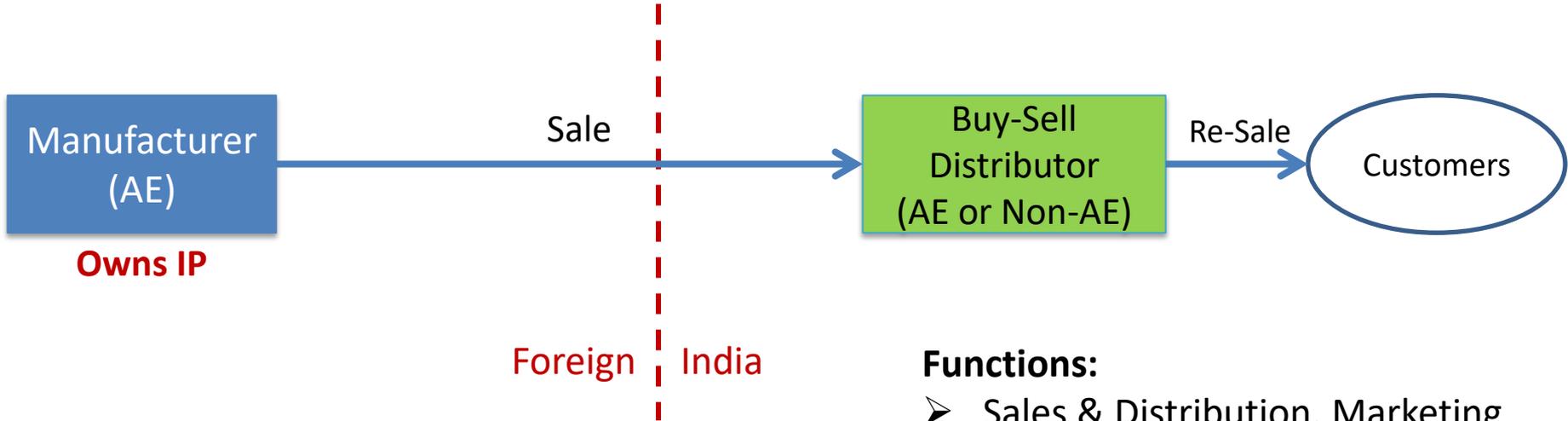
Functions:

- Sales & Distribution, Monitoring Inventories, Monitoring Credit Risk

Risks:

- Limited Inventory Risks, Limited Credit Risks

Principle-to-Principle Transaction



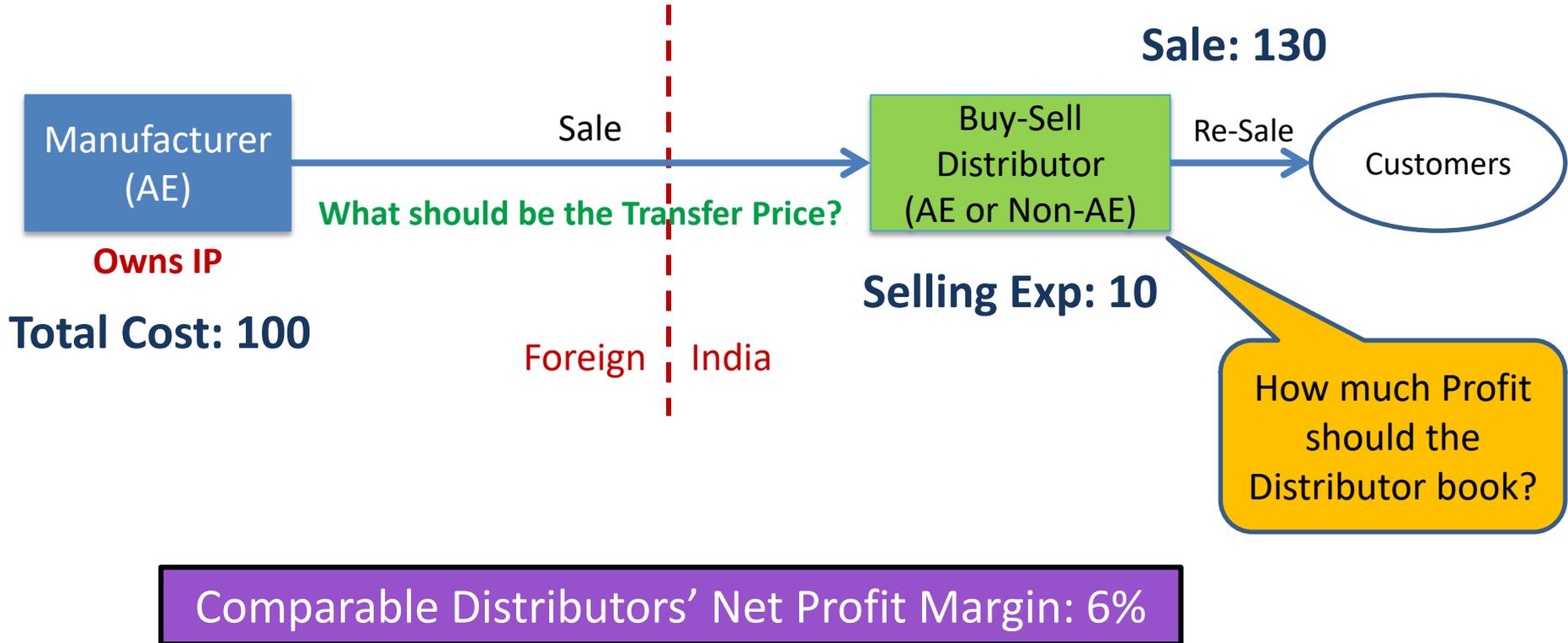
Functions:

- Sales & Distribution, Marketing

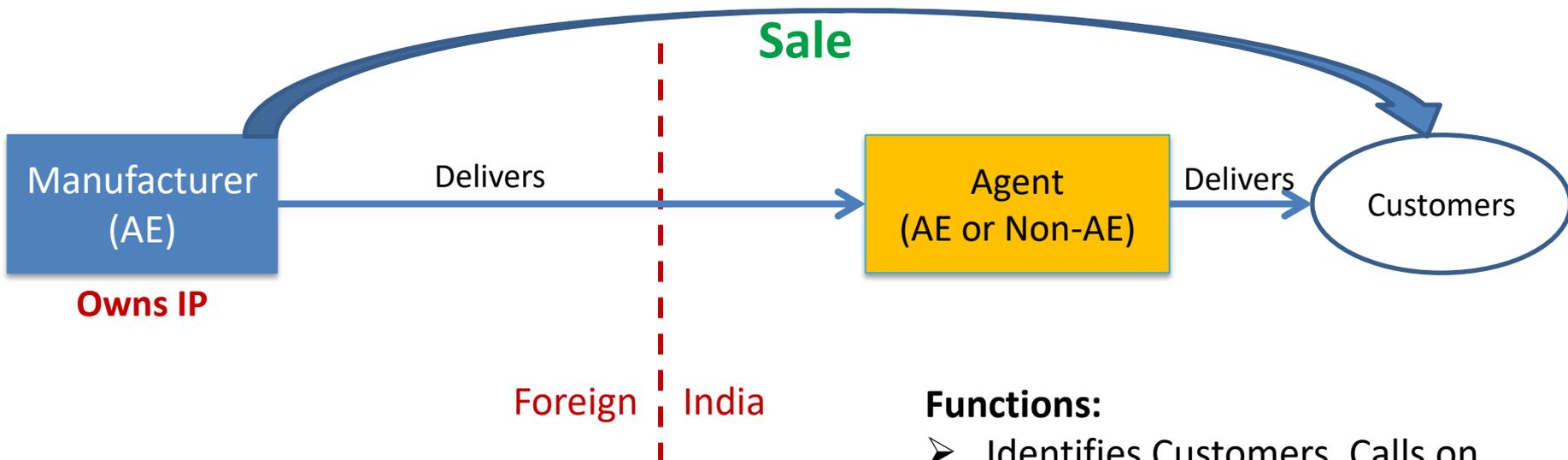
Risks:

