



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

Transfer Pricing Developments

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TP landscape in India



Indian Transfer Pricing Litigation Environment - Past

TP Adjustment scenario in past

Transfer pricing audit year	Assessment year	Amount of adjustment in income (₹ crore)
2005-06	2002-03	1,220
2006-07	2003-04	2,287
2007-08	2004-05	3,432
2008-09	2005-06	7,754
2009-10	2006-07	10,908
2010-11	2007-08	24,111
2011-12	2008-09	44,532
2012-13	2009-10	70,000
2013-14	2010-11	60,000
2014-15	2011-12	47,000

TP disputes in India accounted for 70% of the world's total by volume

Financial Express 1 September 2012

The issue of TP has generated much heat in India involving MNCs operating here such as Vodafone, Shell, WNS and Nokia

Economic Times , 8 April, 2014

TP adjustments data from Financial Express Newspaper dated 25 March 2015

Tax Environment in India – Renewed

Focus

Implementation of BEPS Package

- Preventing artificial avoidance of PE status
- India's acceptance to MLI
- CbC and Master File implemented from FY 2016-17

Uncertainty prevails in few areas

- AMP Issue - still needs finality
- Royalty payments & secondment arrangements - under critical examination

Alternate Dispute Resolution

- 240+ APAs concluded
- First APA renewal concluded within 7 months
- APA conclusion timelines better than some developed countries
- 180+ MAP cases been resolved in last 3 years
- Faster disposal of cases by AAR

New Developments

- Increased PE exposure due to changes proposed by MLIs and BEPS Action Plan 7
- Exchange of CbCR to commence from September 2018
- Sharing of draft regulations for public consultation
- Shift in audit scrutiny criteria to risk-based approach

Recent Developments



Thin Cap rules

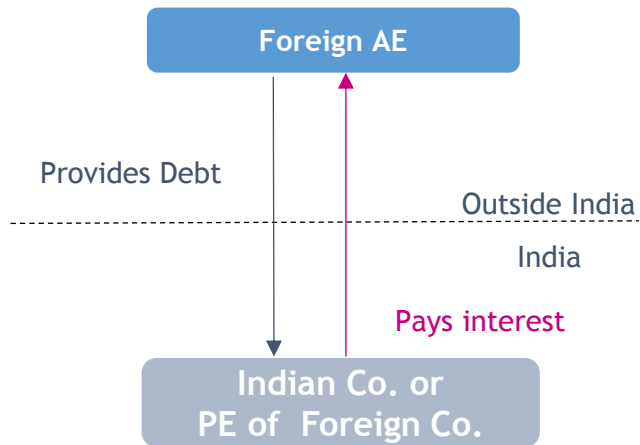


Thin Capitalization – Section 94B

Applicability	<ul style="list-style-type: none">▪ Indian company or PE of a foreign company▪ Interest or similar consideration paid in respect of any debt from AEs or debts guaranteed by AEs
What is disallowed	<ul style="list-style-type: none">▪ Interest or similar consideration exceeding INR 10 Mn, which is▪ deductible in computing business income for a debt issued by a non-resident AE
Exclusions	<ul style="list-style-type: none">▪ Banking and Insurance Companies excluded
Meaning of excess interest	<ul style="list-style-type: none">▪ Amount of total interest paid or payable in excess of 30% of EBITDA; Or▪ Interest paid / payable to AE, whichever is lower
Guarantee	<ul style="list-style-type: none">▪ Lender not associated▪ Implicit or Explicit Guarantee or deposit of corresponding/matching amt. with lender by AE
Carry forward of unamortized interest	<ul style="list-style-type: none">▪ For 8 assessment years

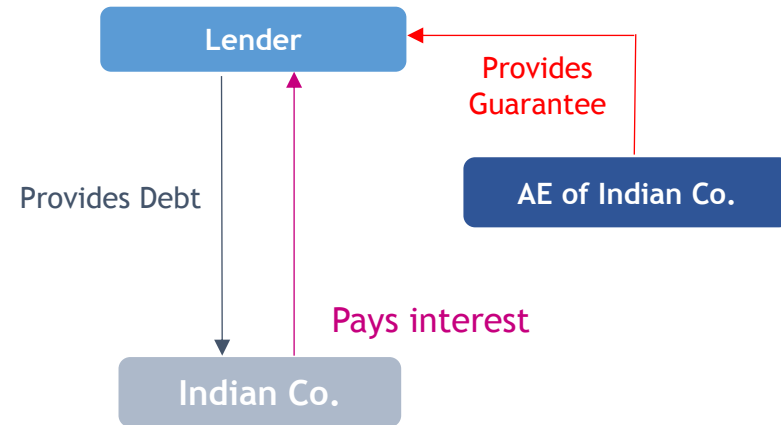
Limitation on Interest Deduction

Situation 1



- Foreign AE provides debt to an Indian Co. or PE of a Foreign Co.
- Indian Co. or PE of Foreign Co. pays interest exceeding INR 10 mn in respect of such debt

Situation 2



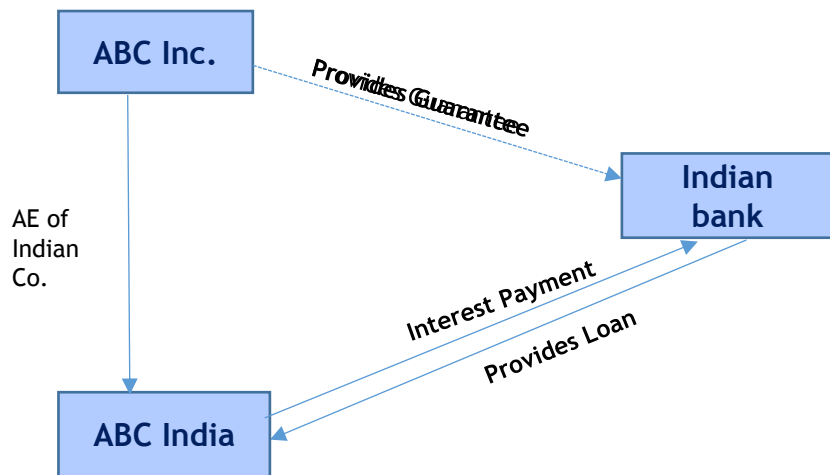
- Lender provides debt to an Indian Co.
- AE of Indian Co. provides guarantee or deposits sum of equivalent amount with lender
- Indian Co. pays interest exceeding INR 10 mn in respect of such debt or guarantee

OR

- Interest paid above 30% of EBITDA not to be allowed as a tax deduction
 - Excess interest paid allowed to be carried forward for 8 years

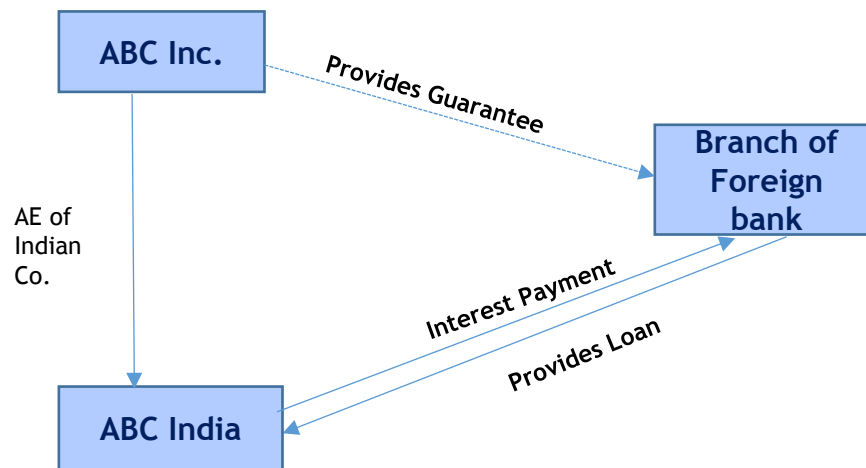
Loan borrowed in India – Whether section 94B applicable?

Situation 1



Since, the lender is a resident in India, the provisions of 94B will not be applicable.

Situation 2



Since the lender is a non-resident, provisions of section 94B will be applicable.

Interest deduction – an example

(Amount in INR)

Particulars	Year 1		Year 2		Year 3	
	Case 1	Case 2	Case 1	Case 2	Case 1	Case 2
EBITDA	100,000	100,000	300,000	300,000	500,000	500,000
30% of EBITDA	30,000	30,000	90,000	90,000	150,000	150,000
Interest Paid to :						
- AE	20,000	80,000	20,000	80,000	20,000	80,000
- Non AE	80,000	20,000	80,000	20,000	80,000	20,000
Total Interest Paid	100,000	100,000	100,000	100,000	100,000	100,000
Add: Brought Forward from last year	-	-	20,000	70,000	30,000	80,000
Total Interest for deduction	100,000	100,000	120,000	170,000	130,000	180,000
Interest to be disallowed, lower of ;						
- Excess of total interest over 30% of EBITDA	70,000	70,000	30,000	80,000	NA*	30,000
- Actual interest paid to AE (including last year's brought forward)	20,000	80,000	40,000	150,000	50,000	160,000
Disallowance to be carried forward for 8 years	20,000	70,000	30,000	80,000	Nil*	30,000

* In this case, since total interest paid is less than 30% of EBITDA, hence there will be no disallowance

Section 94B - Issues for consideration

- Thresholds of 30% is applied regardless of the business, strategic situation, industry, or economic environment - high degree of debt / equity ratio quite common in sectors like Steel, Petroleum, Automobile, Power, Infrastructure, etc.
- Infrastructure companies having large gestation periods and losses in initial years, would have unnecessary limitation on interest deduction in initial years
- Start-ups could have losses / low profitability in initial years, resulting in higher sunk cost and thereby, limiting the investment potential, despite the inherent business strength
- EBIDTA should be as per accounting standards or as per the Income-tax Act
- Arm's length under TP v/s 94B - GAAR v/s. SAAR
- Section 40(a)(i) and Section 94B - order of applicability



Secondary Adjustment



Introduction of Sec 92CE

- Finance Act, 2017 introduced the concept of ‘secondary adjustment’ by way of insertion section 92CE to the Act
- As per section 92CE(3) of the Act,

“secondary adjustment means an adjustment in the books of account of the assessee and its AE to reflect that the actual allocation of profits between the assessee and its AE are consistent with the transfer price determined as a result of primary adjustment, thereby removing the imbalance between cash account and actual profit of the assessee.”

