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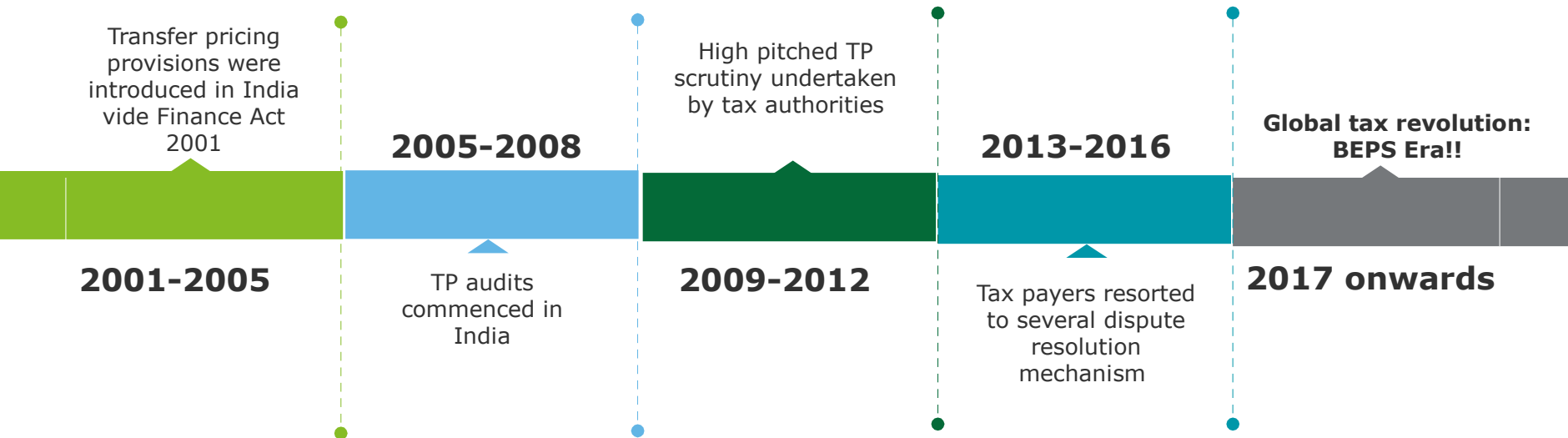
Agenda

- Evolution of Transfer Pricing in India
 - Introduction of Transfer Pricing in India
 - TP Controversies in India
 - Dispute Resolution measures
 - Amendments to TP provisions
 - Global Tax Reset – BEPS Era
- Budget 2017 updates

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Evolution of Transfer Pricing in India

Story so far...



TP introduction

Indian TP vs. OECD Guidelines

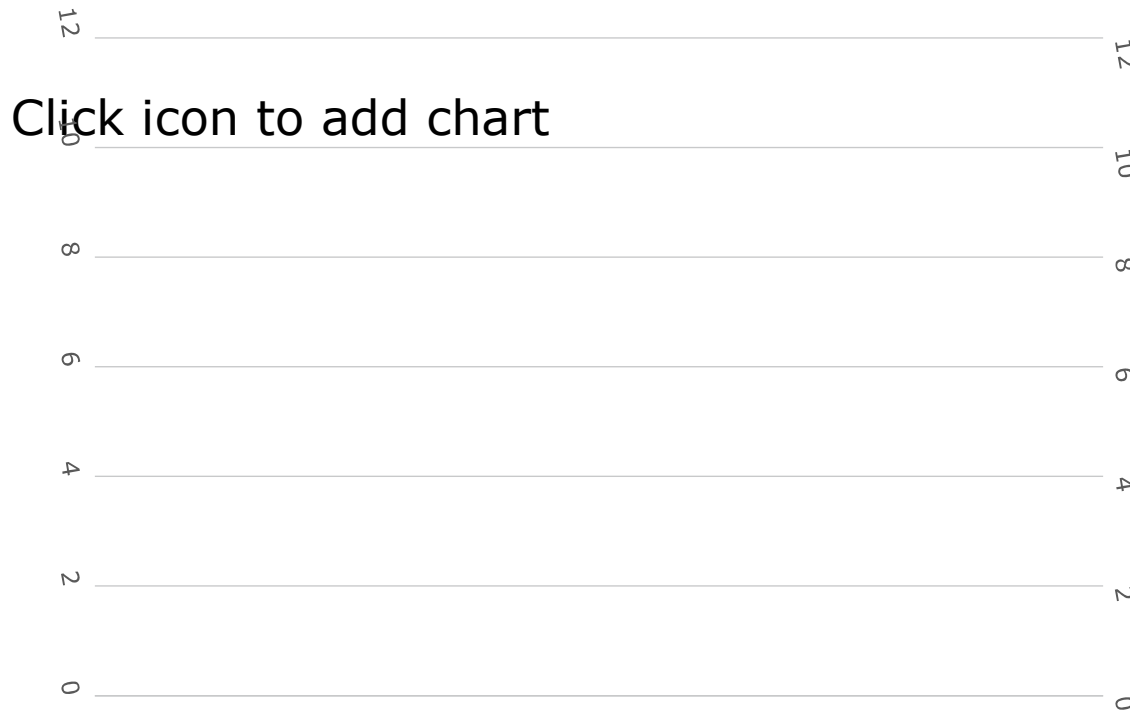
Snapshot view

Concepts	Indian regulations	OECD Guidelines
Associated Enterprise	Very wide definition	Restricted to control entities
Comparable range	Erstwhile allowed arithmetic mean concept (+/- 5%/ 3% range band on avg. results of comparables) Currently have introduced range concept (35th – 65th percentile)	Allows for range of comparable data
Multiple year data	Only allows data of current year (and earlier 2 years under limited circumstances)	Permitted
Foreign comparables	Not permitted in practice	Permitted
Priority of methods	Most appropriate method rule	(Originally) preference for traditional methods
Use of unspecified method	Introduced 'Other method' in 2012	Permitted
Documentation	Stringent	Prudent business principles

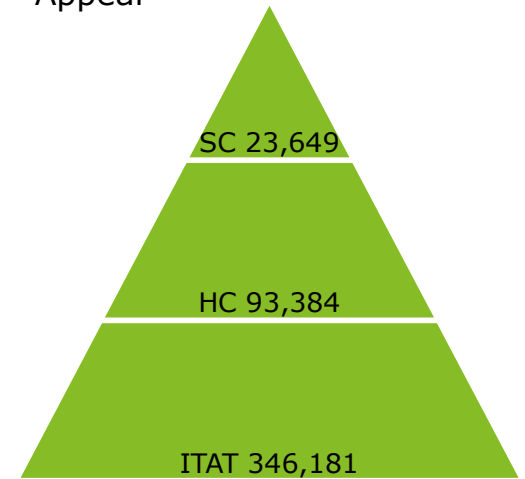
TP controversies in India

India Transfer Pricing (TP) disputes

Increasing Trend of TP litigation



No. of Cases Pending in Appeal



*using exchange rate 1\$ = Rs.65

Key Transfer Pricing controversies in India

In the era from 2005-2008

Key Transfer Pricing controversies in India

In the era from 2008-2012

Rationalisation of cases picked for TP scrutiny!!

In October, 2015, CBDT issued guidelines which focussed on risk based TP assessment and laid down the revised procedures for assessment thereby reducing litigation on mundane issues

Dispute resolution measures

TP Audit Process

Time frame

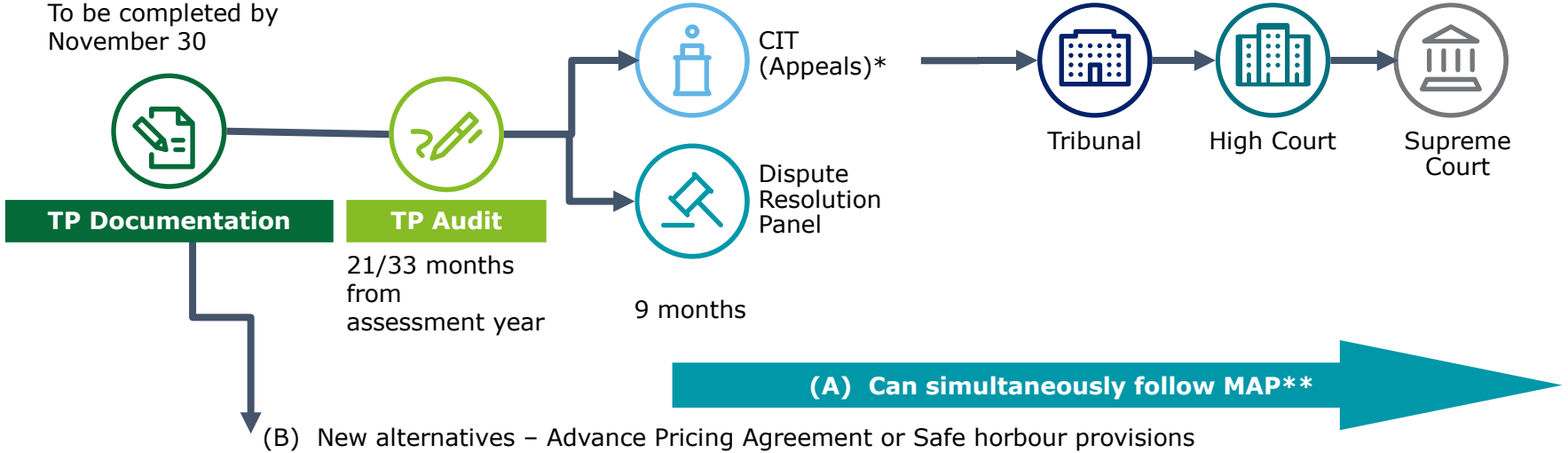
Minimum 13 years span for final resolution