- Market Risk, Inventory Risks, Credit Risks

Principle-to-Principle Transaction



Agent Transaction



An Agent, as a Service Provider, earns much lesser Profit compared to a Principal, a Reseller

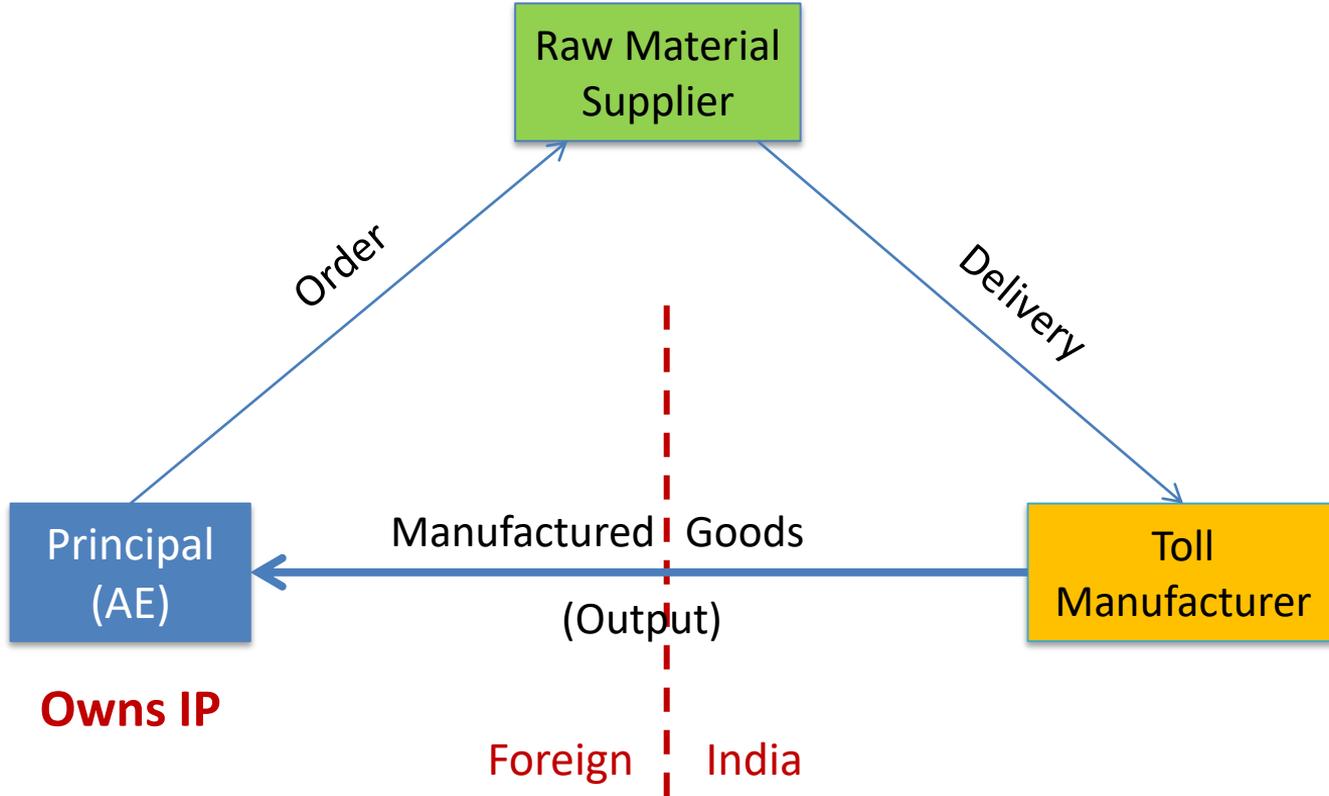
Functions:

- Identifies Customers, Calls on Customers, Presents Product to Customers, Takes Sales Orders

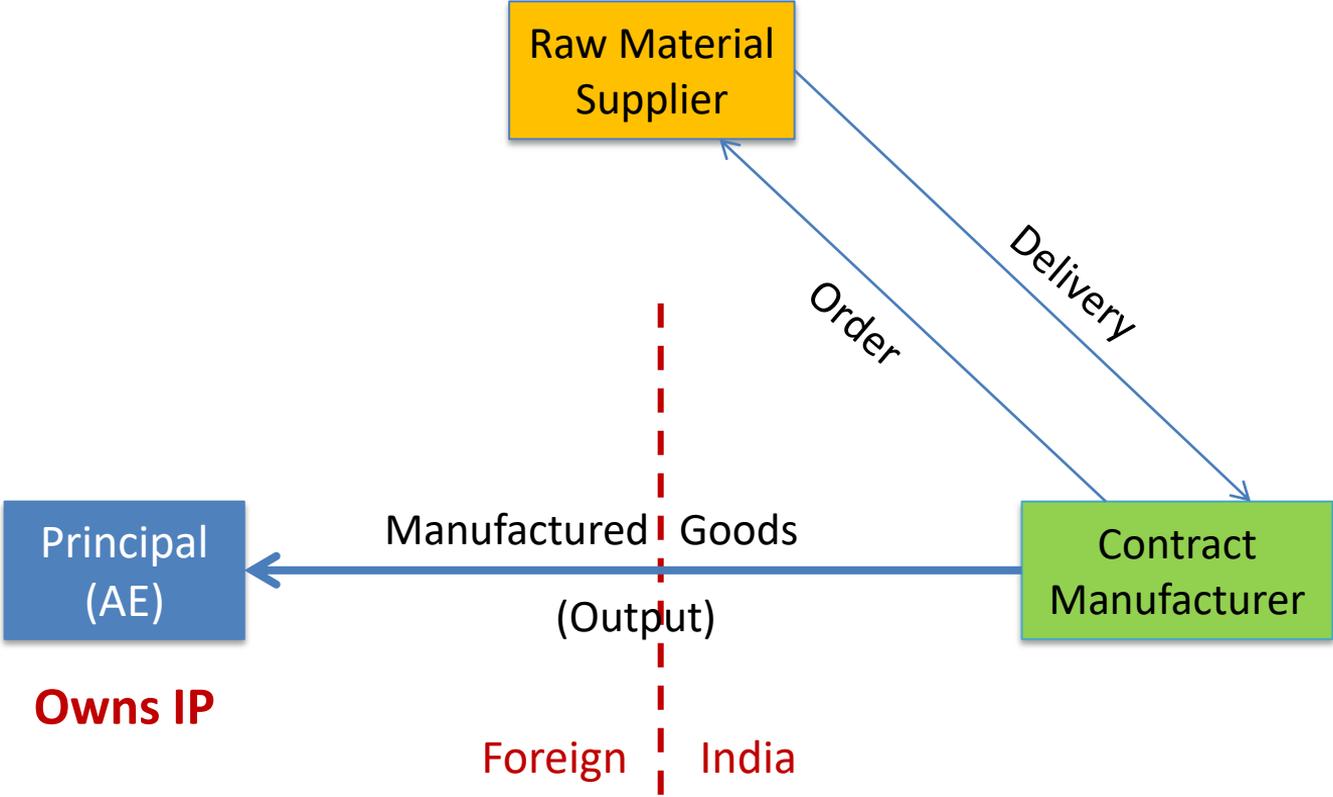
Risks:

- Limited Market Risk

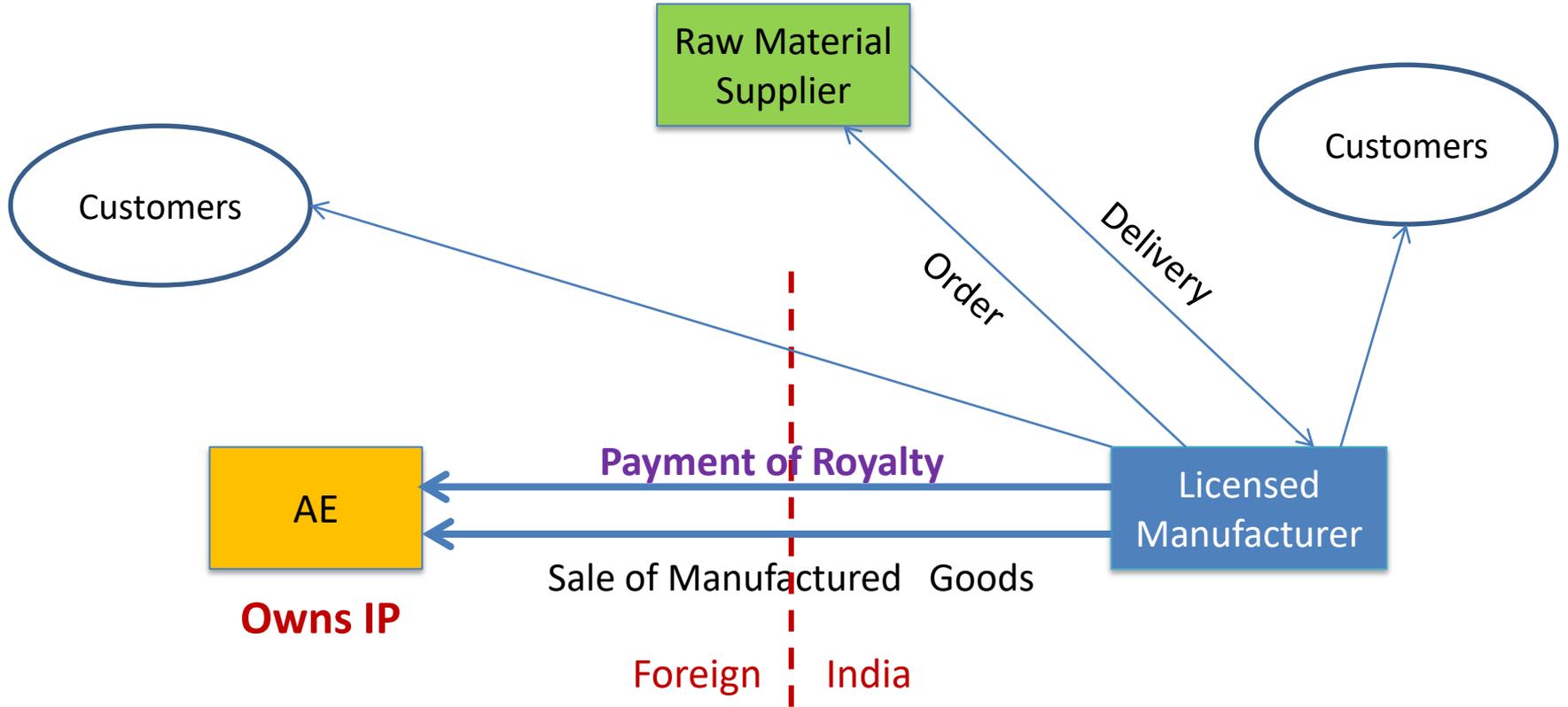
Toll Manufacturing



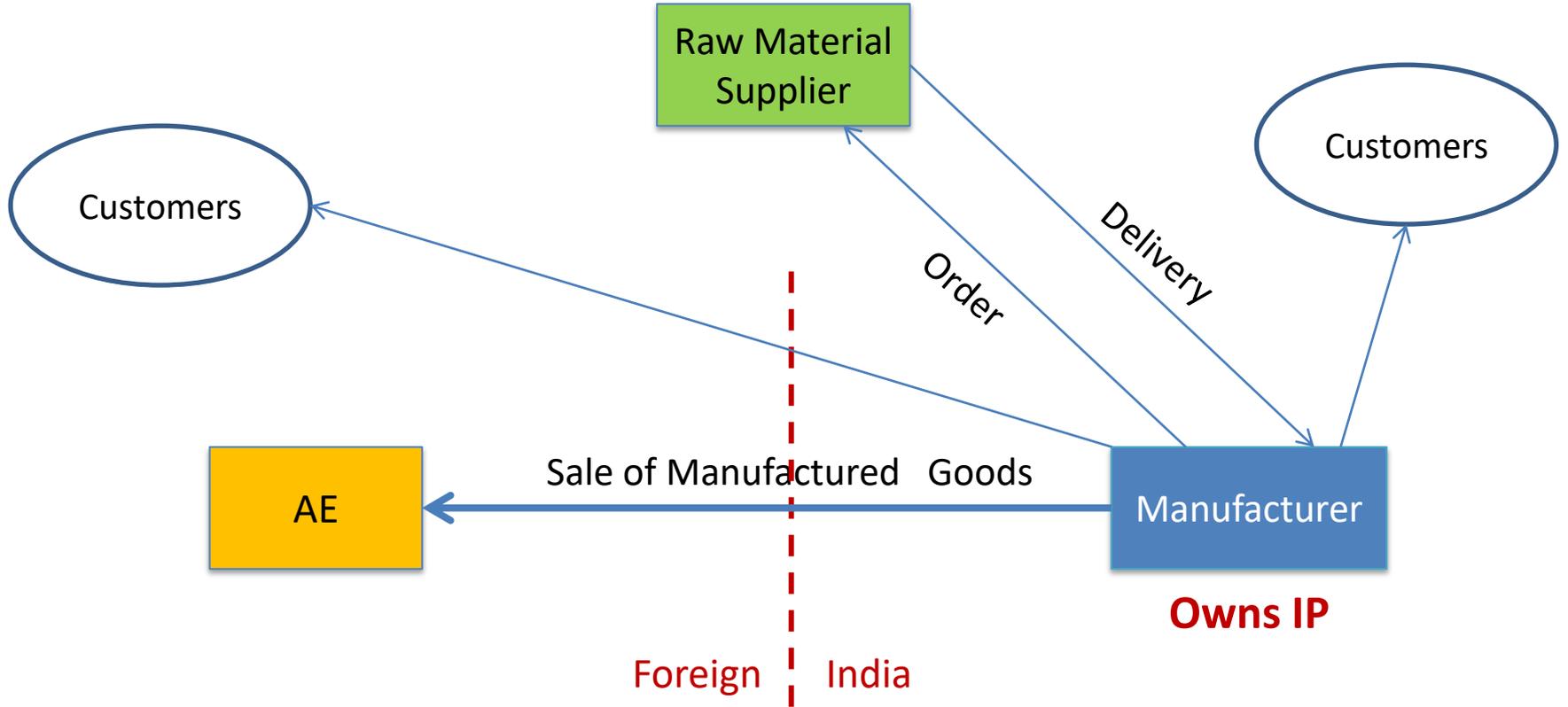
Contract Manufacturing



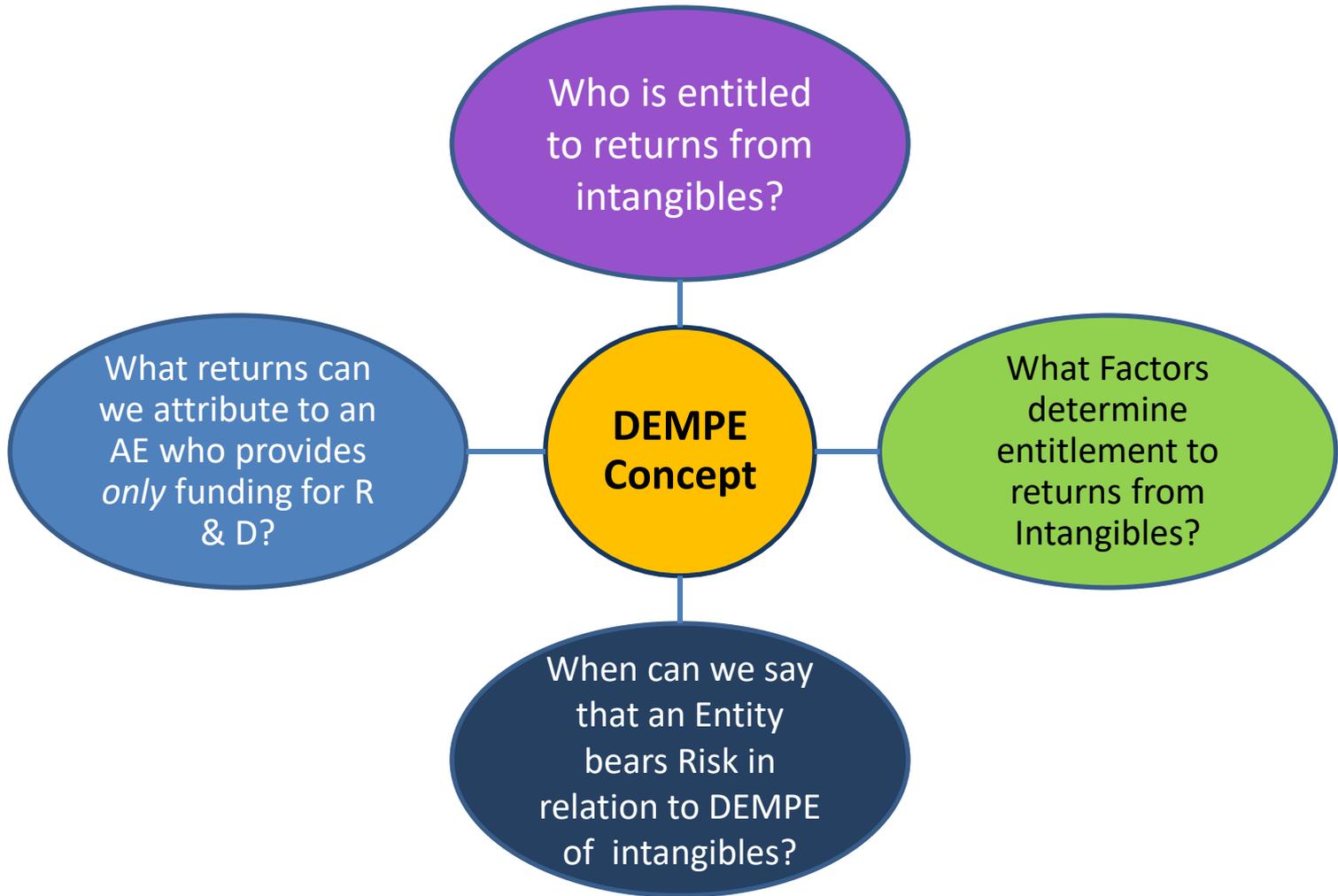
License Manufacturing



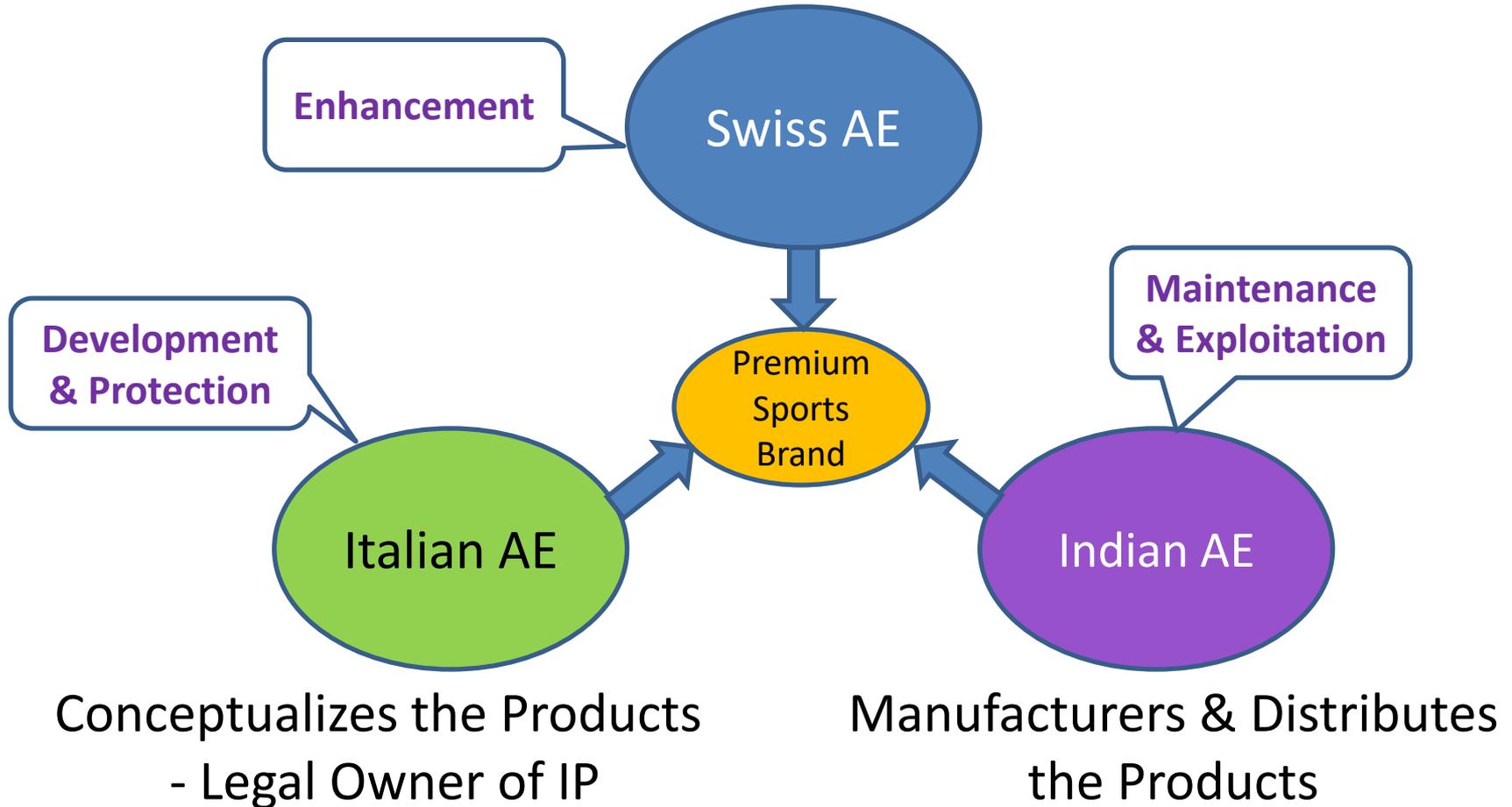