Section	Summary of provisions	Due date prescribed
Section 92CE(1)	<i>A secondary adjustment shall be made only in case of the below mentioned primary adjustments after 90 days of the due date as prescribed:</i>	
	• Suo-moto adjustment in the return of income	Due date of filing return u/s 139(1) of the Act
	• Acceptance of adjustment proposed by the assessing officer	Date of the order of AO or the appellate authority, if primary adjustment is accepted by the taxpayer
	• Determination in an APA	From the date on which the APA has been entered into by the taxpayer under Section 92CC, where the primary adjustment to transfer price is determined by such agreement
	• Adoption of safe harbour rule	Due date of filing return u/s 139(1) of the Act
	• Resolution under MAP	From the date of giving effect by the Assessing Officer under rule 44H of the Income-tax Rules, 1962 to the resolution arrived at under MAP, where the primary adjustment to transfer price is determined by such resolution

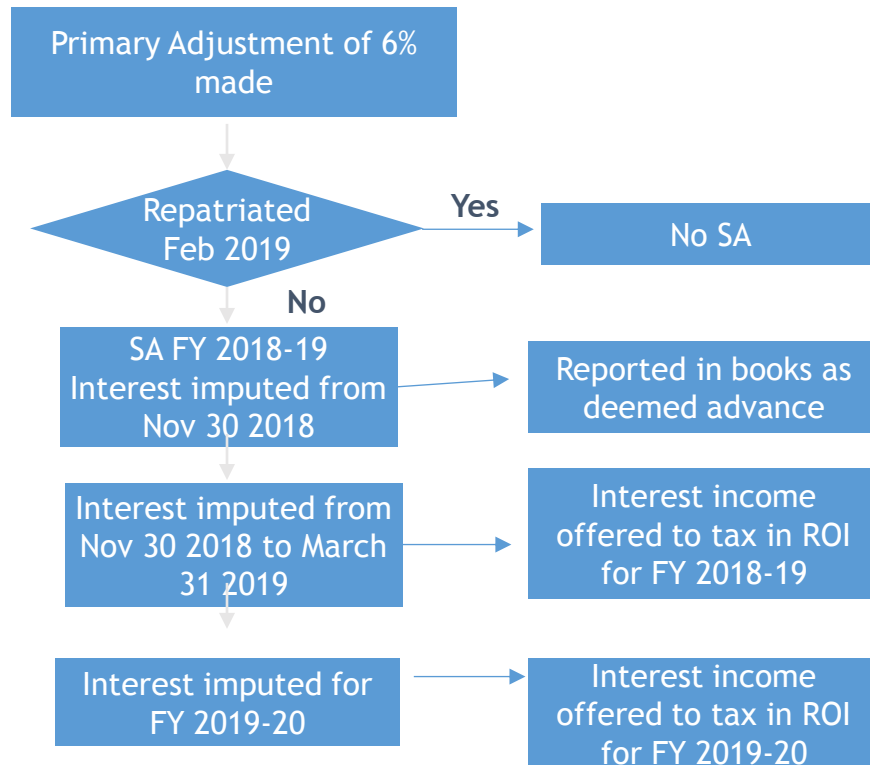
Introduction of Sec 92CE

Section	Summary of provisions
Proviso to section 92CE(1)	<p>No secondary adjustment is required if:</p> <ul style="list-style-type: none"> • The primary adjustment does not exceed INR 10 million and • If the primary adjustment is made in respect of an AY commencing on or before the 1st day of April, 2016
Section 92CE(2)	<ul style="list-style-type: none"> • Secondary adjustments introduced where primary adjustments result in increase in total income or reduction in loss • Excess money available with its AE as a result of primary adjustment, if not repatriated to India within the prescribed time, to be treated as an interest bearing advance

- Sub-rule (2) of Rule 10CB provides the rate of interest to be charged on the “excess money” if not repatriated within the prescribed time limit of 90 days as explained above. The rate of interest shall be as follows:

Currency of international transaction	Rate of interest
Indian National Rupee	One year marginal cost of funds lending rate (MCLR) of State Bank of India as on 1 April of the relevant previous year plus 325 basis points.
Foreign currency	Six-month London Inter-Bank Offer Rate (LIBOR) as on 30 September of the relevant previous year in the relevant foreign currency plus 300 basis points.

Case study



- Provision of marketing support services at **cost plus 10%** by the Indian Co. to its AE
- **Arm's length mark up of 16%** determined by taxpayer for FY 2017-18, at the time of filing return of income
 - **Primary Adjustment (PA) of 6% - secondary adjustment triggered**
- If PA amount repatriated in February 2019 - no secondary adjustment
- If PA amount not repatriated, secondary adjustment triggers in FY 2018-19
 - Interest to be imputed from 30 November 2018 or after the end of 90 days from 30 November 2018 i.e. from March 2019
 - To be reported in the books of accounts as deemed advance?
 - To be offered to tax in which year?
 - FY 2017-18 - revised return required?
 - FY 2018-19 - income of the said year?

Section 92CE – Issues for discussion

Provision in books of account

- Section 92CE does not clarify as to how secondary adjustment would be entered in the books of account as the said approach would (possibly) be in conflict with the Companies Act

Impact on MAT computation

- Whether credit to P&L a/c would form part of book profit for purpose of Section 115 JB

Adjustment required in the books of AE

- Whether Indian authorities have a right to seek such an adjustment in the books of AE, the same being outside their jurisdiction?

Multiple AEs / transactions

- In cases where overall TNMM is applied, whether secondary adjustment needs to be made in respect of a single AE/ transaction or multiple AEs/ transactions? If multiple AEs/ transactions, then on what basis will the quantum be decided?

Imputation of interest up to perpetuity

- Clarification required on the period up to which interest will be imputed

Interplay between TP and GST



Interplay between TP and GST

Common overlapping:

- Determination of arm's length price involving transactions between related parties

Related party coverage:

- GST provisions largely apply to domestic transfer of goods / services between local related parties and import and export of services between related parties
- Ambit of TP regulations so far as domestic transactions are concerned is comparatively narrower i.e. restricted to scenarios where tax holiday is involved
- Thus, the definition of 'related persons' under the GST law is wider than that under the TP provisions.
- Hence, even though the taxpayer may have complied with TP legislation, it would still need to be mindful and examine any other relationships that could get covered within the purview of related parties under the GST legislation and hence require an arm's length analysis.

Benchmarking / Valuation methods

Methods	TP	GST
Comparable Uncontrolled Price Method	<ul style="list-style-type: none"> Price at which unrelated parties have transacted for same goods/ services 	<ul style="list-style-type: none"> Open market value (full value) or value of supply of goods or services of like kind and quality
Cost Plus Method	<ul style="list-style-type: none"> Comparison of gross profit on cost of production of goods / provision of services 	<ul style="list-style-type: none"> Prescribed margin of 10% on cost
Other Method	<ul style="list-style-type: none"> Residuary method which considers price of similar goods / services in transactions between unrelated entities 	<ul style="list-style-type: none"> Residual Method
Resale Price Method	<ul style="list-style-type: none"> Value of imported goods is arrived by deducting distributor's margin from selling price 	Where goods are intended for supply as such, 90% of the value of goods sold to unrelated customer
Transaction Net Margin Method	<ul style="list-style-type: none"> Value of goods / services is indirectly arrived by comparing the margin earned from transaction based on activities performed Aggregation of several closely linked transactions permitted 	<ul style="list-style-type: none"> No corresponding method Each transaction to be benchmarked separately

Key issues

Free of cost services:

- Import of services free of cost from a related person is liable to GST under the reverse charge mechanism - If open market value of identical or similar supplies not available, then GST is payable on cost plus 10% value

Interest for delayed payments

- Notional interest for delayed receivables from the AEs - imputed by taxpayer suo moto / in terms of APA / adjustment made by the Transfer Pricing officer, etc. - would qualify / constitute value of service under GST

Reimbursement/ Recovery of expenses

- Construed as a supply of service (where the place of supply of service is in India) unless the same is evidenced to be incurred in the capacity of a pure agent