Conducted by members of the Indian revenue

Conducted by independent judiciary

Varies, normally 2 years

To be completed by November 30



* CIT(Appeals) – Commission of Income-tax (Appeals)

** MAP – Mutual Agreement Procedure

Mutual Agreement Procedure

- MAP is an alternative available to taxpayer for resolving disputes giving rise to double taxation whether juridical or economic in nature
- Alternative solution for ongoing TP adjustments
- Relationship of the two competent authorities is a driving factor
- Time taking process
- No relief from interest on outstanding taxes
- No user fee/ application fee to be paid to the Indian government
- Relatively slow process and India does not have MAP clause with many countries

India MAP Scheme – Story so Far

- 250 disputes resolved under MAP with US, UK, Japan and China
- Approximately INR 10000 crore tax disputes resolved
- Successful MAP resolution paved the way for Bilateral APA with the US

Advance Pricing Agreement

- Agreement between taxpayer and Central Board of Direct Taxes to determine arm's length price (ALP) or to specify the manner for determination of ALP
- ALP may be determined under any method, whether prescribed or not
- Legally binding on both parties, except in case of any change in law or facts
- Validity – Maximum period of 5 consecutive years and for a period not exceeding 4 previous years
- APA to be void in case of fraud, misrepresentation – regular provisions apply
- Tax authorities get additional time, in case APA is declared void
- APAs concluded are in diverse sectors like telecom, oil exploration, pharma, finance/banking, software development and BPOs, covering international transactions, such as interest payments, corporate guarantees, contract manufacturing, trading and IT/ITeS services.

The total number of concluded APA agreements is now 152 (141 Unilateral and 11 Bilateral)

Particulars (FY)	Unilateral	Bilateral	Total
2013-14	5	0	5
2014-15	3	1	4
2015-16	53	2	55
2016-17	80	8	88
Total	141	11	152



Safe Harbour Rules

- A mechanism under which tax authorities accept the transfer prices declared by taxpayers under certain circumstances without undertaking detailed audit
- Applicability – Beginning assessment year 2013-14 and four assessment years immediately following that assessment years
- The taxpayer is required to maintain transfer pricing documentation and furnish Form no.3CEB irrespective of the fact that the taxpayer opts for safe harbour provisions
- No comparability adjustments and benefit of arm's length range would be available to the transfer price declared while opting for safe harbour rules
- No benefit of safe harbour provisions - where transactions entered into with associated enterprises domiciled in a "No tax or low tax country or territory
- The Government intends to slash safe-harbour margins to align them with market rates*

Safe Harbour Rules – Rationalization Expected

* - www.businessstandard.com

APA, SHR, Litigation Process – A comparison

Criteria	APA	SHR	Appeal
Time frame	Can take 1.5 to 2.5 years for a unilateral APA	6 to 8 months from the end of month in which application filed	Can range from 7 to 12 years, depending upon level
Approach	More scope for negotiation/compromise	No scope for negotiations	Legalistic approach, no negotiations
Taxpayer involvement	Significant involvement. Proceedings take place in presence of company and its advisors	Moderate involvement limited to proving eligibility	Significant involvement. Proceedings take place in presence of company and its advisors
Binding nature	Binding in nature post finalization and signing of the agreement	Binding in nature post finalization and signing of the order, for the period mentioned in order	Binding, but sequential appeals can be made to higher judicial authorities
Double tax mitigation	Only in case of bilateral/multilateral APA	Double tax exposure since MAP procedure cannot be invoked	Double tax exposure if appeal is against taxpayer
Collection of taxes	Not applicable	Not applicable	Stay of demand at the discretion of the Revenue and Appellate Authorities
Finality	Agreement binding on taxpayer as well as Revenue, once it is finalized	Once application is accepted, finality in respect of relevant year	Revenue can prefer further appeal if order is in taxpayer's favor

Amendments to TP provisions

Amendments to TP provisions

- **Detailed definition of 'international transaction' which includes capital financing transactions** such as:
 - Long-term or short term borrowing;
 - Lending;
 - Guarantee;
 - Purchase or sale of marketable securities;
 - Any type of advance, payments or deferred payment or receivable
 - Any other debt arising during the course of business.
- **Introduction of 'use of multiple year data' and 'range concept'**
 - Amendment made in Rule 10B(4) and insertion of new sub-rule 10B(5) allowing multiple year to be used for comparability purposes
 - Insertion of New Rule 10CA for adoption of range concept:-
 - The range concept is applicable when application of MAM results in more than one price;
 - It shall be used only in case the method used for determination of ALP is TNMM, RPM or CPM. Thus, this concept is not applicable in case of Profit Split method and Any Other Method; and
 - A minimum of six entities are required to be selected as comparable of tested party;

Other amendments

Specified domestic transaction

- Finance Act, 2012 extended the TP provisions to SDT wherein, the tax payers having aggregate specified domestic transactions as mentioned below in excess of Rs. 5 crore (now increased to Rs 20 crores) in a previous year would need to comply with transfer pricing provisions.
 - Expenditure for which payment is made or to be made to domestic related parties (Finance Act 2017 has excluded the said transaction w.e.f. 1-4-2017)
 - Tax Holiday/ Deductions claimed by the taxpayer
 - Transfer of goods or services between various businesses of same taxpayer
 - More than ordinary profits derived from transactions with closely connected persons

• Deemed International Transaction

- The erstwhile definition of 'deemed international transaction' led to a doubt whether or not, for the transaction to be treated as an international transaction, the unrelated person should also be a non-resident.
- Therefore, Section 92B(2) of the Act was amended to provide that where, in respect of a transaction entered into by an enterprise with a person other than an associated enterprise, there exists a prior agreement in relation to the relevant transaction between the other person and the associated enterprise or, where the terms of the relevant transaction are determined in substance between such other person and the associated enterprise, and either the enterprise or the associated enterprise or both of them are non-resident, then such

Global Tax reset – BEPS Era

Global Tax Revolution !

Currently MNCs are facing a number of new challenges including:



“These companies have pushed the envelope on reasonableness. They play games. They string us along. They believe we can be stooged.....enough is enough”

This new global tax environment has resulted in the following actions – a Global Tax Revolution:

“We are ruling the line under these protected negotiations, proceedings, immediately to raise assessments and creating liabilities in these cases”

Discourage MNCs that are aggressive in tax planning and make them a little bit more moderate and measured

Company's reaction on BEPS

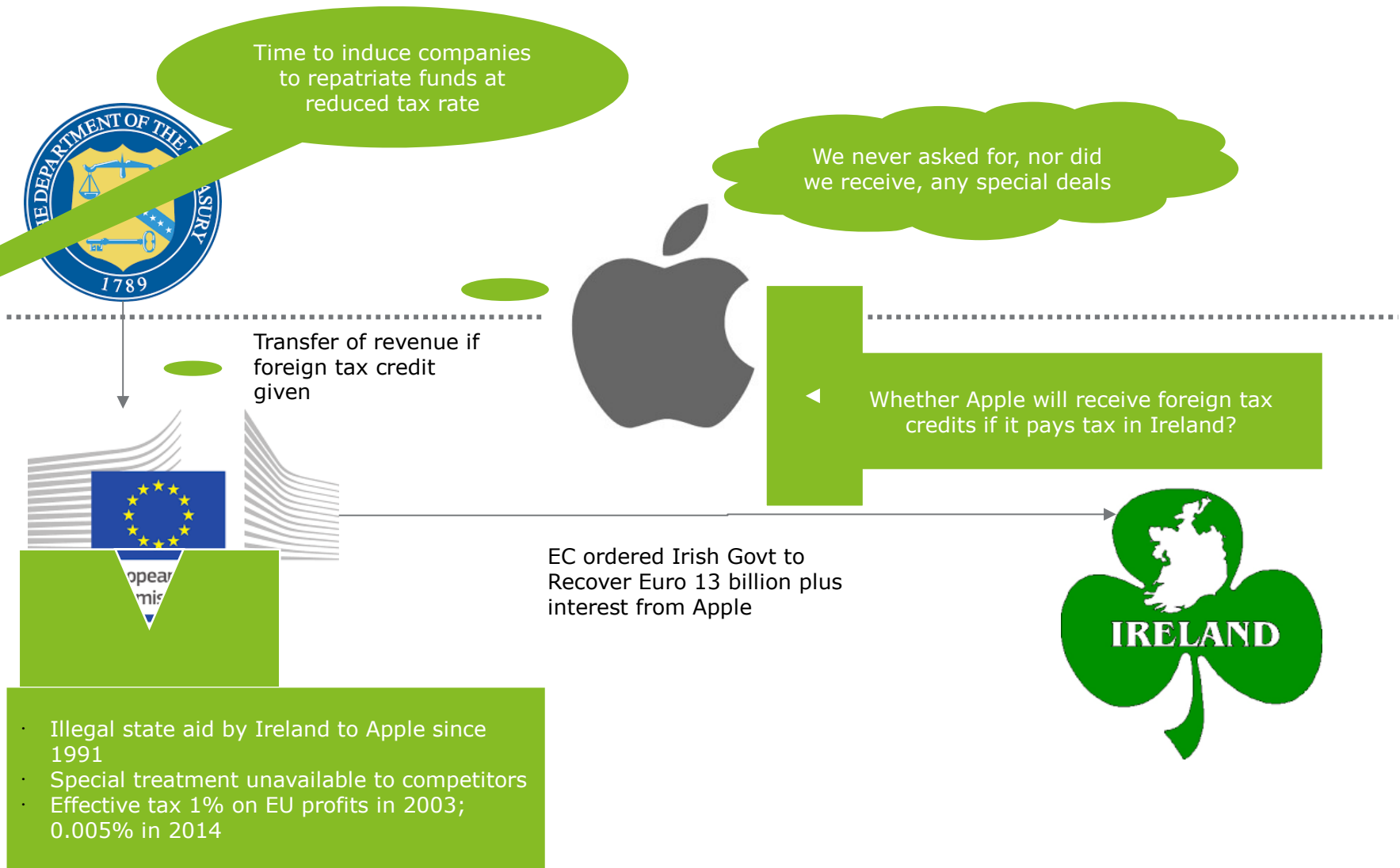
"Hiding things doesn't make sense. You can't. That is not the role of modern tax function, nor it has ever been"

"We all are disclosing information to the tax authorities, but have reservation about having to disclose what is essentially 'raw state' information to the public"

"It takes increased dialogue to explain BEPS to people who are not tax experts and to give their feedback and involvement is essential for many reasons, including the facilitation of accurate communication with external stakeholders"

"It's a business's worst fear when the tax authority publicly claims that your business was involved in a tax avoidance scheme. What should companies do when the authorities get it wrong?"