Full Fledged Manufacturing



DEMPE Concept of Intangibles



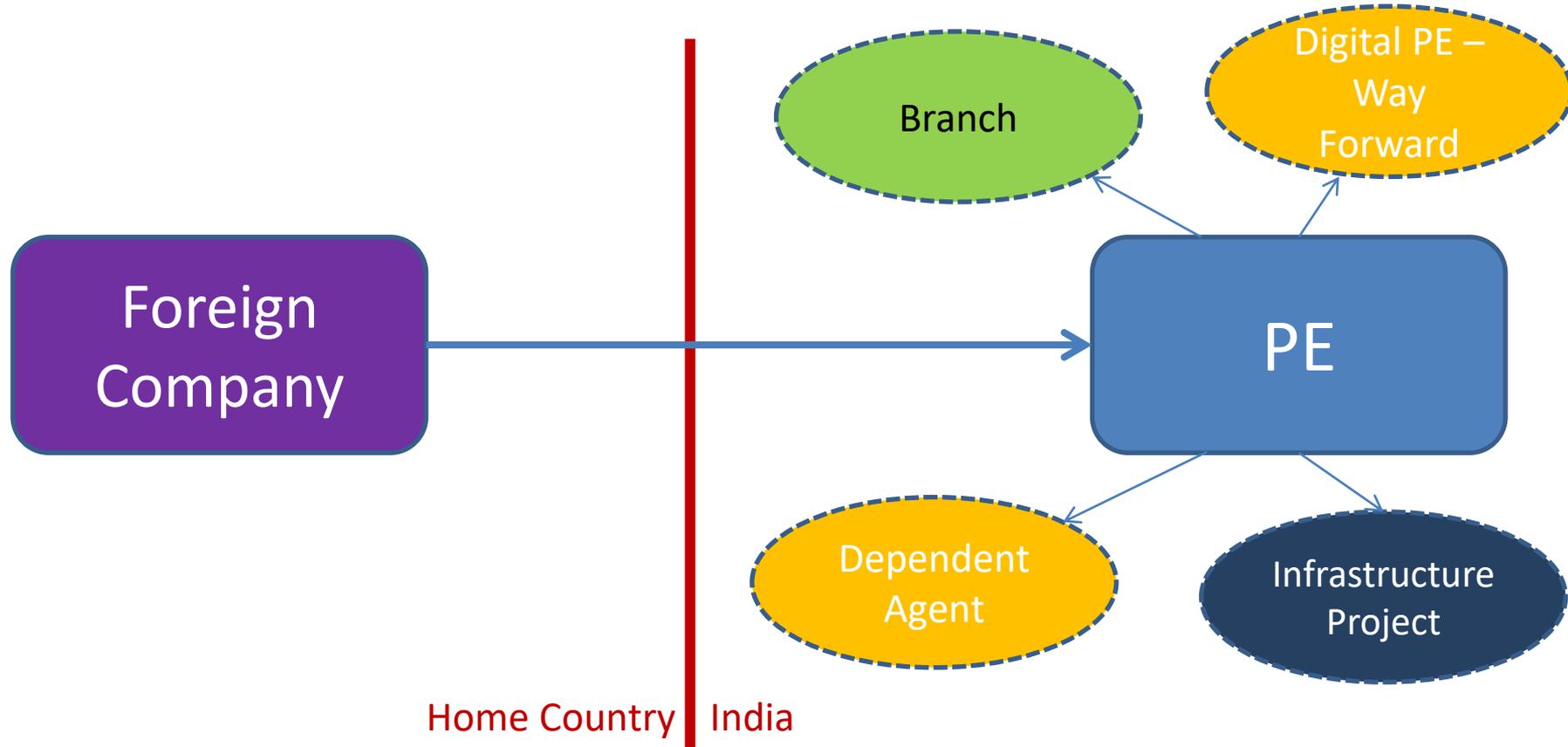
Updates & Enhances the Product Line



Attribution of Profits to PE

Relevance of TP

How to Attribute Profits to Permanent Establishments?