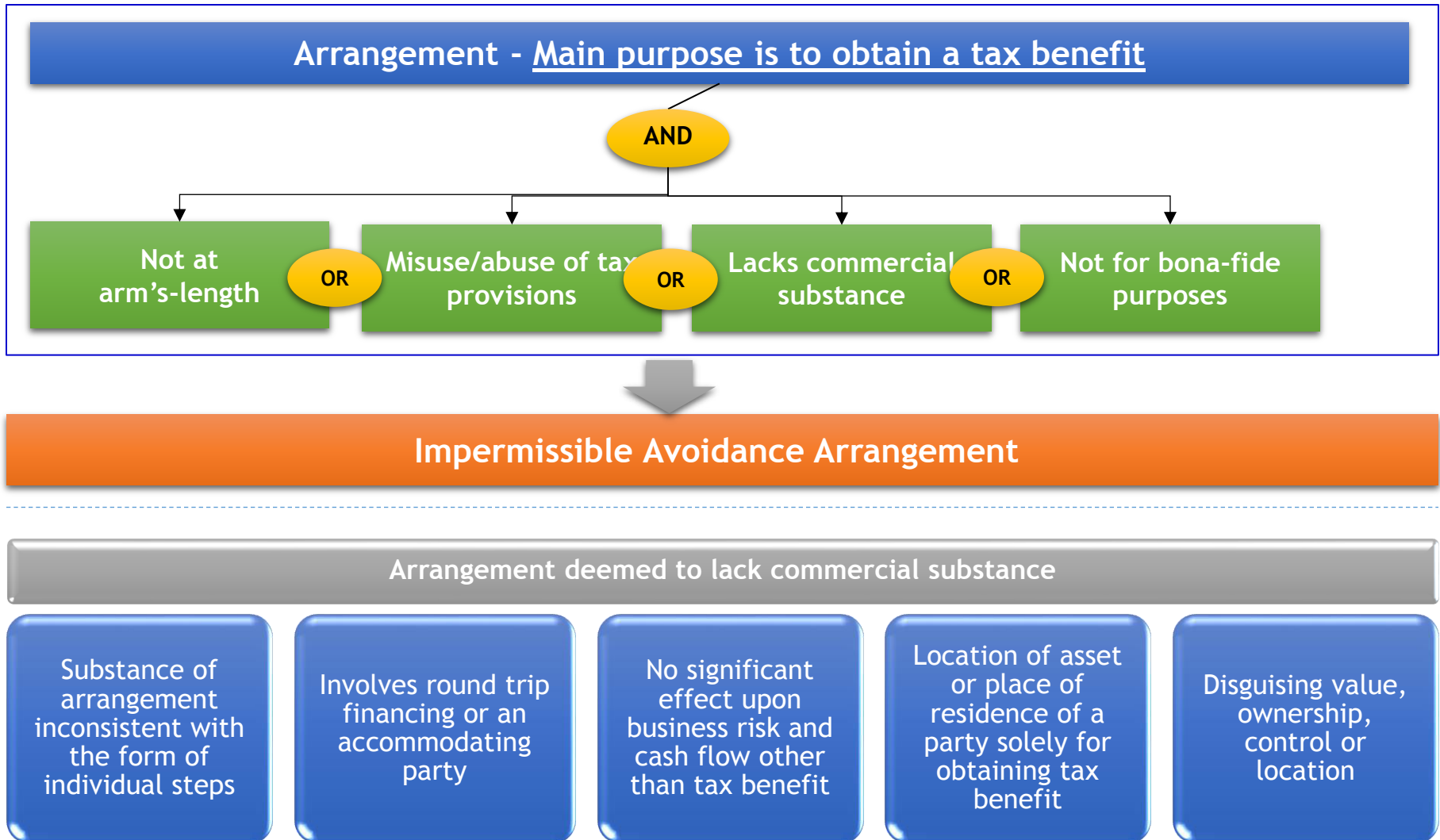
Captive entities

- In case of Indian captive entities, the GST authorities allege that use of brand, logo, group name, etc. constitute services, and if no consideration is charged, Indian entity should discharge the GST liability under reverse charge mechanism

General Anti-Avoidance Rules (GAAR) and Transfer Pricing

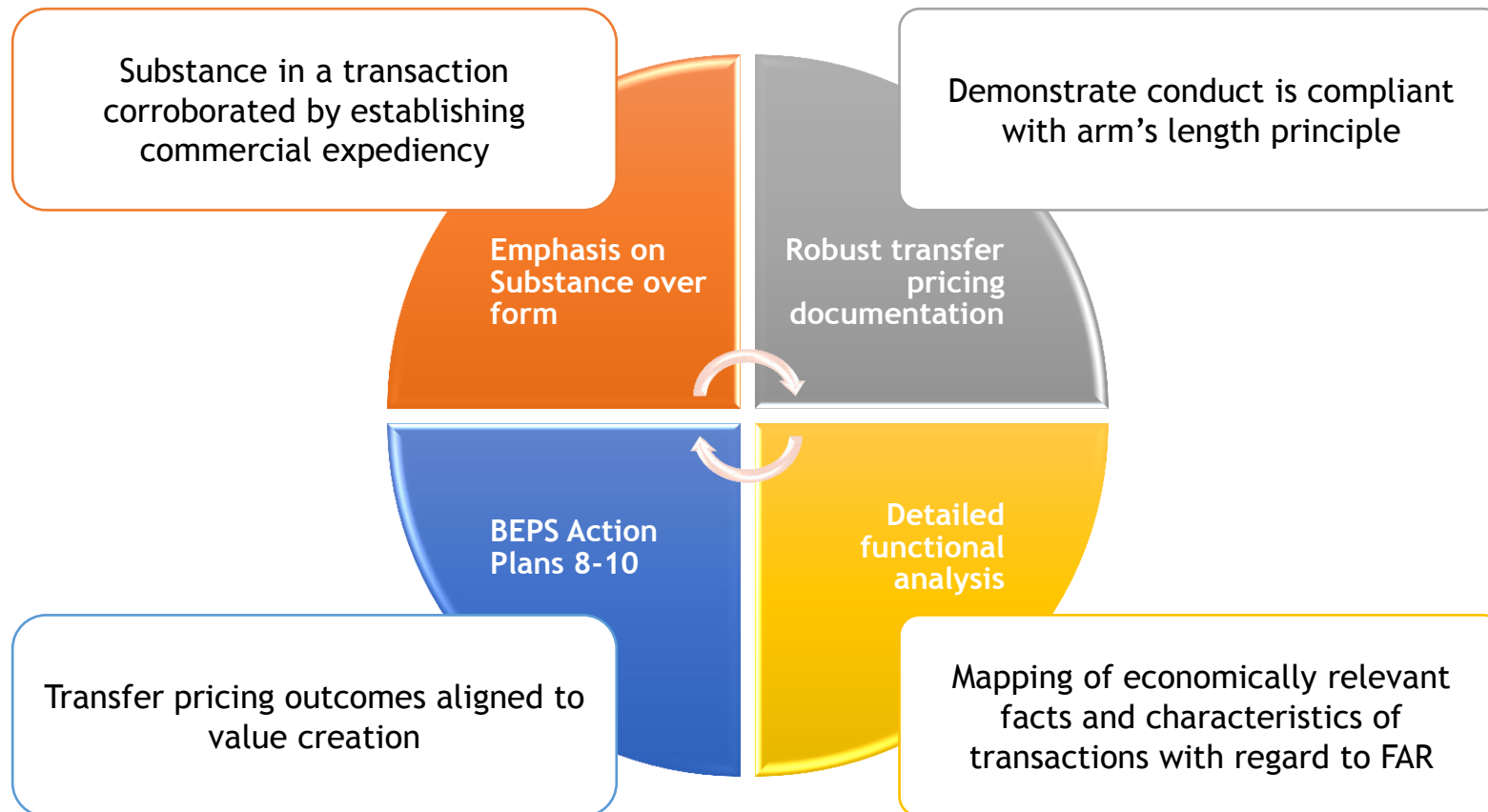


An overview of GAAR framework - Sec 96 & 97

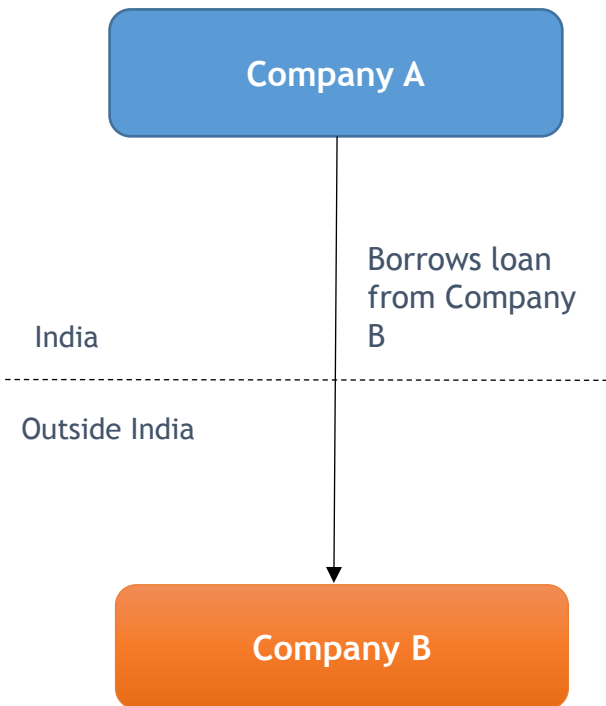


Interplay between GAAR and Transfer pricing

By introduction of GAAR, apprehensions have been raised that there is no distinction between tax mitigation and tax avoidance. In such a situation the transfer pricing principles could be used.