Apple Story



Facebook Story



"Facebook transferred intangibles to an Irish Subsidiary as part of a 2010 restructuring"



"Facebook's tax adviser had severely undervalued the intangibles involved in the restructuring"

The EU is targeting at least 350 companies, many of them American, identified in the so-called LuxLeaks documents and other public tax commissions in the US and UK, including Amazon, Google and Starbucks

Action 8 - Intangibles

BEPS Action Plan 8

Identification of Intangibles

An intangible is something which

- Is not a physical asset or a financial asset
- Is **capable of being owned or controlled** for use in commercial activities, and
- Whose **use or transfer would be compensated** had it occurred in a transaction between independent parties in comparable circumstances

Examples

Intangibles for TP Purposes	Not Intangibles for TP Purposes
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Patents	Group Synergies
---------	-----------------

Know-how and trade secrets	Market specific features
----------------------------	--------------------------

Trademarks, trade names and brands	Assembled workforce
------------------------------------	---------------------

Rights under contracts and government license	
---	--

Licenses and similar limited rights in intangibles	
--	--

Goodwill and ongoing concern	
------------------------------	--

Finance Act, 2012 India has adopted (retrospectively from AY 2002-03) an expanded definition of 'intangible property' covering ten different kinds of intangibles - marketing, technology, artistic, engineering, customer, location, human capital and a few others - and as if that was not enough, a residual clause covering 'any other item deriving its value from intellectual content' is also provided.

BEPS Action Plan 8

Ownership of intangibles and transactions involving DEMPE functions

Six-step analytical framework for transactions involving use or transfer of intangibles

Identify the intangibles and economically significant risks with specificity

Determine contractual arrangements between AEs

Identify the parties performing functions, using assets and managing risks related to Development, Enhancement, Maintenance, Protection, Exploitation (DEMPE)

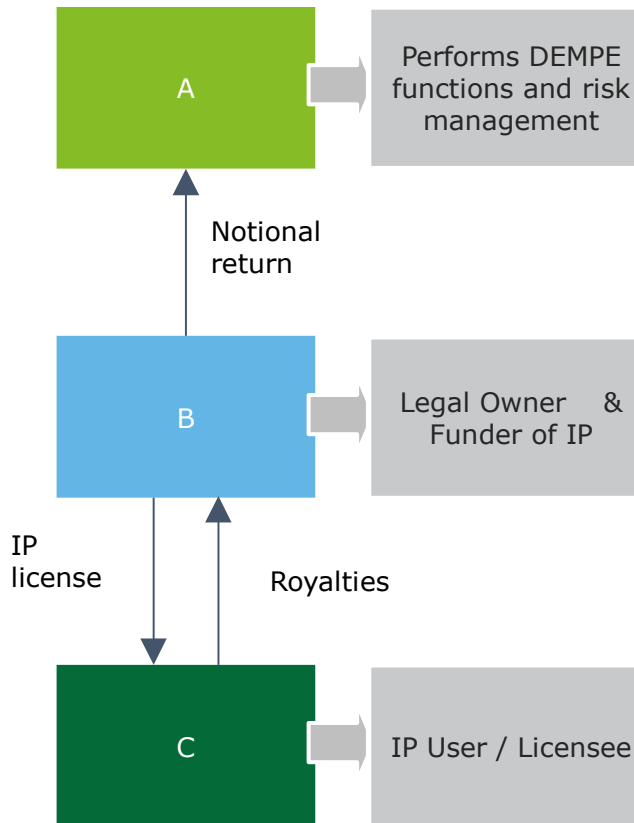
Interpret the outcome of step 1-3 and determine whether the contractual assumption of risk is consistent with actual conduct.

Where the party assuming risk does not control the risk or does not have the financial capacity to assume the risk, apply specific guidance on allocating risk

Determine ALP for transactions consistent with each party's contribution of functions performed, assets used and risks assumed

BEPS Action Plan 8

Example 1



TP outcomes from this example under the new TPG:

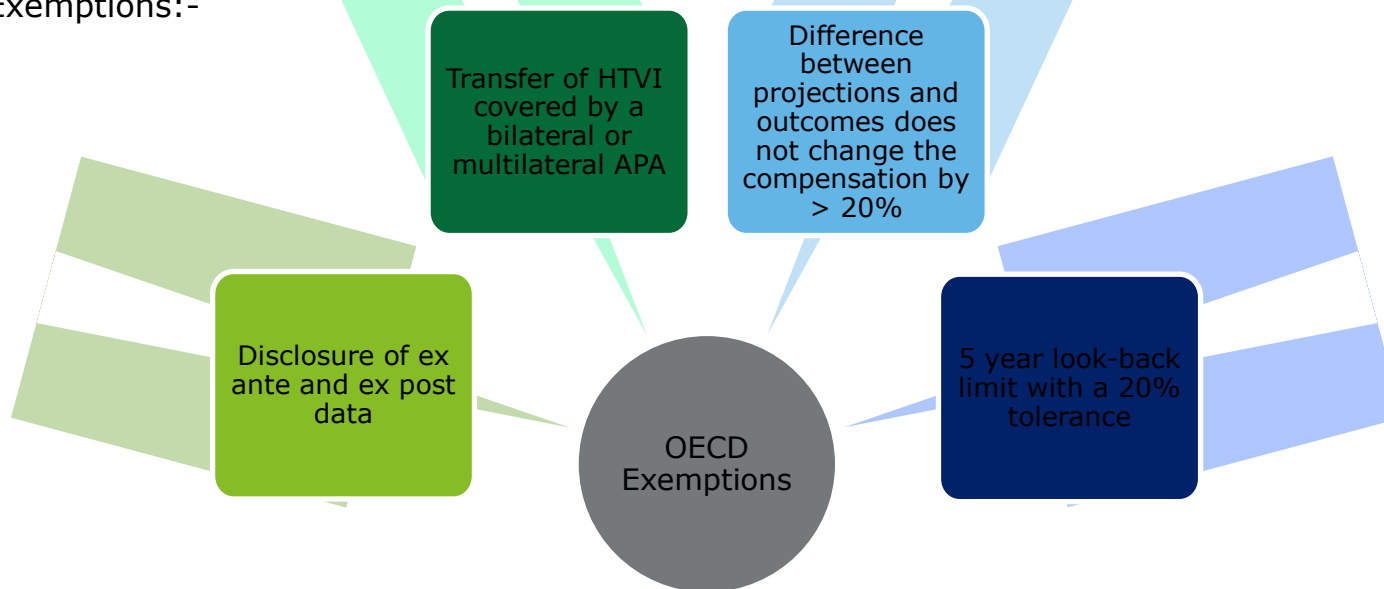
- As legal owner of the IP, B receives royalties from C, in return for granting C the right to use the IP
- A is entitled to a notional return from B – the legal owner – for the performance of DEMPE functions and risk management
- If B only funds the IP and assumes no control over A's DEMPE functions **or risk management (including funding risk)**, B is only entitled to a risk-free return
- For transfer pricing purposes, A is entitled to all of the returns from exploitation of the IP above the risk free return

Hard-to-value intangibles (HTVI)

What is HTVI

- Intangibles for which no reliable comparables exist
- Financial projections or other assumptions for valuation are highly uncertain (e.g. R&D done by pharmaceutical companies)

- Ex post (actual) outcomes can be considered to assess the reliability of the information on which ex ante (anticipated) pricing is based
- If a taxpayer cannot demonstrate that pricing is based on thorough analysis, the ex post outcome will be used as presumptive evidence of appropriateness of ex ante pricing arrangements
- OECD Exemptions:-



BEPS Action Plan 8

Practical Challenges

- What is value creation ?
- More than one entity performing DEMPE function
- DEMPE analysis will put pressure on defining the correct intercompany pricing
- Difficult to find comparable independent parties undertaking DEMPE function
- Undertaking price adjustment in case of non availability of independent comparable companies
- Legal owner of intangible to earn risk free return – Whether the same is comparable to loan transaction?
- Circular 6/2013 – Allocation of routine cost plus – whether arm's length?
- Divergent views in relation to treatment of intangibles as international transaction
- Hard to value intangibles – Practical application?

Action 9

Aligning Transfer Pricing Outcomes with Value Creation (Risk and Capital)

What does Action-9 contain?