How to Attribute Profits to Permanent Establishments?

Sec. 92F (iii) Defines PE as an AE

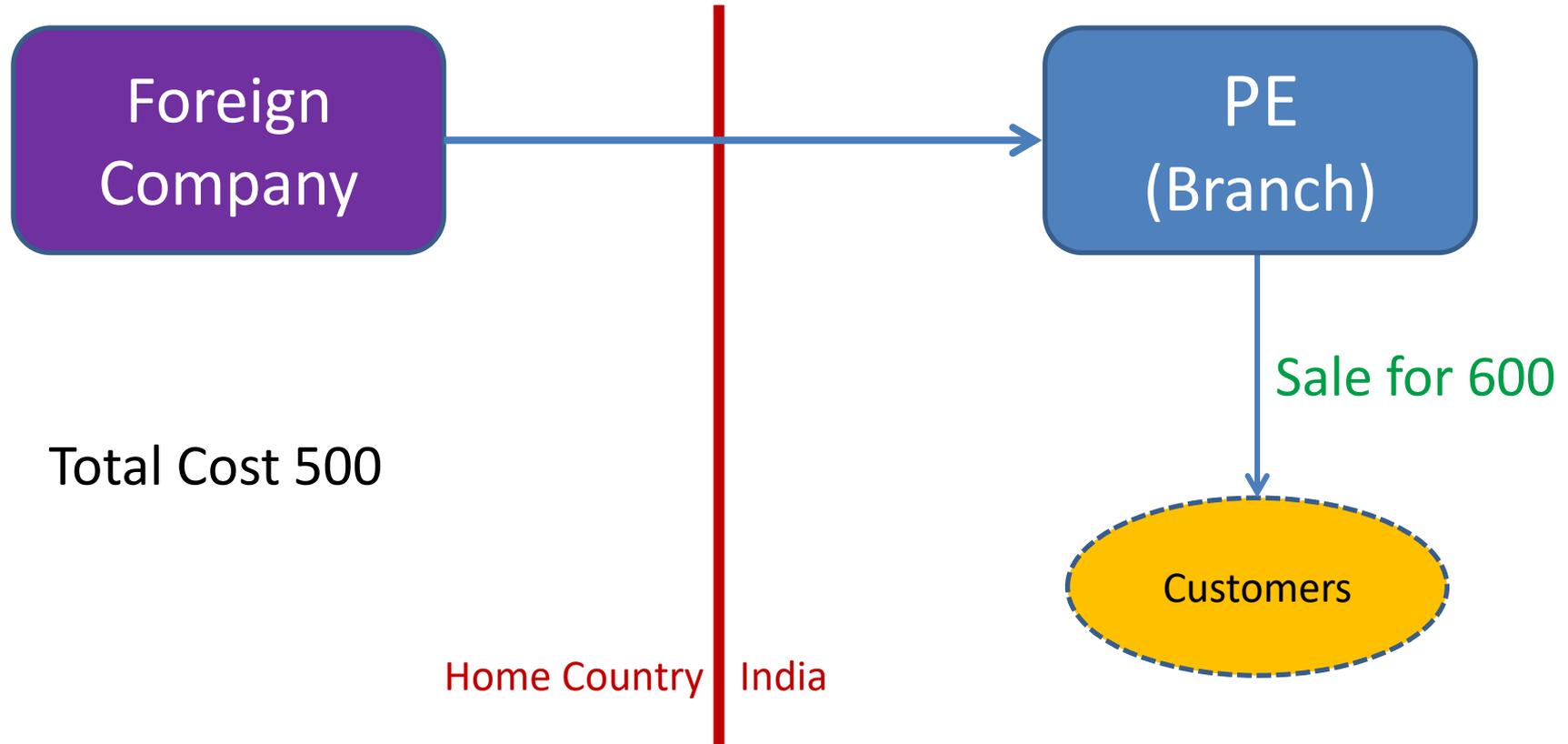
So Indian PE and its Foreign HO are AEs

Aithent Technologies Pvt. Ltd
[TS-752-ITAT-2016(DEL)-TP]