Case study



Microsoft Excel
Worksheet

Facts

- Company B has set up Company A with minimum equity capital and funded Company A's operations by significant inter-company debt @ 12 % p.a. (Debt Amt. - INR 1000cr)
- Net-worth of Company A is negative and third party loan is not available to Company A

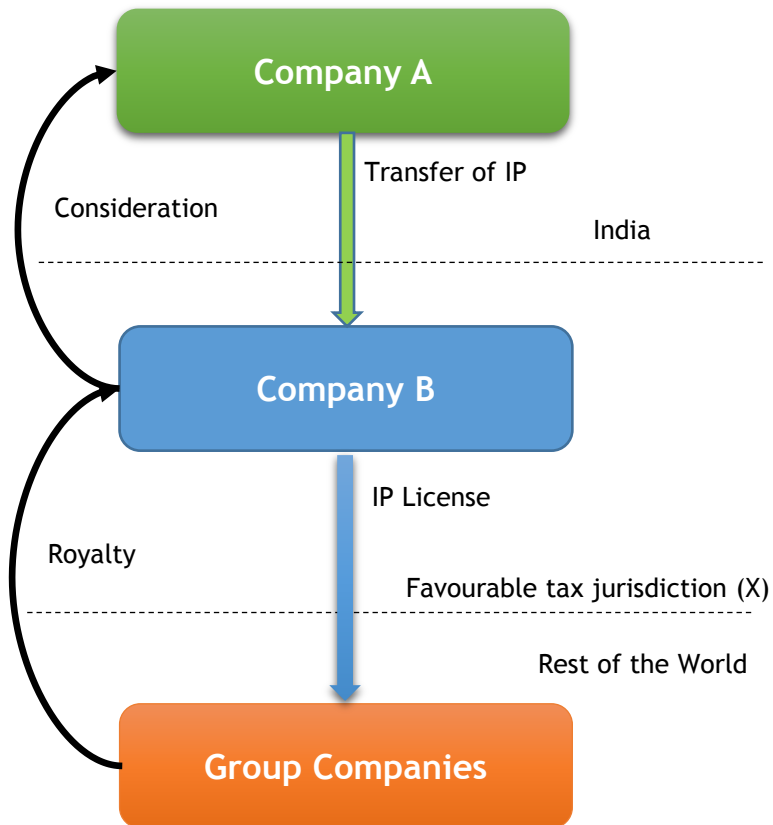
Assuming only related party debt

- For FY 2016-17, Company A has paid interest amounting to INR 120cr
- The Arm's length rate of interest is determined at 8% - hence, deduction for interest restricted to INR 80cr - INR 40cr disallowed as TP adjustment
- Further, 30% of EBITDA of Company A is INR 75cr - Excess INR 5cr disallowed u/s. 94B
- Net effect is that only INR 75cr out of total interest of INR 120 cr is allowed as deduction of interest

Issue:

- Whether the Income-tax authorities can characterize the debt provided by Company A into equity and invoke the provisions of GAAR, even though SAAR (TP) is applicable?

Case study



Facts

- Company A resident in India is an Entrepreneurial entity engaged in manufacturing of Pharmaceuticals.
- Company B, is the parent company of A, resident in a favourable tax jurisdiction
- Company A in India transfer the IP to Company B for a consideration. Company B does not have any substance in its operations.
- Company B licenses the IP to the other group companies and earns royalty income.
- Company A continues to be engaged in manufacturing and R&D operations.

Issue:

Can this entire transaction be disregarded under GAAR?

Transfer pricing analysis including FAR in line with actual conduct would be critical in such case

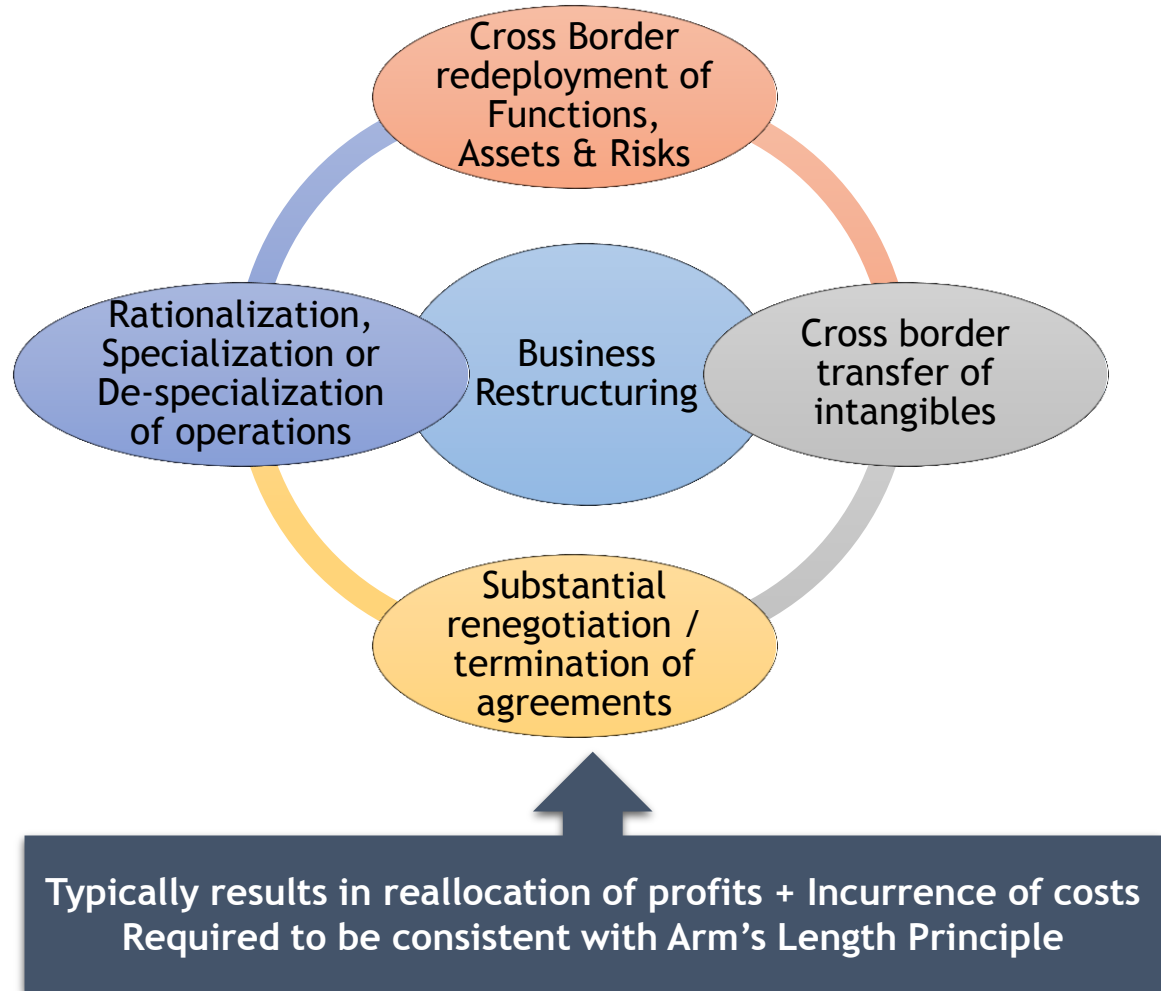
Business Restructuring



OECD Explanation of Business Restructuring

Concept - Business Restructuring

- **Why??** - Commercial and business reasons
- **How??** - Often, one of the entity is stripped of its functions resulting in a lower risk for the restructured entity.
- **Effect??** - Corresponding change results in reduction of future earning capacity of the restructured entity.
- **'Exit Charge'** - Rationale - If an entity is stripped off its risks and functions as a consequence of the restructuring, it should be compensated for the loss of future earning capacity in that jurisdiction.



Key Drivers behind Business restructuring

Commercial drivers

Reducing Supply Chain / Back office costs

Standardizing business processes

Centralizing strategic competencies

Globalization, international growth and market penetration

Consistency in product and service standards delivered and customer relationships

Tax drivers

Embedded lower tax rate in the business

Reduce Complexity

Simplify compliance requirements

Consistency of approach with a view to decreasing cross jurisdictional difference

“Business Restructuring in context of Indian TP Regulations

➤ **Section 92B of the Act - Meaning of International Transaction**

➤ Amended by Finance Act 2012 with retrospective effect from 1st April 2002

➤ Explanation inserted to provide inclusive definition of international transaction -

“Explanation –For the removal of doubts, it is hereby clarified that–

(i) the expression "international transaction" shall include–

.....