- Action 9 replaces OECD's "Guidance for applying the arm's length principle" (contained in Section-D of Chapter-I of OECD 2010 Guidelines)
- The report provides guidance on following:

Transaction reflects Economic Reality

Business transaction to reflect alignment between contractual arrangement and economic reality

Substance in Capital Funding

Capital without functionality will generate "risk free returns"
No premium returns to "Cash boxes"



Risk vis-à-vis Actual Decision Making

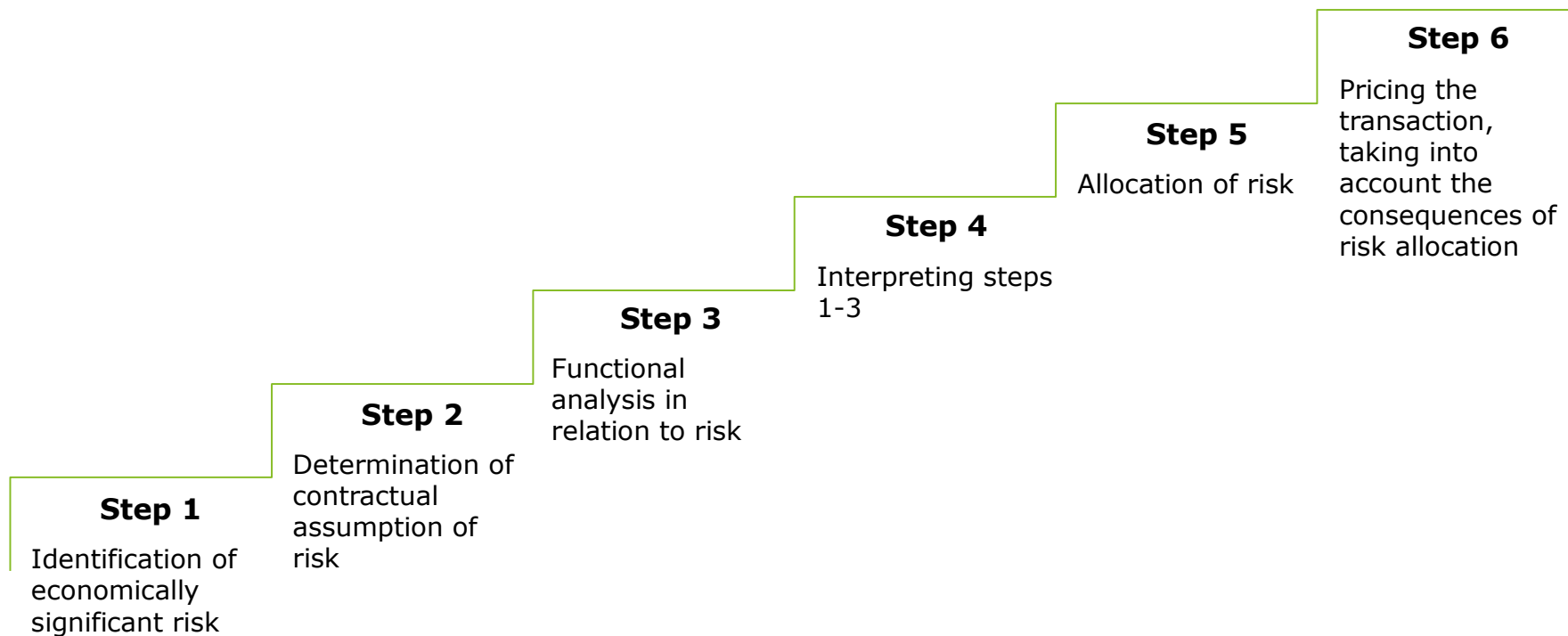
Contractual allocation of risk respected only if supported by actual decision making

Guidance to Tax Authorities in peculiar situation

Transaction can be disregarded for exceptional circumstances of commercial irrationality

Guidance on application of the ALP

6 step analytical framework for risk analysis



Implications on transfer pricing structure

- Not all arrangements have written contracts
- Practically difficult to provide actual conduct v/s contractual arrangement
- Review transfer pricing policies which is merely based on the contractual arrangements and legal ownership
- Implications on transfer pricing structure
 - Accurately define transactions
 - Analyze contractual risk vis-à-vis risk taking abilities and decision making
 - Analyze contractual relations vis-à-vis actual conduct of the parties
 - Substantiate value created by the group entities in various countries to support their transfer pricing

Is Action 9 old wine in new bottle?

Action 10

Other high risk transactions

Low value adding intra-group services

Definition

1. Characteristics

Intra-group services are:

- Supportive in nature
- Not a part of core group business
- Can be principal business activity of the service provider
- Do not require unique/valuable intangibles
- Do not lead to creating of unique/valuable intangibles
- Do not involve or give rise to significant risk

2. Examples

- Accounting & auditing
- Processing and management of debtors/creditors
- Activities in connection with human resources
- Information technology support services
- Internal and external communications and public relations support
- Legal, administrative, tax compliance and other clerical services

3. Exceptions

- Services constituting core group business
- Research & development
- Manufacturing and production
- Purchasing, sales, marketing and distribution
- Financial transactions
- Extraction, exploration or processing of natural resources
- Insurance/ reinsurance
- Services of Corporate Senior management

Cautions that if a company's activities do not qualify for the simplified method, it should not be assumed that such activities should generate high returns

Low value adding intra-group services

Simplified determination of arm's length charge

Application of benefits test

- An obligation to pay for an intra-group service arises only when benefit test is satisfied
 - the activity enhances or maintains the commercial position of the service recipients
- Benefit test for low value-adding services may require greater efforts than the amount of charge warrants
- Certain documentation and reporting requirement should be considered sufficient to evidence benefit test of low value adding services

Threshold limit

- Application of a threshold limit has been suggested to enable a review
- On exceeding the threshold limit, a full functional and comparability analysis including the application of benefits test to specific service charges may be called for

Low value adding intra-group services

Indian perspective

- Payment of management/HO services considered as one of the high risk areas
- Satisfaction of benefit test – navigating mix judicial pronouncements.
- Helpful for taxpayers especially where it is difficult or costly to provide evidence to support charges across a wide number of jurisdictions
- Mark-up of 5% on services rendered from India – Acceptable ?
- Withholding tax – on full cost vis a vis markup
- Considering the litigation background in India and the present form / definition of low value adding services, the suggested approach not likely to be adopted from an Indian perspective.

Action 13

Transfer Pricing Documentation and Country-by-country Reporting

BEPS Action 13 recommendations

BEPS Action 13 proposes a new three tier global standard for transfer pricing documentation. The text in green represents additional information required under the new documentation model as compared to current OECD guidelines



Master File



Local File



Country by Country template

Evolution of existing transfer pricing documentation requirements

- Group wide description including supply chain, value drivers, main markets, high level functional analysis, details of business changes
- High level description of IP strategies, IP location and R&D management and location
- High level description of group financing arrangements
- **Consolidated group accounts**
- Description of APAs or other rulings

- Transactional/entity specific
 - Local management structure, detailed functional analysis, economic analysis and **reconciliations of TP to accounts**
 - Local documentation nuances continue?

A new requirement

- Revenue
- Profit before tax
- Cash tax paid
- Current Tax Accrual
- Capital and retained earnings
- NBV of tangible assets
- Number of employees
- Complete list of entities and PE's for each country, with activity codes to be attached to template