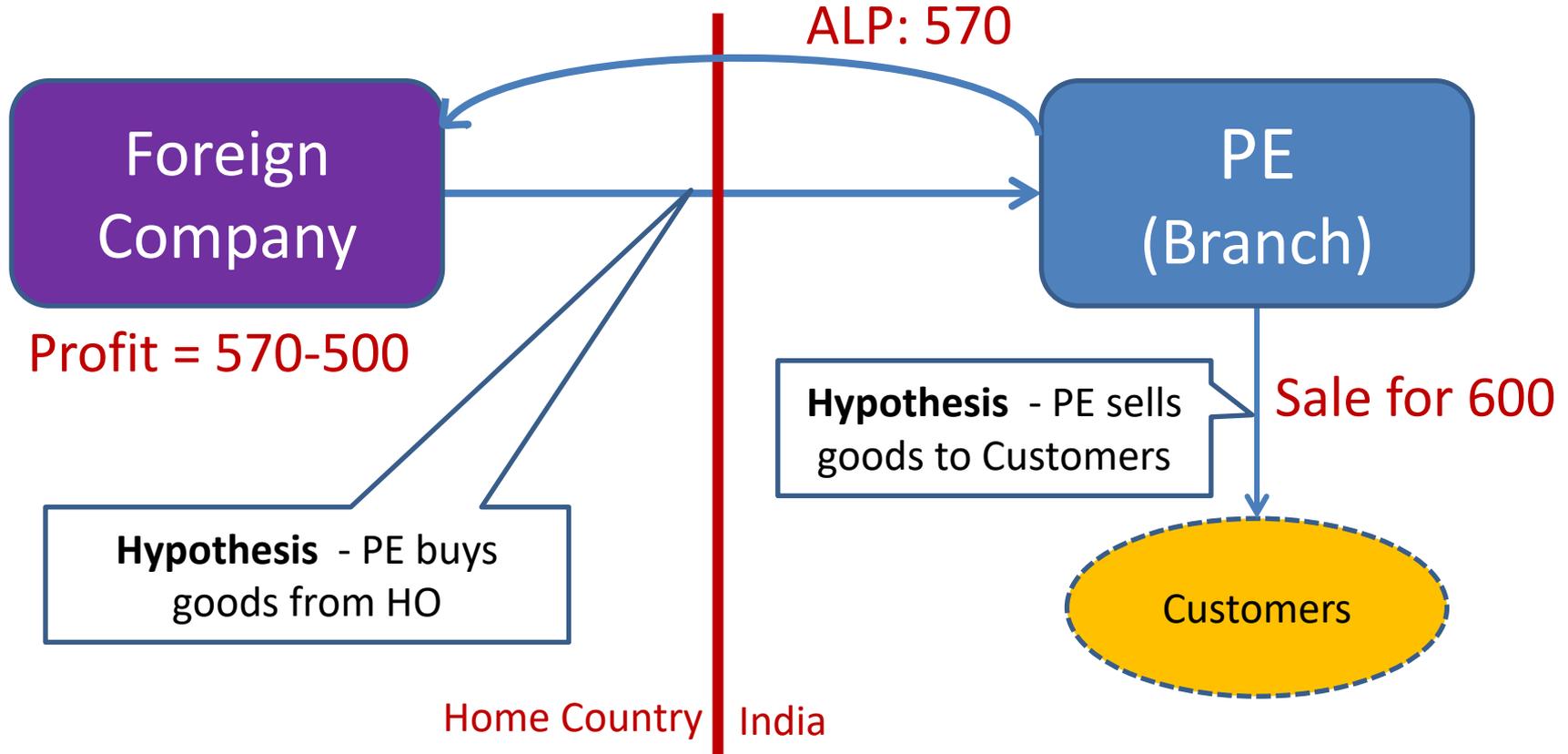
How to Attribute Profits to Permanent Establishments?

By virtue of Article 7 (2) of Tax Treaties we have to apply TP principles for attributing profits to PE

How to Attribute Profits to Permanent Establishments?



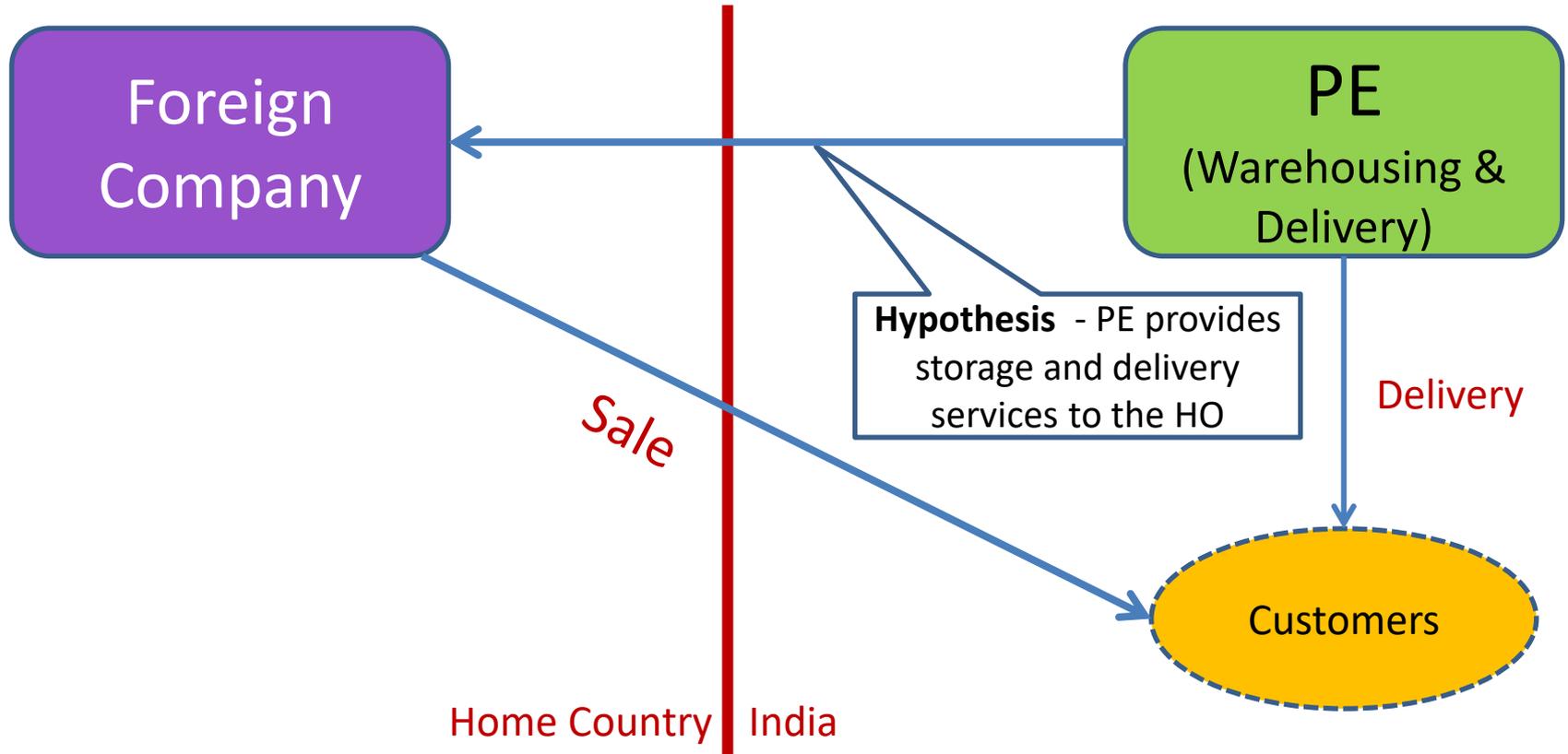
PE Sells Goods to Third Party Customers



PE Sells Goods to Third Party Customers

Description of Functions Performed	HO	PE
Management	✓✓✓✓✓	
Financial and Human Resources Management	✓✓✓✓✓	
Marketing and Sales Strategy Formulation	✓✓✓	✓✓
Responsibility for Terms and Conditions of Sale as well as Pricing	✓✓✓	✓✓
Customer Meetings and Product Presentation		✓✓✓✓✓
Upkeep of Customer Relations		✓✓✓✓✓
Reception and Handling of Orders		✓✓✓✓✓
Preparation of Sales Contracts		✓✓✓✓✓
Procurement of Goods for sale in India		✓✓✓✓✓
Storage of Goods for sale in India		✓✓✓✓✓