“a transaction of business restructuring or reorganisation, entered into by an enterprise with an associated enterprise, irrespective of the fact that it has bearing on the profit, income, losses or assets of such enterprises at the time of the transaction or at any future date”

Business Restructuring not defined in the Act

➤ **Disclosure requirement as per Form No. 3CEB - Annexure : Part B**

➤ **Clause 18:** Transactions arising out of / being part of business restructuring or reorganizations:

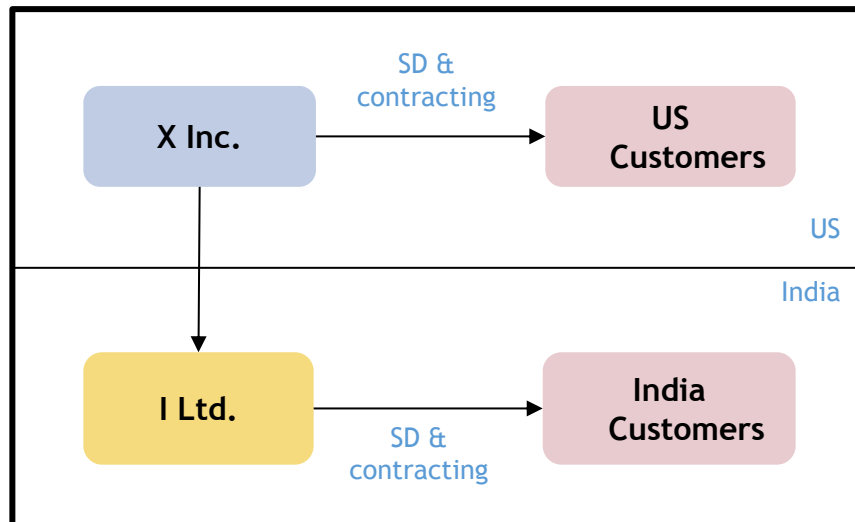
- a) Name and address of the AE with whom the international transaction has been entered into.
- b) Nature of transaction.
- c) Agreement in relation to such business restructuring/reorganization
- d) Terms of business restructuring/ reorganization

Value / Consideration - Not to be disclosed

Case study - Exit Charge

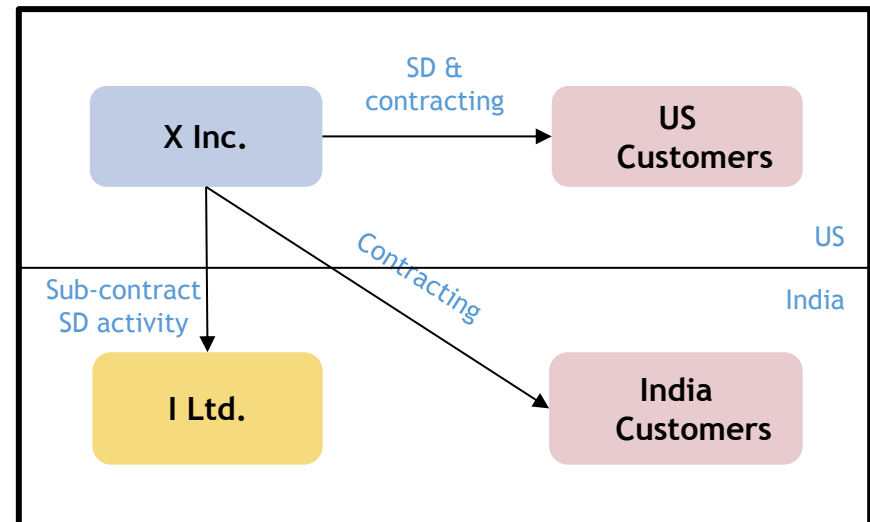
Facts - Entrepreneurial Software Developer (SD) converted to pure SD captive service provider

Scenario 1



- X Inc. - an overseas parent (performs SD and enters into contract with US customers)
- I Ltd., an Indian subsidiary - (performs SD and enters into contract with Indian customers)
- I Ltd. earns entrepreneurial margins

Scenario 2



- Post Restructuring - X Inc. enters into contract with Indian customers as well.
- X Inc. sub-contracts SD activity for the Indian customers to I Ltd.
- I Ltd. shall be compensated on a cost plus basis

Exit Charge - Issues

Issues involved

- I Ltd. - Stripped of its functions and risks - Lowering of future earning capacity - ITA might demand 'Exit Charges'
- Probable questions under audit scrutiny:
 - **upfront compensation??** (Y/N) - If 'Y', what is the **valuation approach** to be adopted;
 - What **discounting rates** are to be used for such discounting of expected future income stream; and
 - Would an **independent enterprise** have ever undergone such a restructuring.

Safeguards

- 'Contemporaneous documentation'
- Important factors from an audit defense perspective:
 - Undertake **in-depth FAR** analysis - pre and post restructuring
 - Identify **key value drivers** - basis of the profit earning capability
 - Analyse profits of Indian taxpayer **before and after the restructuring**
 - Undertake and document an **economic analysis** involving benchmarking analysis to justify the arm's length nature

Analyse whether:

- Restructuring, has any bearing on the income and profit/ loss of the Indian entity; and
- Whether the transfer of functions qualifies as a taxable event/transaction

Foreign Companies

Compliance obligations in India



India Income Tax Return filing obligation on Foreign Companies

Provisions

- The Indian Income-tax law mandates filing of Return of Income by every Company and Firm.
- **The ambit of 'company' includes a foreign company**, so every foreign company having India source income liable to file Income-tax return in India, even if appropriate taxes have been withheld at source, e.g. Royalties or Fees for Technical Services.
- Tax return filing not obliged for Foreign Company, if the income consists of specified income on which appropriate taxes have been deducted at source (**primarily interest**).
- Additional obligation to comply with TP regulations, if transactions with an AE – filing of Accountant's Report (Form No. 3CEB) and maintenance of TP documentation
- The CBDT, vide its Notifications dated 24 June 2016, has provided relaxation to non-resident from obtaining PAN for prescribed payments. However, relaxation for filing of return has not been provided as yet.

Increased Tracking and Penalties

- Non-Residents having PAN and not filing tax return can now be easily tracked by the tax authorities.
- Through Non-filer Monitoring System (NMS) Indian Tax Department has been tracking non-filers of return and taking necessary action to foster compliance.
- According to a press release issued in the context of tracking of high value transactions for all categories of taxpayers, additional Tax of INR 473.36 mio is collected and 30,68,662 New Returns are Filed in 2013, 2014 and 2015 (upto 31 March 2015) due to NMS.

Implications of non-compliance

- Stringent penal consequences - 50% of under- reported / 200% of misreported of income
- Besides penal implications for the Foreign Group entities, Indian Affiliate may also face an exposure of being considered as agent of the Foreign Group entities in the capacity of a 'Representative Assessee'.
- Under the Income-tax regulations, the assessee (i.e. Foreign Group entities) and its Representative Assessee shall be considered as one and the same.
- Accordingly, all the Income-tax compliances obligated upon the Foreign Group entities shall be required to be undertaken by Indian Affiliate.
- Failing the above, Indian Affiliate could be subjected to recovery of taxes in the like manner and to the same extent as applicable to the Foreign Group entities.



Income-tax return filing, Transfer pricing compliance and bonafide disclosures therein go a long way to reduce penalty exposure.

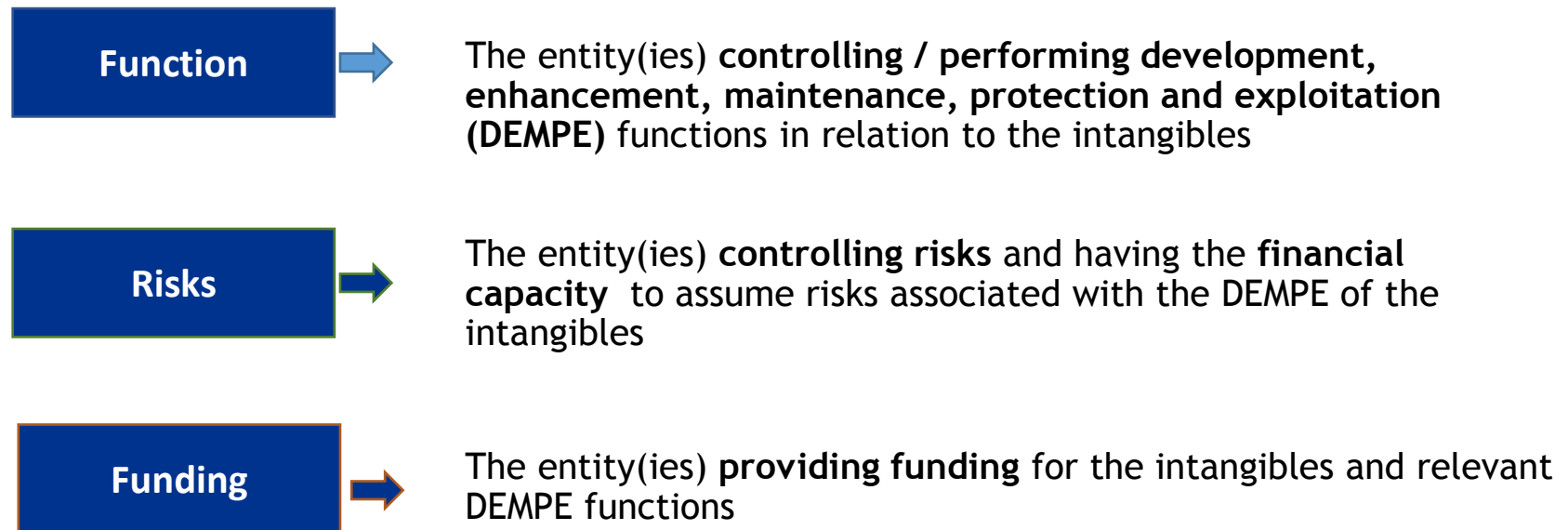
BEPS – TP update



Action Plans - 8 – 10 – Intangibles

- **Objective**
- Prevent BEPS that may result from abuse of TP rules related to cross-border relocation of intangibles and other transactions involving use of intangibles
- Ensure that transfer pricing outcomes are in line with 'Value Creation'

The entities within a multinational group which are entitled to share in returns derived by the group from exploiting intangibles are those entities making the following contributions



Action Plans - 8 – 10 – Low Value Adding Intra Group Services

LVIGS definition

- Services of supportive nature and not a part of core business of the Group
- Do not require the use of or lead to the creation of valuable and unique intangibles
- No assumption, control or creation of substantial or significant risk

The following activities are likely to meet the definition of LVIGS	The following activities would not be considered LVIGS
Accounting and auditing	Services relating to the core business of the Group
Processing and management of account receivable and account payable	R & D, manufacturing and production services
Human resource related activities	Sales, marketing and distribution activities
Monitoring and compilation of data relating to - health, safety, environment etc	Financial transactions
Information technology services	Insurance and reinsurance
Internal and external communication and public support services	Extraction, exploration or processing of natural resources
Legal services / activities relating to tax obligations / general services of administrative or clerical nature	Services of corporate senior management

Not endorsed by India in the UN TP Manual !!