Objectives



Ensure consideration of transfer pricing requirements

Transfer pricing risk assessment



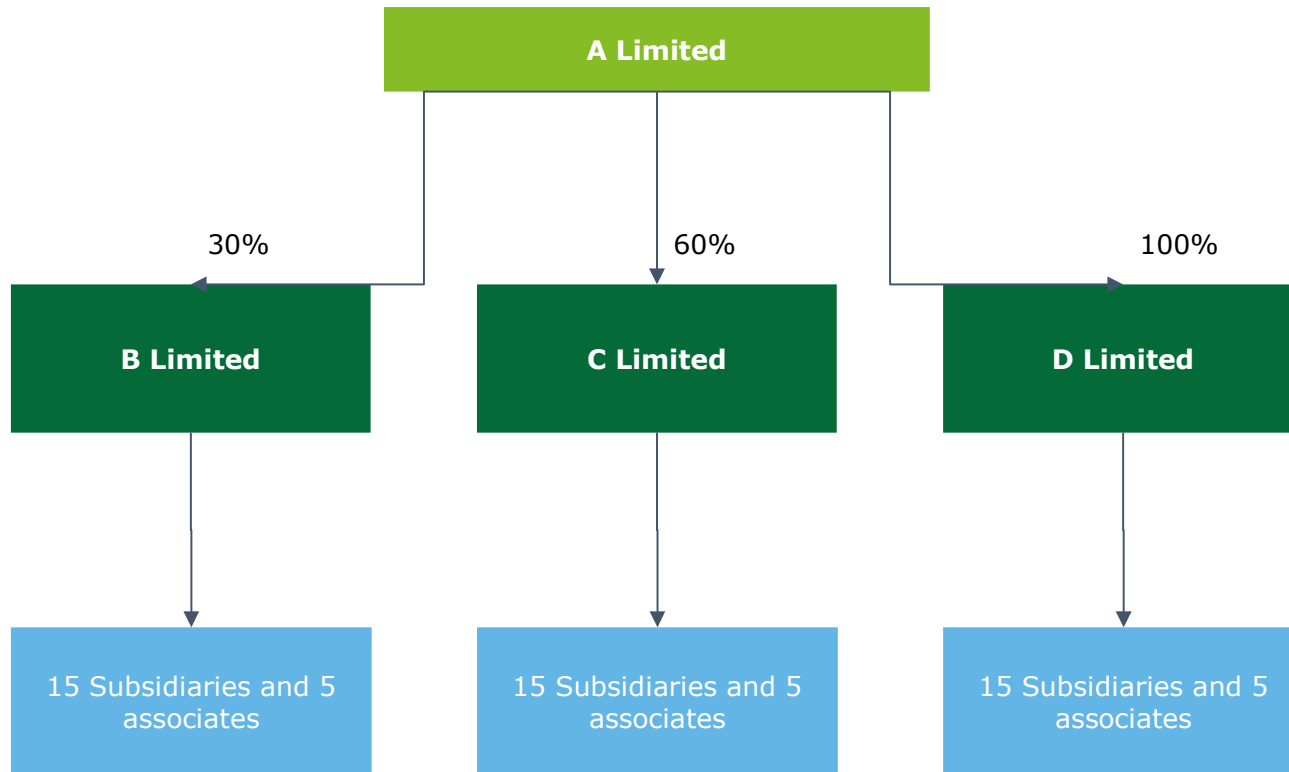
Transfer pricing audit

Introduction

BEPS Action 13 documentation requirement introduced in India

Requirements	Timeline	Threshold	Penalty
<ul style="list-style-type: none">– CbC Reporting– Master File	<ul style="list-style-type: none">– CbC report to be filed in prescribed format on or before due date of filing return of income– Effective from Assessment Year 2017-18 (Financial Year 2016-17)	<ul style="list-style-type: none">– International group has consolidated revenue exceeding € 750 million (in line with BEPS)– Threshold in Indian currency – to be computed based on exchange rate as on the last day of previous year. E.g. Threshold for FY 2015-16 - ₹5,632 crores (exchange rate as on 31 March 2016 – 1EURO=Rs.75.09)	<ul style="list-style-type: none">• Graded penalty structure from ₹5,000 to ₹50,000 per day for:<ul style="list-style-type: none">– Non-furnishing of CbC report– Non- submission of required information• Penalty of ₹500,000 for:<ul style="list-style-type: none">– Furnishing of inaccurate particulars– Non-furnishing of master file data

Scenario 1- CBC reporting



For the respective entire step down overseas structures under B Co, C Co and D Co, who would be the “reporting entity” in India for the purposes of CbC report, namely whether it would be A Co, being the ultimate parent entity; or B Co and/or C Co and/or D Co?

CbCR and master file – points to ponder

- To reconcile the data furnished in the CbC report with the consolidated financial statements?
- Whether CbCR has to be certified by a Chartered Accountant?
- Monetary threshold for the preparation and filing of master file in India?
- Is master file required to be maintained (as TP Documentation) or needs to be filed with the tax authorities by prescribed date?
- Whether Trusts and LLP's are included in the definition of constituent entities?
- In case a constituent entity is involved in two or more business activities, then how do we determine the main business activities or whether all business activities are to be disclosed?

Points to ponder

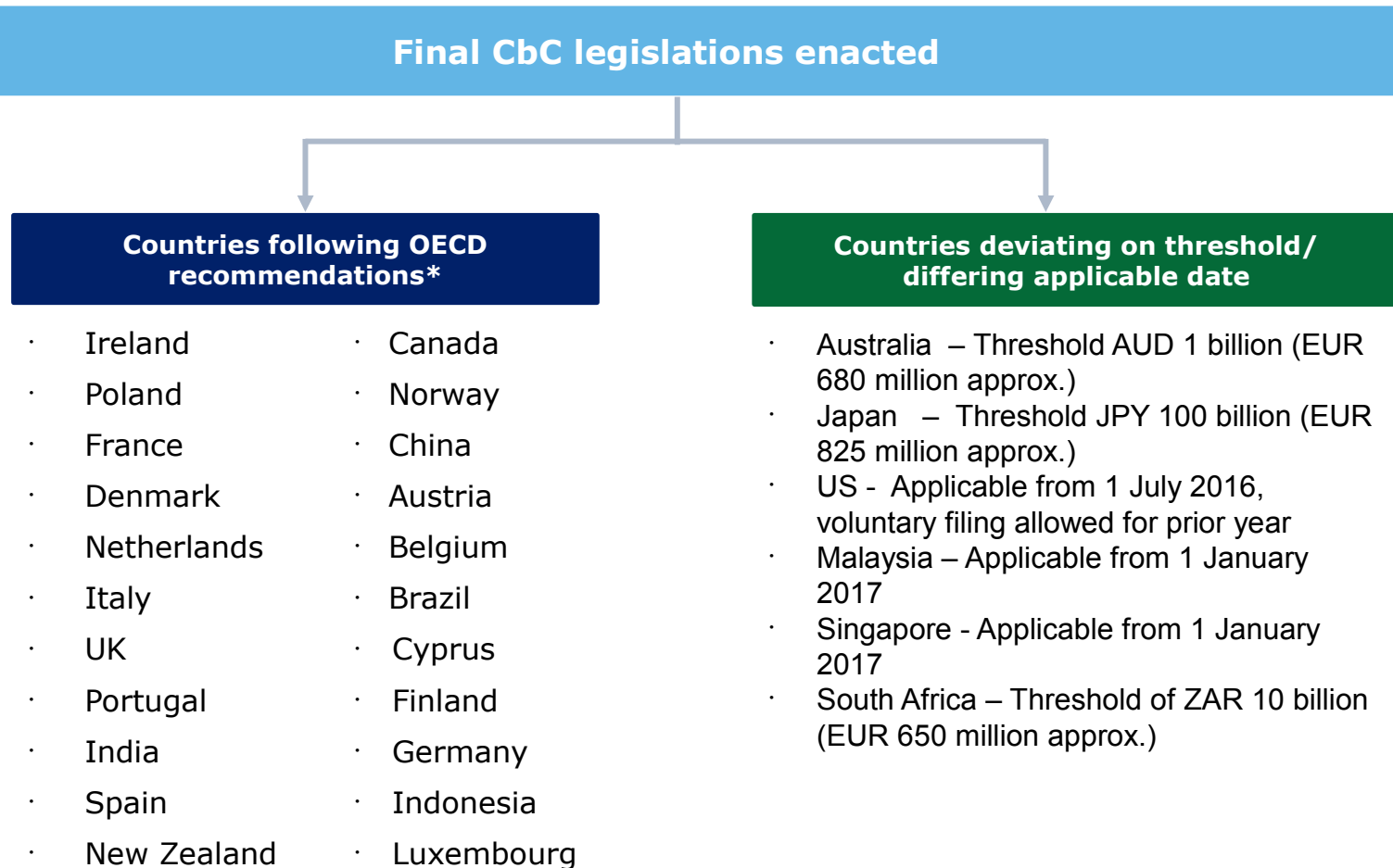
- CbC XML Schema – Automatic exchange of CbC reports
- Master file – Compilation of business functions, allocation of risk, threshold & detailed rules awaited
- Determination / exemption of reporting entity for CbC reporting
- Consideration for Trusts, LLPs and Branches
- Gap year analysis – e.g. US
- Application of BEPS Action plan(s) by tax jurisdiction
- Moving towards formulary apportionment?

“Proper systems will be put in place. Assessee need not be scared of how the information will be used. Not everyone will get this information and we will follow best practices. It will not fall into the wrong hands.”

Global updates on AP 13

Actions Plan 13: Transfer pricing documentation

Global perspective - CbC reporting implementation



* Threshold of EUR 750 million and CbC filing for Fiscal year beginning on or after 1 January 2016

Actions Plan 13: Transfer pricing documentation

Global perspective – Master File implementation – Final rules

Country	First year applicability	OECD MF required	Threshold
Australia	1 Jan 2016	Yes	Global AUD 1 billion turnover (EUR 685 million approx.)
Austria	1 Jan 2016	Yes	EUR 50 million turnover is exceeded for two consecutive fiscal years
Belgium	1 Jan 2016	Yes	Staggered threshold – 3 levels
China	1 Jan 2016	Yes	Related party transactions over CNY 1 billion (EUR 137 million approx.) or if foreign headquartered has prepared a Master File
Denmark	1 Jan 2017	Yes	No threshold – to be prepared by all taxpayers
Finland	1 Jan 2017	Yes	Staggered threshold – 3 levels
France	Already required	No, Existing rules	More than EUR 400 million of gross annual turnover or gross assets
Germany	1 Jan 2017	Yes	Revenues in the previous fiscal year exceeded EUR 100 million
Greece	Already required	No, Existing rules	Annual IG transactions exceed 100k for small companies and 200k for large companies
Indonesia	1 Jan 2016	Yes	Staggered threshold – 4 levels
Italy	Already required	No, Existing rules	Not mentioned
Japan	1 April 2016	Yes	¥100 billion turnover (EUR 815 million approx.)
Korea	1 Jan 2016	Yes	Annual sales revenue of KRW 100 billion (EUR 80 million approx.) or more and intercompany transactions of KRW 50 billion or more
Mexico	1 Jan 2016	Yes	686,252,580 Mexican pesos turnover (EUR 31 million approx.)
Netherlands	1 Jan 2016	Yes	EUR 50 million turnover
Peru	1 Jan 2017	Yes	PEN 81 million revenue (EUR 23 million approx.)
Poland	1 Jan 2017	Yes	Revenue or costs - EUR 20,000,000 in the year preceding the tax year
South Africa	1 Oct 2016	Yes	ZAR 100 million (EUR 7 million approx.)
Spain	1 Jan 2016	Yes	EUR 45 million of revenues

Action Plan 13 : Transfer pricing documentation

List of signatories to the Multilateral Competent Authority Agreement (MCAA)

57 countries **including India** are signatories to the MCAA on exchange of CBC reports as on January 2017

S. No.	Country	S. No.	Country	S. No.	Country	S. No.	Country
1	Argentina	16	France	31	Jersey	46	Poland
2	Australia	17	Gabon	32	Korea	47	Portugal
3	Austria	18	Georgia	33	Latvia	48	Russian Federation
4	Belgium	19	Germany	34	Liechtenstein	49	Senegal
5	Bermuda	20	Greece	35	Lithuania	50	Slovak Republic
6	Brazil	21	Guernsey	36	Luxembourg	51	Slovenia
7	Canada	22	Hungary	37	Malaysia	52	South Africa
8	Chile	23	Iceland	38	Malta	53	Spain
9	Costa Rica	24	India	39	Mauritius	54	Sweden
10	Curacao	25	Indonesia	40	Mexico	55	Switzerland
11	Cyprus	26	Ireland	41	Netherlands	56	United Kingdom
12	Czech Republic	27	Isle of Man	42	New Zealand	57	Uruguay
13	Denmark	28	Israel	43	Nigeria		
14	Estonia	29	Italy	44	Norway		
15	Finland	30	Japan	45	Peoples Republic of China		