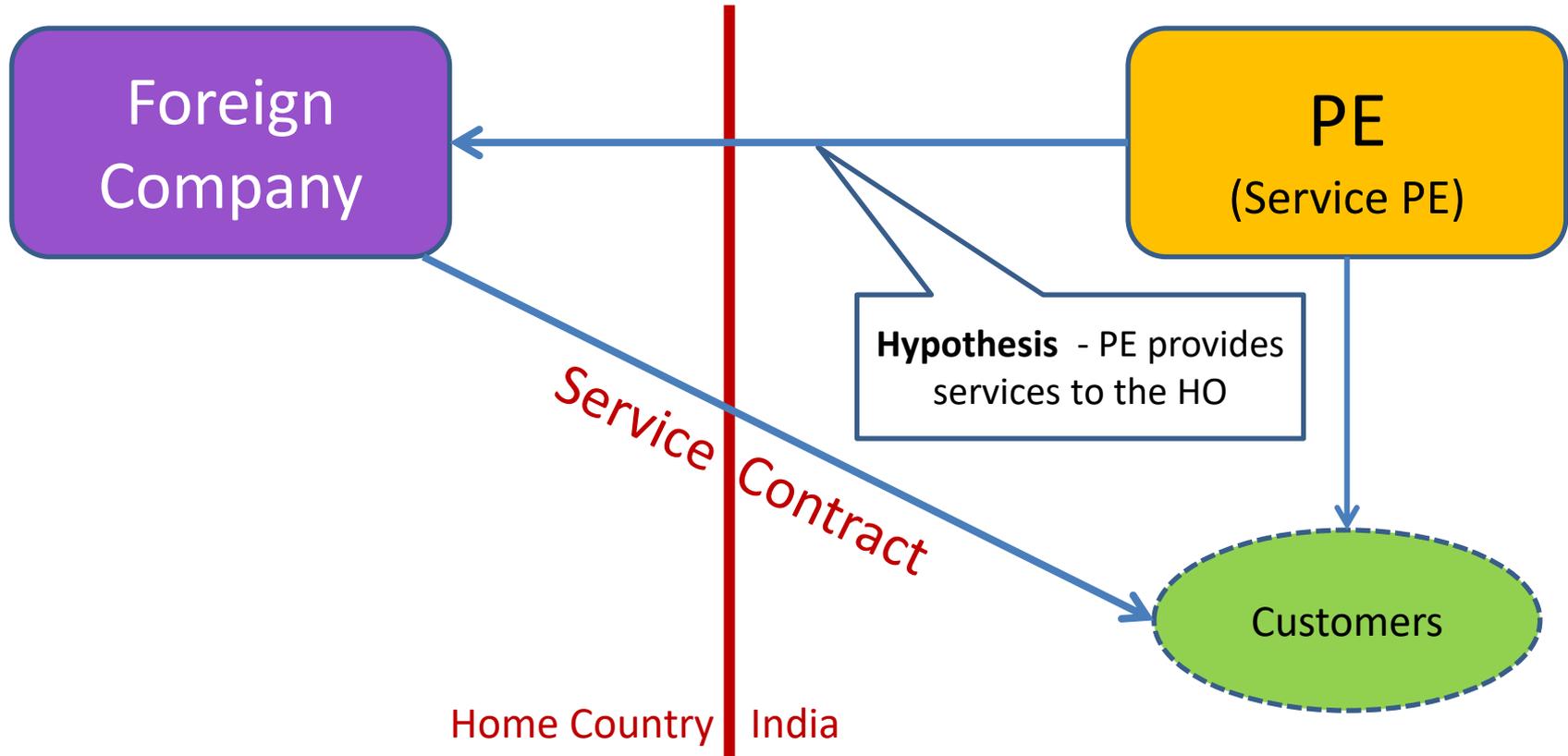
How to Attribute Profits to Permanent Establishments?



PE Stores and Delivers Goods to Third Party Customers

Description of Functions Performed	HO	PE
Management and Administration	✓✓✓✓✓	
Marketing and Sales Strategy Formulation	✓✓✓✓✓	
Preparation and Pricing of Sales Contracts	✓✓✓✓✓	
Search for and Contact with Customers		✓✓✓✓✓
Customer Meetings and Product Presentation		✓✓✓✓✓
Upkeep of Customer Relations		✓✓✓✓✓
Reception of Orders and Customer Complaints	✓✓✓✓✓	
Concluding Contracts	✓✓✓✓✓	
Storage of Goods		✓✓✓✓✓
Delivery of Goods		✓✓✓✓✓

PE provides Services to Customers on behalf of the HO



How to Attribute Profits to Permanent Establishments?

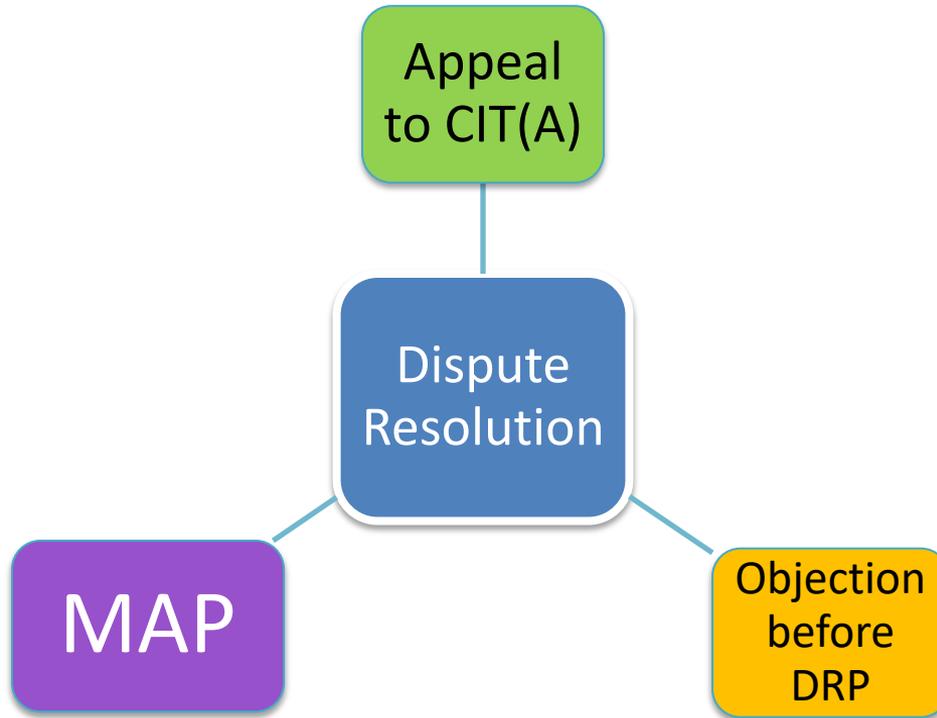
Sec. 44C — Head Office Expenses (Executive & General Administrative Expenses outside India) are to be allowed only up to 5% of Adjusted Total Income

How to Attribute Profits to Permanent Establishments?

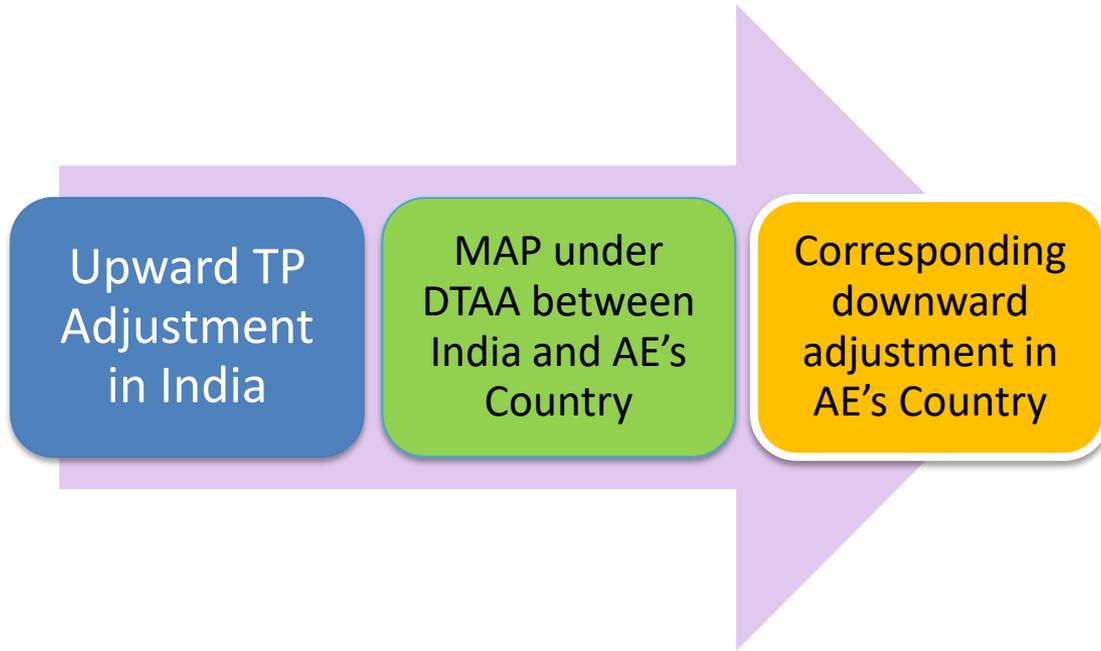
Rule 10 versus Article 7 (2)