Action Plan 13 - TP Documentation

CbC Report

- Objective: Prioritize Audit Issues
- Approach: Summary data by jurisdiction (revenue, income, taxes) & indicators of economic activity within

Who prepares?

Ultimate Parent who Consolidates

Master file

- Objective: Risk Assessment & Possible Exposures
- Approach: Multinational group and business details of all “material” cross-border related party transactions

What gets covered?

All transactions of ALL Consolidated

Local file


- Objective: Appropriate considerations in setting transfer prices
- Approach: Provides additional detail on the operations and transactions relevant to that jurisdiction

What is different?

Local file focus - jurisdictional nuance

Consistency Imperative for managing transfer pricing risk

CbCR Filing – Applicability in India

Applicability	Particulars	Value during the accounting year
	Consolidated group revenue for the accounting year <u>preceding</u> the reporting year exceeds	INR 5,500 Crore (in line with Action 13 threshold of EURO 750 million)

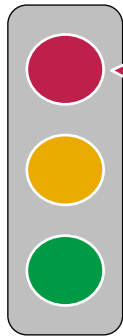
Description of applicable Forms and timelines for filing

Form No	Description	FY 2016-17	FY 2017-18 onwards
3CEAC	Intimation by Indian CE of foreign parented entity	30 January 2018	Two months prior to due date of filing CbCR
3CEAD	CbCR	31 March 2018	Within 12 months from end of reporting accounting year
3CEAE	Intimation by Indian reporting CE filing under certain circumstances	Due date has not yet been prescribed	

All documents to be e-filed with the Director General of Income-tax (Risk Assessment)

CbCR Requirements

While the primary purpose of the CbCR is to provide information to a tax authority to enable it to undertake a transfer pricing risk assessment, it is acknowledged that the data will be used to assess wider BEPS related risks.



The CbCR contains information not previously provided to tax authorities.

The country-by-country report requires aggregate tax jurisdictional information relating to the global allocation of:

The income;

The taxes paid;

Certain indicators of the location of economic activity among tax jurisdictions in which a group operates

- Listing of all the Constituent Entities for which financial information is reported, including the tax jurisdiction of incorporation, where different from the tax jurisdiction of residence, as well as the nature of the main business activities carried out by that Constituent Entity.

Tax Jurisdiction	Unrelated Party Revenue	Related Party Revenue	Total Revenue	Profit (loss) before income tax	Income tax paid (on a cash basis)	Income tax accrued - current year	Stated Capital	Accumulated Earnings	Number of employees	Tangible Assets other than Cash and Cash Equivalents
Country A	x	x	x	x	x	x	x	x	x	x
Country B	x	x	x	x	x	x	x	x	x	x
Not resident in any tax jurisdiction	x	x	x	x	x	x	x	x	x	x

Tax Jurisdiction	Constituent entities resident in the tax jurisdiction	Tax jurisdiction of organisation or incorporation if different from tax jurisdiction of residence	Activities												
			Research and development	Holding or Managing intellectual property	Purchasing or procurement	Manufacturing or production	Sales, marketing or distribution	Admin, management or support services	Provision of services to unrelated parties	Internal group finance	Regulated financial services	Insurance	Holding shares or other equity instruments	Dormant	Other
Country A	Entity A	Country B		✓											
	Entity B				✓	✓				✓					✓
Country B	Entity C		✓									✓			
	PE 1							✓							

Master file – Applicability in India

Applicability



Particulars	Value during the accounting year
Consolidated group revenue for the reporting accounting year exceeds	INR 500 Crore (USD 75 million)
And	
Aggregate value of international transactions:	
a. overall as per books exceeds	INR 50 Crore (USD 7.5 million)
OR	
b. of intangible transactions as per books exceeds	INR10 Crore (USD 1.5 million)

Time Lines



Financial Year (FY)	Time Line
FY 2016-17	31 March 2018
FY 2017-18 and onwards	30 Nov following fiscal year end in March

**All documents to be filed with the Director General of Income-tax (Risk Assessment)
E-filing procedures to be provided**

Other developments



Range concept and use of Multiple

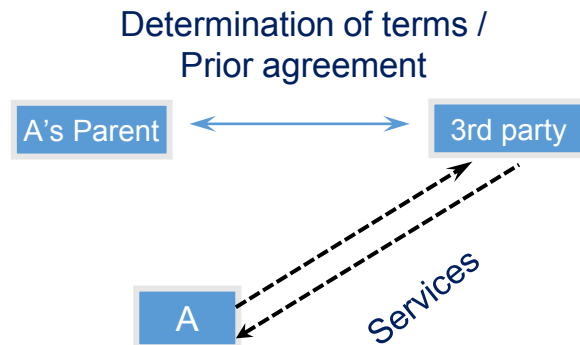
year data

- Introduction of new rules for determination of ALP, effective from FY 2014-15 onwards
 - Range of 35th to 65th percentile as against the historic “Arithmetic Mean” concept *
 - Stringent condition of minimum six comparables necessary for application of range
 - Adjustment, if any, for shortfall to be made up to Median
- Use of past 2 years comparable data allowed for benchmarking analysis, subject to conditions



Deemed International Transaction – Section 92B(2)

Earlier Provisions – Before Finance Act 2014-15

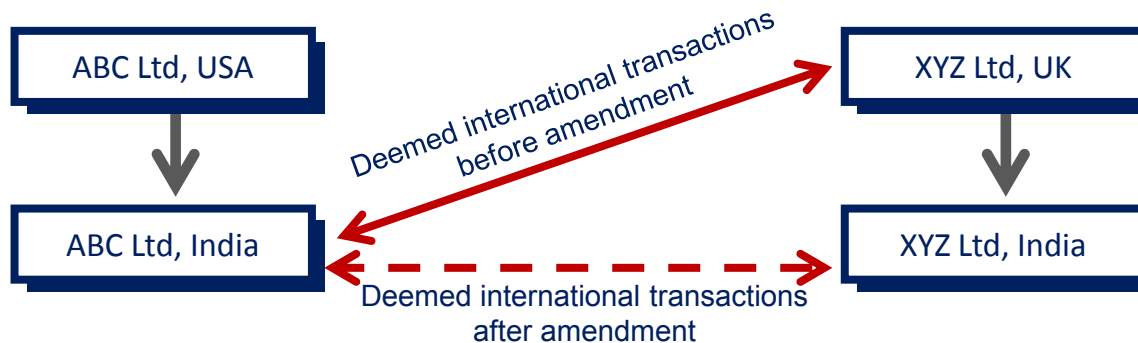


Transaction between A and Third party also subject to transfer pricing norms, if:

- a prior agreement exists between A's parent and Third party; or
- terms of transaction are determined in substance between A's parent and Third party

Earlier provisions could be interpreted to exist only if the independent person was a non-resident

Current Provisions after Finance Act 2014-15



Applies to transactions between an enterprise & an independent person irrespective of whether such independent person is non-resident or not

Case Study

ABC Inc.
(AE of ABC India)

Enters into Global arrangement for procurement of laptops

XYZ Inc.
(unrelated party)

Outside India

ABC India
(Assessee)

Procures laptop and makes payment pursuant to the global arrangement between ABC Overseas and XYZ Overseas.

XYZ India
(AE of XYZ overseas)

India

View 1 - Yes, as ABC India's transaction with XYZ India is the outcome/result of the global arrangement between ABC Inc. and XYZ Inc.

View 2 - No, since XYZ India is not a party to the agreement between ABC Inc. and XYZ Inc.