Budget 2017 updates

Specified domestic transaction

Regulations for specified domestic transaction rationalized

- Definition of specified domestic transaction has been relaxed to exclude expenditure in respect of which payment has been made or to be made to certain specified persons
- This change will be effective from 1 April 2017 and will apply for AY 2017-18 and onwards
- However, transfer pricing regulations in respect of transactions between related parties enjoying specified profit linked deductions, will continue to apply

This will reduce compliance burden of the taxpayers

Introduction of secondary adjustment (1)

Introduction of secondary adjustment in the Transfer Pricing regulations

- “Secondary adjustment” is an adjustment in the books of accounts of the taxpayer and its AE to align the actual allocation of profits between the taxpayer and its AE, with those determined based on the application of arm’s length principle, thereby removing the imbalance between cash account and actual profit of the taxpayer

This will align actual profit allocation (consistent with the arm’s length principle) with cash account of the taxpayer

Introduction of secondary adjustment (2)

- Every taxpayer shall be required to carry out a secondary adjustment in case a primary adjustment to transfer price has been made:
 - By means of a suo-motu adjustment carried out by the taxpayer in its return of income
 - By the Assessing Officer and subsequently accepted by the taxpayer
 - Pursuant to an agreement reached in an Advance Pricing Agreement
 - In conformity to the margins/ rates as prescribed by the Safe Harbour Rules
 - Pursuant to a Mutual Agreement Procedure resolution
- The excess money available with the AE consequent to the primary adjustment, if not repatriated to India within the prescribed time, shall be deemed to be an advance made by the taxpayer, requiring imputation of interest income, as may be prescribed

Introduction of secondary adjustment (3)

- These provisions, however, would not apply in case:
 - The amount of primary adjustment does not exceed INR 10 million;
 - and**
 - The primary adjustment is made in relation to any FY prior to 1 April 2016
- This change will be effective from 1 April 2018 and will apply for AY 2018-19 and onwards

Limit on interest deductions (1)

- It is proposed to limit interest deduction in certain cases – in line with recommendation of OECD BEPS Action Plan 4
- It is proposed to restrict deduction of interest expense or similar consideration paid or payable by an entity to its AE to 30% of its EBITDA
- Provision applicable to an Indian company or a PE of a foreign company in India (other than those in the business of banking or insurance), being the borrower, who pays interest or similar consideration in respect of any debt issued by a non-resident AE
- Restriction applicable where interest or similar consideration to its AE exceeds INR 10 million
- Disallowed interest expense shall be carried forward up to 8 assessment years immediately succeeding the assessment year for which the disallowance is first made
 - Deduction in subsequent assessment year will be subject to same restrictions

- Debt – any loan, financial instrument, finance lease, financial derivative, or any arrangement that gives rise to interest, discounts or other finance charges that are deductible in the computation of income chargeable under the head “Profits and gains of business or profession”

Limit on interest deductions (2)

Illustration

Amount in millions

Particulars	Year 1	Year 2
EBITDA	2,000	3,000
Interest expenditure to AE	700	700
Maximum interest deduction allowable (30% of EBITDA)	600	900
Interest allowed in computation of income*	600	800 (700+100)
Interest disallowed & carried forward	100	-

Presuming interest is deductible in computation of income chargeable to tax under the head 'profits and gains of business and profession'

Thank You

Annexures

Continuing controversies

Comparability Issue

Concept

- 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
- Rule 10B(3), expressly requires that an appropriate adjustment to the price or margin should be made to enhance comparability
- In case the comparable transactions/enterprises have functionally different profile or bear significant risks or owns valuable intangibles as compared to the controlled transaction/enterprise, then ideally, such comparables should not be considered while testing the price/margins of the controlled transaction/enterprise

Issues

- Functional similarity
- Timing and availability of comparable data
- Use of secret comparables/cherry picking
- Applicability of suitable filters for identifying comparable companies
- Acceptability of outliers

Comparability Issue

Views of ITAT/HC

Ruling	Observations
Mentor Graphics, E-gain, 3 Global, Maersk Global, Avineon India, Market Tools, Saven Technologies, Hyundai Motors, Scancafe Digital Solutions, Broadcom Communications Technologies, Flour Daniel India	<ul style="list-style-type: none"> · Comparables should be selected considering Function, Asset and Risk (FAR) profiles
E-gain, Philips Software, Mentor Graphics, Quark Systems Pvt. Ltd, Agnity India, Deloitte Consulting	<ul style="list-style-type: none"> · Various parameters be considered while determining comparability
Ranbaxy, Tata Motors	<ul style="list-style-type: none"> · Same geographical area
Mentor Graphics, E-gain (on risk), Philips Software, Sony India, Schefenacker Motherson, Global Vantage, Cordys R&D (India) Pvt. Ltd (Remanded to the AO)	<ul style="list-style-type: none"> · Adjustments to bridge the differences in FAR profiles
Mentor Graphics, E-gain, Intellinet Technologies, Outsource Partners International	<ul style="list-style-type: none"> · Significant risks, such as market risk, contract credit risk and intellectual property right (IPR) risk
E-gain, Schefenacker Motherson, Sumi Motherson Innovative	<ul style="list-style-type: none"> · Adjustment to the operating profit to enhance comparability.
Philips Software, Mentor Graphics, NIIT Technologies, Avaya India, Vodafone India, ADP Pvt, Global Logic, Obopay Mobile Technology	<ul style="list-style-type: none"> · Companies having any/ significant related party transactions should not be considered
E-gain, Sony India, Honeywell Automation India, Fiat India, Philips Software, Schefenacker Motherson, Chrys Capital	<ul style="list-style-type: none"> · Exclusion of non-operating income and expenses
E-gain, Philips Software, MSS India, Quark Systems, Adobe Systems, Actis Advisors, Adobe, Sapient Corporation, Genisys Integrating, 24/7 Customer.Com,	<ul style="list-style-type: none"> · Close examination if potential Comps show extraordinary/ volatile results before being accepted as Comps or rejected outright.

Selection of most appropriate method

Concept

- Rule 10C governs selection of the most appropriate method (MAM)
- In selecting MAM, the following factors to be kept in mind:
 - Nature and class of the international transactions,
 - The class of AE entering into the transaction and its FAR
 - Availability, coverage and reliability of data
 - Degree of comparability existing between the international transaction and the uncontrolled transaction
 - Whether reliable and accurate adjustments can be made
 - The nature, extent and reliability of assumptions required to be made in application of a method.

Issues

- No hierarchy of methods
- Information on prices of external comparables are limited (database limitation)
- Large businesses, generally well integrated-making it difficult to apply TNMM on an aggregate level
- Segmental accounts not robust

Selection of most appropriate method

Views of ITAT (1/2)

Ruling	Observations
Philips Software Center P Ltd (Bangalore ITAT) ITA No. 218/Bangalore/08	<ul style="list-style-type: none">· TP study cannot be disregarded, in case there exists no infirmity
MSS India (Pune ITAT) ITA No. 393/Pune/07	<ul style="list-style-type: none">· Method adopted by a taxpayer cannot be rejected, without providing detailed reasons for such rejection· Factors laid down in Rule 10C to be followed for selection of the most appropriate method
UCB India P Ltd (Mumbai ITAT) ITA No. 428 & 29/Mum/2007	<ul style="list-style-type: none">· CUP method requires a high degree of comparability with regard to quality, contractual terms, level of market, geography involved, date of transaction, intangible property, foreign currency and alternatives available with buyer and seller
Serdia Pharmaceuticals (Mumbai ITAT) ITA No. 2649/Mum/2006	<ul style="list-style-type: none">· CUP method preferable over other methods, unless latter proven more reliable based on facts. Onus on taxpayer to prove that method adopted was most appropriate and correctly applied
L'oreal India P. Ltd (Mumbai ITAT) ITA No. 823/Mum/2010 Upheld by Delhi High Court	<ul style="list-style-type: none">· RPM to be applied as the most appropriate method in the case of a distributor, not adding substantial value to the goods

Selection of most appropriate method

Views of ITAT (2/2)

Ruling	Observations
Global One India P. Ltd (Delhi ITAT) ITA No. 5571/Del/2011 & ITA No. 5896/Del/2012	<ul style="list-style-type: none">· PSM to be applied as the most appropriate method to determine the arm's length in case of a taxpayer whose activities with its AEs are closely inter-related and hence cannot be evaluated separately
Marubeni India P. Ltd. (Delhi ITAT) ITA No. 5397/Del/2012	<ul style="list-style-type: none">· TNMM and not PSM should be applied to a company engaged in provision of sourcing services, assuming minimal risks



Selection of tested party

Concept

- A participant to the international transaction with reference to whom the international transaction is tested is known as tested party
- Tested party may be either the local or the foreign enterprise
- The Indian transfer pricing regulations are per-se silent on this concept
- However, OECD advocates that the tested party should be:
 - Least complex FAR and does not own significant intangibles
 - Selected transfer pricing method can be applied in most reliable manner
 - Availability of reliable comparable data
 - Requiring least adjustments

Issues

- Generally Indian company is selected as the tested party both by the taxpayer as well as the tax department
- Even if the foreign entity is selected as the tested party, detailed records should be available, which is generally difficult
- Availability of foreign databases both with the taxpayer as well as with the tax authorities is a pre-requisite in case foreign entity is selected as the tested party