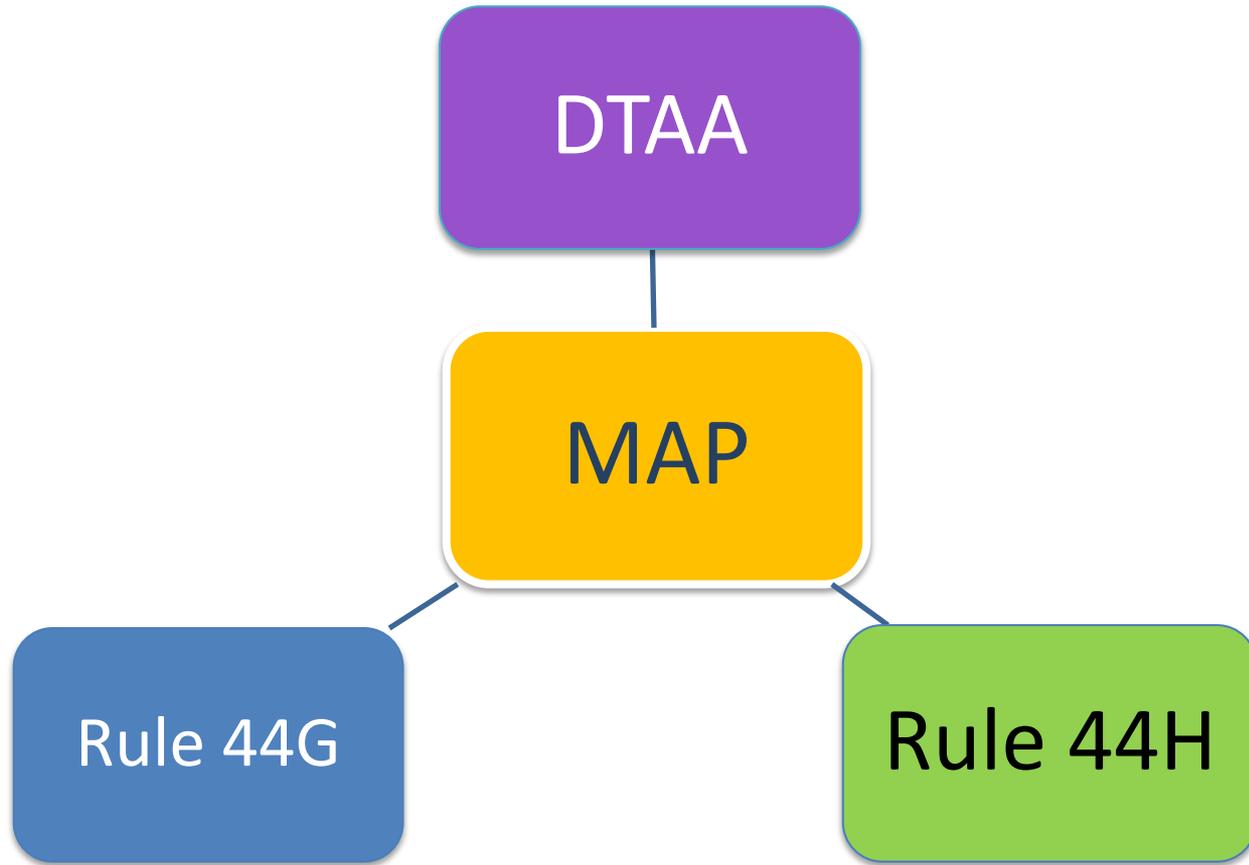
Mutual Agreement Procedure (MAP)

Resolution of TP Disputes



Mutual Agreement Procedure (MAP)





Advance Pricing Agreement (APA)

APA – 5 PHASE PROCESS

Process	What happens during the Process?
Pre-Filing Consultation (Form 3CEC)	<ul style="list-style-type: none">• Explores suitability of an APA with the APA Teams• Provides opportunity to discuss upfront the Process, Scope of Covered Transaction, Documents & Data required for the APA negotiations
APA Evaluation	<ul style="list-style-type: none">• Post the Pre-filing Consultation the APA Team evaluates the APA request made by the Taxpayer and confirms, through a written intimation, the acceptance by the APA Team, of the Taxpayer's request
Main Filing (Form 3CED)	<ul style="list-style-type: none">• Detailed Application containing information on the Entity, AEs, RPTs, Industry, TP Method, Critical Assumptions, etc. to be filed
Negotiation & Finalisation	<ul style="list-style-type: none">• Submission reviewed by APA Team• Site Visits, Discussions, Joint Meetings to gain a better understanding• After review, analysis & evaluation stage, position of the APA Team is discussed and agreed with the Taxpayer• After the preparation of a Mutually Agreed Draft, the Taxpayer and the CBDT sign the APA
Annual Compliance	<ul style="list-style-type: none">• Annual Compliance Report and Compliance Audit for the APA term

APA – PROS AND CONS



- Certainty for 9 years with simpler compliances after the APA has been entered into
- Reduces documentation burden
- Time and cost saving
- Preferred by tax authorities
- Mandatory pre-filing consultation helps in taking a decision for entering into an APA
- Possible persuasive value in litigation and open audit years



- High upfront cost
- No time limit to finalise agreement prescribed under the APA rules
- Onerous details required in Pre-filing / APA application

Safe Harbour Rules

Sr. No.	International transactions	Monetary Threshold	Safe harbour rates
1.	Software Development Services and Information Technology Enabled Services	Up to Rs. 100 crore	17%
		Rs. 100 crores to Rs. 200 crores	18%
2.	Knowledge Process Outsourcing Services	Up to Rs. 200 crores and Employee Cost to Total Cost ratio is:	
		Up to 40%	18%
		40% to 60%	21%
		Greater than 60%	24%

Sr. No.	International transactions	Monetary Threshold	Safe harbour rates
3.	Contract Research and Development Services relating to Software Development	Up to Rs. 200 crores	24%
4.	Contract Research and Development Services relating to Generic Pharmaceutical Drugs	Up to Rs. 200 crores	24%
5.	Intra Group Loans denominated in Indian Currency	CRISIL rating of AE:	One year Marginal Cost of Funds Lending Rate of SBI as on 1st April, 2019 plus
		'AAA' to 'D'	1.75% – 6.75%

Sr. No.	International transactions	Monetary Threshold	Safe harbour rates
8.	Manufacture and export of core auto components	No Threshold	Operating Cost plus Mark Up of 12%
9.	Manufacture and export of non- core auto components	No Threshold	Operating cost plus Mark Up of 8.5%
10.	Receipt of low value adding intra group services (IGS)	Total Value of IGS does not exceed Rs 10 crores	Not in Excess of Operating cost plus Mark Up of 5%

“Anyone who stops learning gets Old, whether at Twenty or Eighty. Anyone who keeps learning stays Young.”

- Henry Ford

Thank You

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