New Safe Harbour Rules (from FY 2016-17 to 2018-19)

International Transaction	Value of International Transaction (in INR) / Criteria	Safe Harbour
IT / ITES	<ul style="list-style-type: none"> Upto 100 crore Exceeds 100 crore upto 200 crore 	<ul style="list-style-type: none"> Not less than 17% Not less than 18%
Knowledge processes outsourcing services	Upto 200 crore & employee cost ratio of: <ul style="list-style-type: none"> 60% and above 40-60% Upto 40% 	<ul style="list-style-type: none"> Not less than 24% Not less than 21% Not less than 18%
Contract research and development services wholly or partly relating to: <ul style="list-style-type: none"> Software development Generic pharmaceutical drugs 	Upto 200 crore	<ul style="list-style-type: none"> Not less than 24%
Providing corporate guarantee	None	<ul style="list-style-type: none"> Commission - not less than 1% p.a. on guaranteed amount
Manufacture and export of: <ul style="list-style-type: none"> core auto components non-core auto components 	No monetary limit	<ul style="list-style-type: none"> Not less than 12% Not less than 8.5%
Receipt of low value-adding intra-group services	Upto 10 crore	<ul style="list-style-type: none"> Not exceeding 5%

New Safe Harbour Rules (from FY 2016-17 to 2018-19)

International Transaction	Value of International Transaction (in INR) / Criteria	Safe Harbour
Advancing of INR denominated intra-group loan	<p>CRISIL credit rating of AE:</p> <ul style="list-style-type: none"> • Between AAA to A or its equivalent • BBB-, BBB or BBB+ or its equivalent • Between BB to B or its equivalent • Between C to D or its equivalent • Not available and total amount of loan to AEs does not exceed 100 crores 	<p>Not less than one-year marginal cost of funds lending rate of SBI, plus</p> <ul style="list-style-type: none"> • 175 bps • 325 bps • 475 bps • 625 bps • 425 bps
Advancing of foreign currency denominated intra-group loan	<p>CRISIL credit rating of AE:</p> <ul style="list-style-type: none"> • Between AAA to A or its equivalent • BBB-, BBB or BBB+ or its equivalent • Between BB to B or its equivalent • Between C to D or its equivalent • Not available and total amount of loan to AEs does not exceed 100 crores 	<p>Not less than six month LIBOR, plus</p> <ul style="list-style-type: none"> • 150 bps • 300 bps • 450 bps • 600 bps • 400 bps

*SBI - State Bank of India

Safe Harbour Rules – Experiences

- Safe Harbour Margins - appear higher than the Arm's Length Price ordinarily computed
 - No adjustments permitted to taxpayers opting for Safe Harbour
 - No benefit of range
 - Use of different benchmarks - SBI Vs. LIBOR
 - Guarantee fees - ad-hoc Vs. benefit to borrower
 - No respite is provided from maintenance of mandatory documentation
- Exposure to possibility of economic double taxation
- Once option exercised, not allowed to opt for MAP proceedings
- Due to apprehension in various industry sectors - Government has issued instructions that Safe Harbour margins not to be followed for general Audit or APA purposes.



Tepid Response received

APA Program in India – Salient

Features

- **Types:** Unilateral, Bilateral, Multilateral - Option to get Unilateral APA converted to Bilateral / Multilateral
- **Can be entered into for:** either determining the arm's length price ('ALP') or specifying the manner in which the ALP is to be determined
- **Coverage:** Ongoing transactions as well as proposed transactions
- **Validity:** up to 5 years (renewal possible for up to additional 5 years); Rollback option available for prior 4 years
- **Pre-filing consultation:** Optional, Anonymous filing possible to gauge views of APA authorities
- **Rollback of APA:** Covers previous 4 years - withdrawal of rollback application possible
- **Specified formats:** for Pre-filing, Main APA and APA Rollback application
- The APA team may include a panel of experts such as **Economists, Statisticians, Lawyers, etc.** - if nominated by the Director General - International Taxation
- **Prescribed compliance:** Annual compliance report followed by compliance audit
- **TP audits:** no regular audits, relatively simple annual compliance audit
- **Taxpayer can withdraw/ renew** the APA application

APA is an Effective Controversy Management tool

Experiences with the APA authorities

- Pragmatic and fact-cognizant approach; cordial and non-intrusive
- Focus is on in-depth understanding of the business and the nature of the services rendered by Indian entity in the overall supply chain
- Strong emphasis on establishing and mutually agreeing on detailed analyses to mitigate subjectivity by field officers
- Flexible and open-minded to fair suggestions regarding the potential practical challenges in implementation of proposed terms in agreements
- Fair progress on ground also on Bilateral APA discussions



Penalties

Penalty provisions for cases involving under-reporting / misreporting of income (Section 270A):

Nature of default / failure	Penalty prescribed	Sample instances related to Transfer Pricing
Under-reporting of income	50% of the tax payable on under-reported income	<ul style="list-style-type: none"> • Non-maintenance of prescribed information and documents • Non-declaration of international transactions • Non-disclosure of all material facts relating to the transaction
Misreporting of income	200% of the tax payable on misreported income	<ul style="list-style-type: none"> • Misrepresentation or suppression of facts • Failure to report any international transaction / deemed international transaction / specified domestic transaction

Penalty provisions in relation to local transfer pricing compliances and documentation:

Nature of default	Penalty prescribed
Failure to furnish Accountant's Report (i.e. a form prescribed for reporting of international transactions)	INR 100,000
<ul style="list-style-type: none"> • Failure to report an international transaction • Failure to maintain prescribed information / documents • Maintenance or furnishing of incorrect information / documents 	2% of value of international transactions as determined by the tax authorities
Failure to furnish information / documents during transfer pricing scrutiny assessment	2% of value of international transaction as determined by the tax authorities

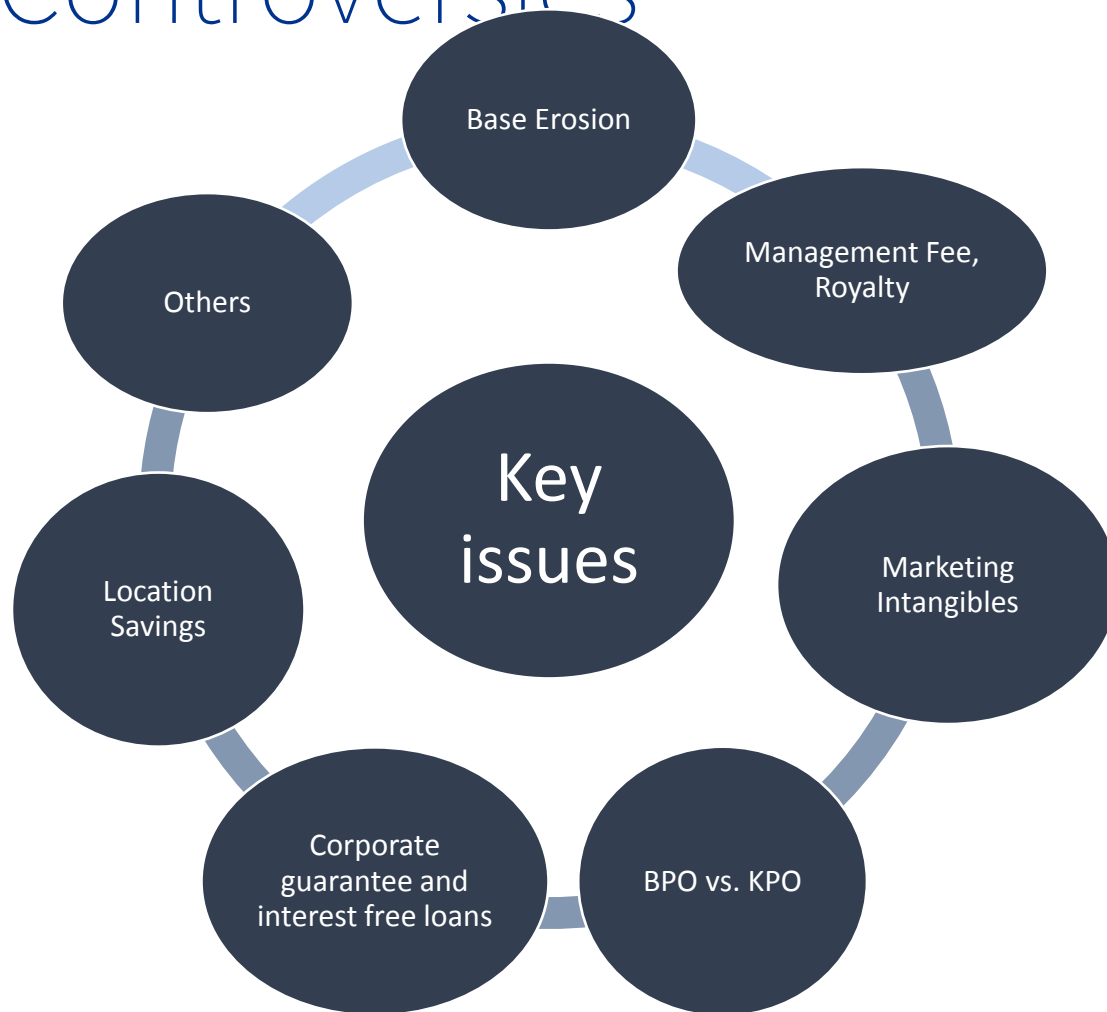
Time limit for completion of assessment proceedings

Assessment Year ('AY')	Time limit	Due Date for Completion	
		Cases not referred to TPO	Cases referred to TPO
Existing Time Limit			
2017-18	21 months from the end of relevant AY Plus 12 months in case of reference to TPO	AO order - 31 Dec. 2019	TPO order – 31 Oct. 2020; Draft AO order – 31 Dec. 2020
Proposed Time Limit as per Budget 2017			
2018-19	18 months from the end of relevant AY Plus 12 months in case of reference to TPO	AO order - 30 Sept. 2020	TPO order – 31 July 2021; Draft AO order - 30 Sept. 2021
2019-20 & subsequent AYs	12 months from the end of relevant AY Plus 12 months in case of reference to TPO	AO order - 31 Mar 2021	TPO order – 31 Jan. 2022; Draft AO order - 31 March 2022