Selection of tested party

Views of ITAT (1/2)

Ruling	Observations
Aztec Software & Technology Services. Ltd (Bangalore ITAT - SB) I.T.A. No.585/Bangalore/2006 and I.T.A. No.585/Bangalore/2006	<ul style="list-style-type: none">· Tested party to be Indian entity as it was least complex
Development Consultants (India) Pvt. Ltd (Kolkata ITAT) ITA No. 79/Kol./2008 and ITA No. 80/Kol./2008	<p>Tested party is the entity which is:</p> <ul style="list-style-type: none">· Least complex;· Whose operating profit can be verified in a reliable manner; and· Which does not own valuable intangibles or assets
Ranbaxy Laboratories (Delhi ITAT) ITA No. 2146/Del/2007 IDS Infotech Ltd. (Chandigarh ITAT) ITA No. 130/Chd/2016	<ul style="list-style-type: none">· If foreign AE is selected as the tested party, then the data for comparison should be available in public domain and should be furnished to the revenue authorities
Onward Technologies Limited (Mumbai ITAT) ITA No.7985/Mum/2010	<ul style="list-style-type: none">· Foreign AE can't be considered as the tested party for determining ALP
General Motors India Pvt. Ltd. (Ahmedabad ITAT) I.T.A. Nos. 3096/Ahd/2010 and 3308/Ahd/2011	<ul style="list-style-type: none">· Foreign AE can be considered as the tested party, if is least complex and not unique
GE Money Financial Services Pvt. Ltd. (Delhi ITAT) ITA No. 440/Del/ 2014	<ul style="list-style-type: none">· The foreign AE cannot be selected as the tested party for benchmarking intra-group services availed from AEs. Under TNMM, the profit realized by the Indian Assessee needs to be compared

Selection of tested party

Views of ITAT (2/2)

Ruling	Observations
Landis Gyr Limited [TS-518-ITAT-2016(Kol)-TP]	<ul style="list-style-type: none">· The concept of overseas tested party and foreign comparable companies is well recognized and acknowledged by Indian Revenue and holds that foreign AE should be chosen as tested party being the least complex entity
Tata Motors European Technical Centre Plc [TS-440-ITAT-2014(Mum)-TP]	<ul style="list-style-type: none">· Notes Rule 10B does not specify comparability only with Indian companies, and that in UN TP Manual, Indian Transfer Pricing Regulations have not rejected concept of foreign comparables, if the tested party chosen was foreign AE



Intra-group management services and payment of royalty

Concept

Intra Group Service (IGS)

- It is a common practice within multinational enterprises to leverage on expertise available within the group, by creating a shared service centre
- The shared service centre may render service to all the group companies across the globe:
 - **For a specific group member** –
Administrative, technical, financial and commercial services
 - **Common services for the whole group** –
Management, coordination and control functions

Royalty

- Royalty means payment of any kind of consideration for the use of, or the right to use any intangible property like patent, copyright, trademark etc.
- Royalties reflect usage-based payments made by one party to another for ongoing use of intangible assets.

Issues

- Determining whether intra-group service has actually been rendered?
- Whether the tax officer can question the need for availing the services or the Intellectual Property?
- Question of duplication of activities
- Comparison of intra-group charges paid with local market price of similar services:
 - Granular data generally not available
 - Cost base in India is considerably lower compared to developed countries
- Economic or commercial value of service ?
- Absence of payment does not necessarily mean that no services have been rendered
- Difficulty in establishing that payments are commensurate to the services received
- Extensive documentary evidences required by the tax authorities
- Separate benchmarking analysis required by the tax authorities
- Impact of BEPS recommendation wr.t. “Low Value Adding Services”

Intra-group management services and payment of royalty

Views of ITAT (1/2)

Ruling	Observations
E I DuPont India Pvt. Ltd. (Delhi ITAT) TS-338-ITAT-2016(DEL)	<ul style="list-style-type: none">· Necessary to see whether the services were received for the purpose of business or not· The Income-tax Act, 1961 does not prohibits the receipt of similar services from a number of consultants as it is a right of businessman to decide on how many service provider he needs for rendering a particular service· It is not the prerogative of tax authorities to ascertain the benefit received from the availment of services, and that the benefit received from a particular service has to be perceived from the point of view of businessman and not the tax authorities
Alfa Laval India Ltd. TS-147-ITAT-2016(PUN)-TP	<ul style="list-style-type: none">· Agreement is not necessary to prove the expenditure being incurred. If no agreement has been entered into, it does not merit the disallowance of expenditure per se
Frigoglass India Pvt. Ltd. (Delhi ITAT) ITA No. 1906/Del/2015	<ul style="list-style-type: none">· TPO cannot disallow certain expenditure so long the taxpayer is demonstrating to have these expenses been incurred for the purpose of business· While applying overall TNMM, royalty transaction has also been benchmarked
Avery Dennison (India) P. Ltd. (Delhi ITAT) ITA No. 4869/Del/2014	<ul style="list-style-type: none">• Accepted TNMM applied by the taxpayer for the purpose of benchmarking the payment of intra-group management service fee by observing that transactions are interlinked• When there is an agreement for services and certain services out of a bundle of services are undisputedly rendered, the entire agreement has to be viewed• Whether the services have actually resulted in a benefit or not is immaterial

Intra-group management services and payment of royalty

Views of ITAT (2/2)

Ruling	Observations
McCann Erickson India Pvt. Ltd. (Delhi ITAT) ITA No. 5871/Del/2011	<ul style="list-style-type: none">· Only a business expert can evaluate the true intrinsic and creative value of services received· Engaged in only one class of business i.e. advertising and its allied services. There are no segments or different activities which can be said to be independent of each other. Hence TNMM justified
AWB India Pvt. Ltd. (Delhi ITAT) ITA No. 4454/Del/2011	<ul style="list-style-type: none">· Not possible to document every receipt of the service in question· Commercial expediency cannot be questioned· CUP method applied by the TPO cannot be considered in view of non-availability of CUP data
Knorr-Bremse India Pvt. Ltd. (Delhi ITAT) ITA No. 5097/Del/2011	<ul style="list-style-type: none">· Cross subsidization is not permitted under Indian regulations hence CUP is payment for intra-group services need to be benchmarked separately· Commercial expediency and arm's length principle are two different concepts· Taxpayer has not received any tangible or real benefit
Dresser Rand India Pvt. Ltd. (Mumbai ITAT) ITA No. 8753/Mum/2010	<ul style="list-style-type: none">· Commercial expediency cannot be questioned· Contemporaneous documentation submitted· No infirmity in the cost allocation method adopted by the taxpayer· TNMM most appropriate method
TNS India Pvt. Ltd. (Hyderabad ITAT) ITA No. 944/Hyd/2007	<ul style="list-style-type: none">· No justification in determining ALP of management fee at NIL· It is difficult to place on record a concrete evidence in respect of advise given by AEs in day-to-day manner, but it can be perceived from way of conducting business· TPO went beyond his jurisdiction in denying payment out-rightly when his role is limited to determination of ALP

Interest on receivables

Issues

- The key issue is whether receivables can be considered separately from the main transaction
- Mostly tax tribunals have not upheld the “separation”
- But the Finance Act 2012 introduced retrospective amendment which included the term “receivables” within the definition of international transactions
- In the last round of TP audit, many companies have been revisited with the issue:
 - Separation concept followed
 - Only receivables pertaining to AEs considered
 - The addition being made regardless of business activity
 - Presumptive selection of allowable holding period
 - Interest rate based on Indian long term lending rates

Interest on receivables

Views of ITAT/ HC (1/2)

Ruling	Observations
CIT vs. Indo American Jewellery Ltd (ITA (L) NO. 1053 OF 2012) (Bombay HC)	<ul style="list-style-type: none">· Delayed receipts from AEs are only incidental to the main international transaction of sale and not a separate transaction. If the ALP of the sale transaction is determined, then no separate adjustment on account of delayed receipts is warranted· In case there is uniformity in not charging interest from both the AEs and Non-AEs, then no interest can be charged on delayed receipt of payments.
Kusum Healthcare Pvt. Ltd. Vs. ACIT (ITA no. 6814/Del/2014)	<ul style="list-style-type: none">· Allowing a credit period above normal industry trend is relevant and part of the main international transaction, and cannot be treated as an independent transaction.· If the differential impact of working capital of the Assessee vis-a-vis its comparables is already factored in the working capital adjusted profitability, then no further adjustment on the pretext of outstanding receivables is warranted.
Lintas India Pvt. Ltd vs. ACIT (ITA No.2024/Mum/2007)	<ul style="list-style-type: none">· In case there is uniformity in not charging interest from both the AEs and Non-AEs, then no interest can be charged on delayed receipt of payments.
Nimbus Communications Ltd. vs. ACIT (ITA No. 6579/Mum/09)	<ul style="list-style-type: none">· A continuing debit balance is not an international transaction perse, but a result of the international transaction.
Dell International Services India Pvt. Ltd vs. JCIT (I.T.(T.P.) A. No.308/Bang/2015)	<ul style="list-style-type: none">· If after working capital adjustment, the international transaction is at arm's length, then no separate adjustment on account of delayed receipts from AE is warranted.· Normal credit period allowed for the receivables shall be in line with the industry trend.