Key IP Controversies / Issues

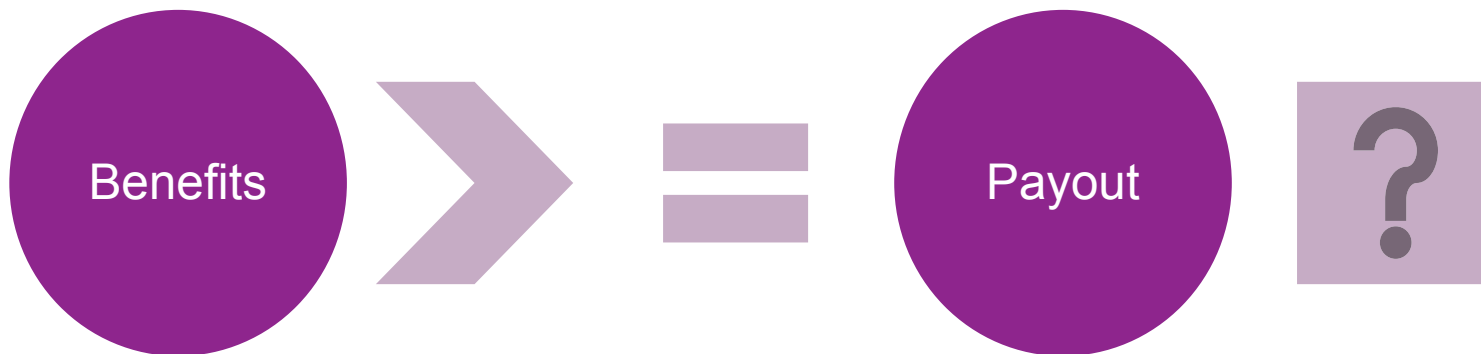


Transfer Pricing - Key Issues/Controversies



Payment for Management Fees, Royalty, etc.

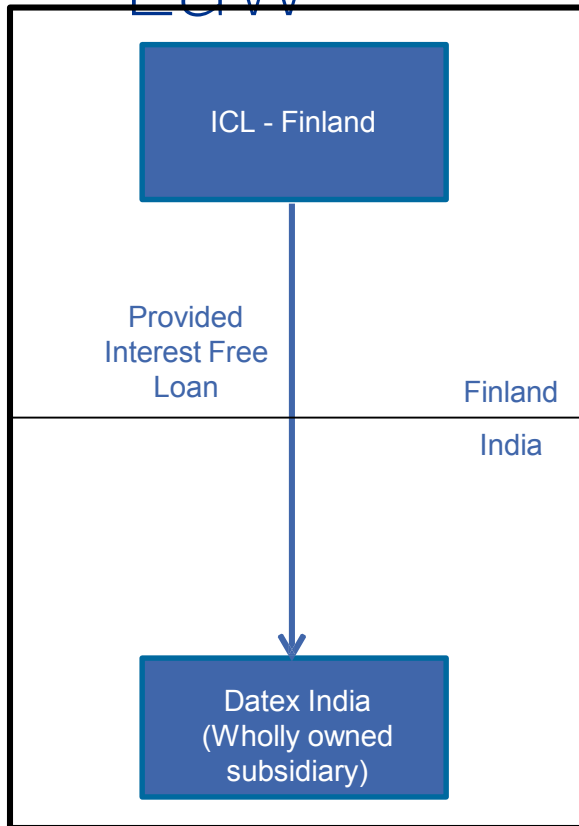
- Management fee charge-outs by AEs are investigated in great detail by the Revenue department
- Robust / exhaustive documentation requirement demanded to evidence
 - appropriateness of fee charged
 - receipt of services
 - benefits received
- Complete / partial disallowance of fee charged , if all of the above is not provided
- Revenue also enquires 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.



Base Erosion and TP – Case

Instrumentarium Corporation - Kolkatta ITAT (Special Bench) - 2016

Law



Special Bench ruling

- Sec 92(3) requires independent computation in ALP in the hands of each taxpayer and not a holistic view considering the taxpayer and its AE
- Sec 92(3) considers each year on a standalone basis
- If an ALP adjustment is made in the hands of the foreign taxpayer - the Indian AE shall not be entitled to get a corresponding adjustment in respect of the same
- CBDT circular no. 14 of 2001 is not an 'order, instruction or direction' (as referred in section 119) which binds the field officers, but is in the nature of an explanatory note providing guidance during the introduction of TP provisions in India
- 'Intent of legislature' at best comes into play only when there is ambiguity in the words of the status sought to be interpreted - which was not so in the instant case - hence no need to resort to the above Circular

Base Erosion theory' – rejected in principle - could have repercussions not only on financial transactions (i.e. loans and guarantees), but also to wider classes of transactions!!!

BPO v/s. KPO

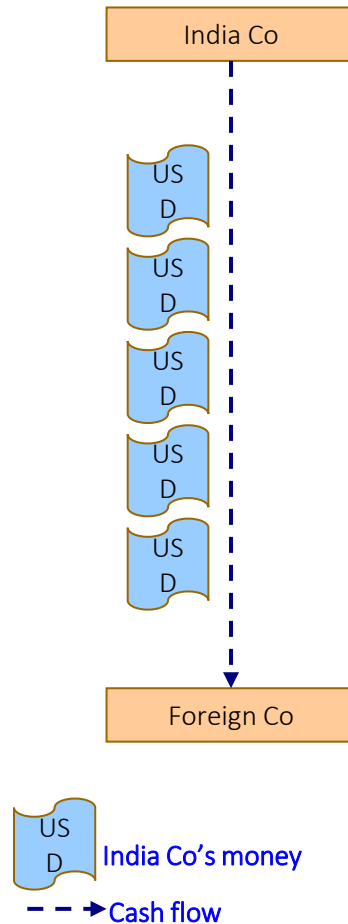
- Captive Service providers - a cost plus arrangement with mark-up between 10 to 20 percent, whereas, revenue authorities allege mark-up in the range of 25 to 35 percent
- In some case, low end back office support services ('BPO') characterized as High end Knowledge Process services ('KPO')
- High margin companies mainly providing KPO services are generally alleged as comparables (*companies such as Accentia Technologies Limited; eClerx Services Limited; etc.*)
- Loss making comparables usually rejected
- Revenue authorities allege Location Savings (low employee cost, etc.) and Location Specific Advantages (access to growing market, etc.) provided by India should be considered while carrying out comparability analysis
- Stringent Filters applied: 75 percent export turnover filter, different accounting year end, consistent loss making / diminishing revenue, turnover filter of 10 times, etc.



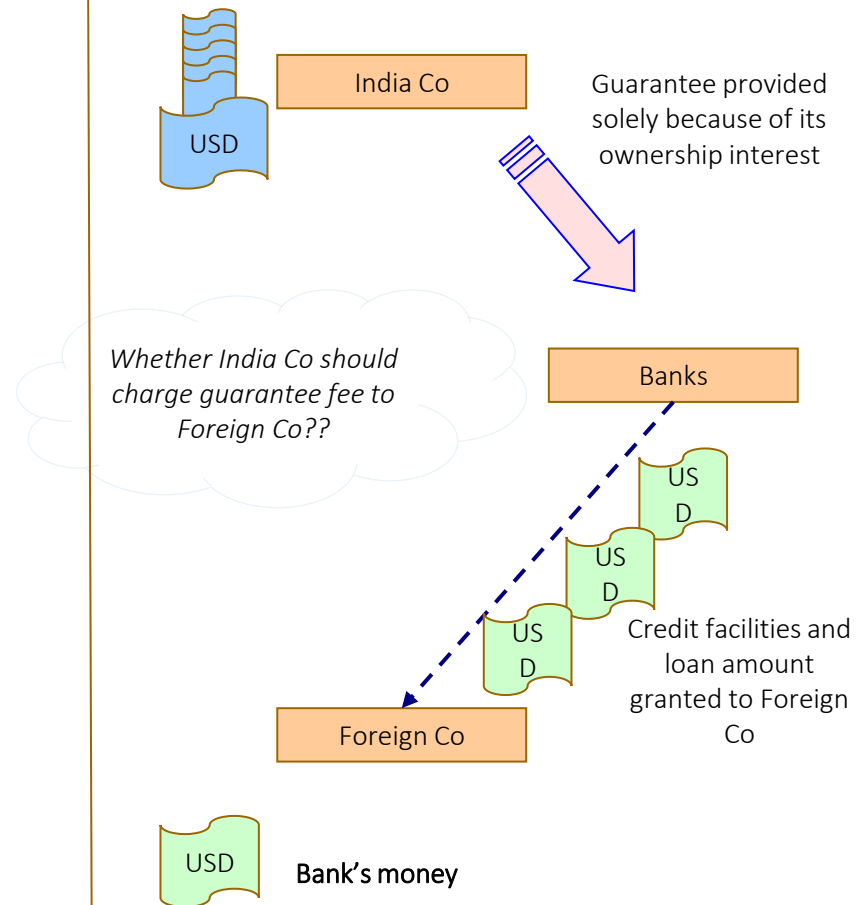
Corporate guarantee and interest free loans

- Corporate Guarantee is a legally binding agreement under which the guarantor agrees to pay any or all of the amount due on a loan instrument in the event of non payment by the borrower
- Generally, no charge for guarantee fee on the ground that there is no cost of guarantee
- At times, Comfort Letters are also viewed as Guarantee
- Granting of interest free loans has historically led to tax controversies with the Revenue authorities.

Option I – To infuse capital



Option II – To maximize cash utilization



Key points for success in Transfer Pricing audits

- Detailed Functions-Assets-Risks analysis
- Proactive Planning
- Price setting mechanisms to be documented
- 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
- Involve operational teams in tax and TP planning and documentation process
- Harmonize TP documentation with other regulatory requirements



Questions?



Thank you

CA. Bhavesh Dedhia