Interest on receivables

Views of ITAT/ HC (2/2)

Ruling	Observations
Evonik Degussa India P. Ltd. Vs. ACIT – OSD (ITA no. 7653/Mum./2011)	<ul style="list-style-type: none">· Adjustment on account of delayed receipts cannot be made on hypothetical and notional basis, unless there is some material on record that there has been under charging of real income.
Pega Systems Worldwide India Pvt. Ltd. Vs. ACIT (ITA No.1758/Hyd/2014)	<ul style="list-style-type: none">· Notional interest on delayed receipts cannot be brought to tax under the provisions of Transfer Pricing.
GSS Infotech Limited vs. Asst. CIT (ITA No. 497/HYD/2015)	<ul style="list-style-type: none">· If the credit period is reasonable then no interest can be levied, just because there are outstanding receivables.
Logix Micro Systems Ltd. Vs. ACIT (ITA No.423 /Bang/2009)	<ul style="list-style-type: none">· Huge receivables outstanding for more than 6 months could amount to financing the AE. Imputing of interest on such receivables constitutes valid adjustment.
Rusabh Diamonds vs. ACIT (ITA No.2840/Mum/2014)	<ul style="list-style-type: none">· If the revenue transaction is benchmarked on TNMM basis, separate adjustment for delay in realization of debts is not warranted.
ACIT vs. Millipore India Ltd. (ITA No. 327/Bang/2015)	<ul style="list-style-type: none">· Deletes TP adjustment on account of notional interest on overdue receivables from AEs· The transaction was an integral part of sale made by the assessee to AEs and thus, must be considered alongwith the main transaction

Treatment of R&D service provider

The concept and issues

- To minimize costs, companies located in developed countries are either shifting R&D work wholly or partially to developing countries
- Such R&D activity is carried under a contract, which generally stipulates that the principal (foreign AE) and not the service provider (Indian taxpayer) would be the legal owner of any intangible arising out of such R&D activities
- In India, mostly Indian taxpayers render routine services and claim to earn routine mark-up on its costs whereas the foreign AE is entitled to return on intangible including location savings, if any
- The CBDT vide circular 6/ 2013, classified R&D centres in the following broad categories:
 - Centres which are entrepreneurial in nature;
 - Centres which are based on cost-sharing arrangement; and
 - Centres which undertake contract R&D

Treatment of R&D service provider

Views of ITAT

Ruling

GE India Technology Centre Pvt. Ltd.
(Bangalore ITAT) ITA No. 789/Bang/2010
& ITA No. 487 & 925/Bang/2011

Observations

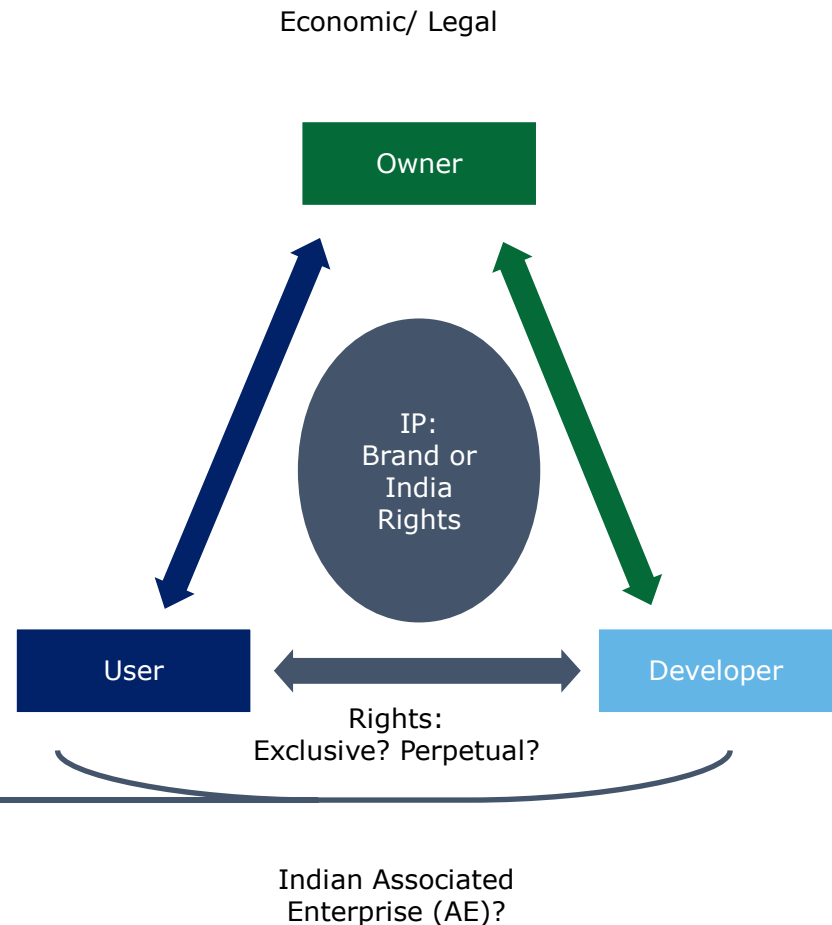
- The ITAT held that the notion that risk can be controlled remotely by the parent company and that the Indian subsidiary is engaged in core functions, such as carrying out R&D activities or providing services as risk free entities, is something which needs to be demonstrated
- The ability of the parent company to exercise control over the risk - remotely and from a place where core functions of R&D and services are not located - is very limited
- In summary, the extent of risk associated with the Indian entity is matter of facts to be established with evidences



Recent controversies

Marketing Intangibles- AMP Expenses

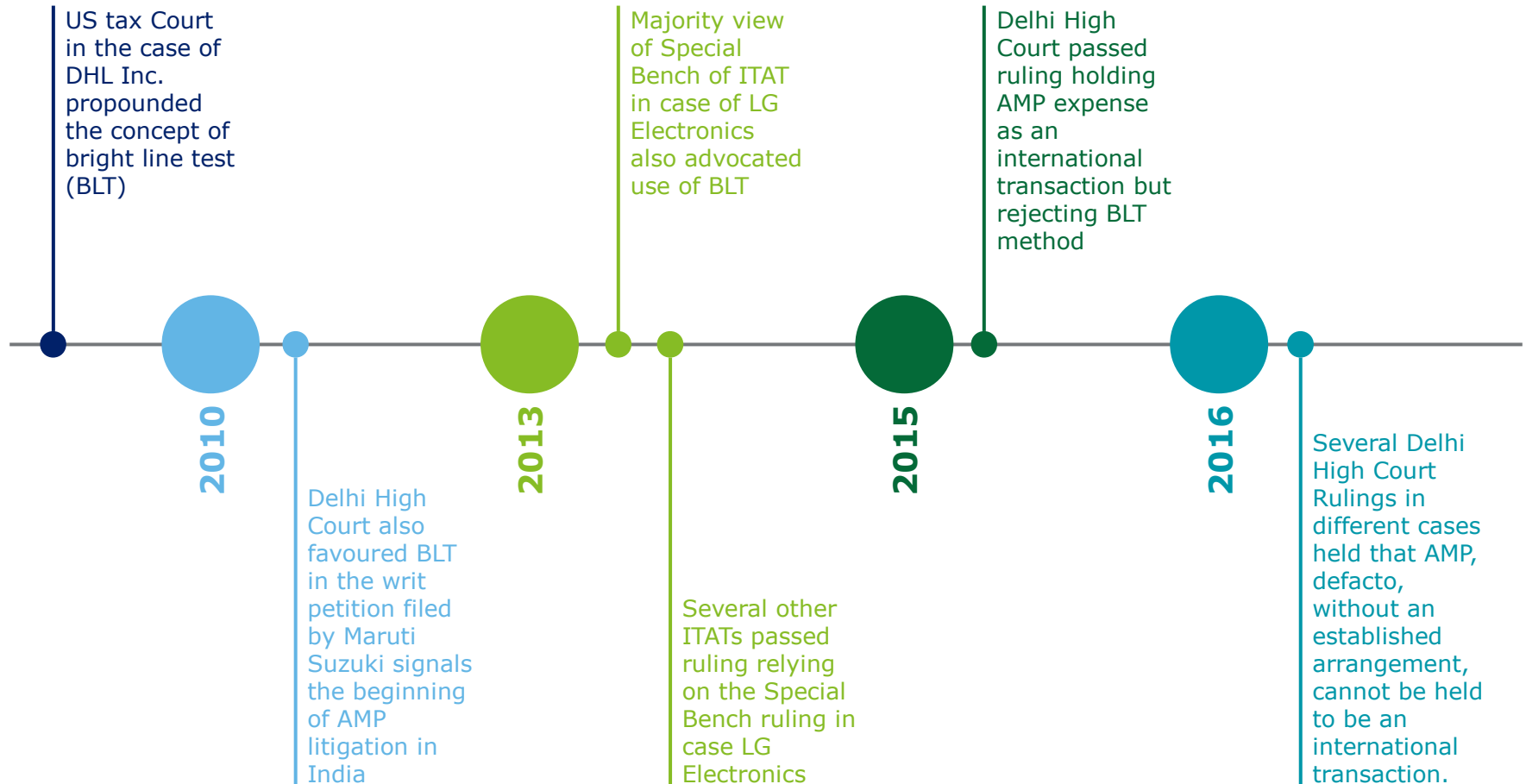
- Meaning of “Marketing Intangibles”
 - ordinarily includes a bundle of IP rights such as: Trade names, trademarks, knowhow on distribution channels and customer relationships
 - The amendment to Indian TPR does not mention “AMP expenses”
- As per revenue authorities main investment in marketing intangibles is through advertising, marketing & promotion spend
- Which of the following have the responsibility to bear AMP spend and to what extent :
 - Legal owner of the brand name
 - Entrepreneur but not economic owner i.e. using brand name by paying license fee
 - Entrepreneur and economic owner
- How should user be remunerated for AMP spend i.e. what should be the benchmarking analysis for AMP



AMP Expenses- TPO's view

- Arrangement or agreement may be written or oral
- Marketing expenses incurred by distributor/manufacturer – Whether for building the brand of the foreign AE in India?
- Since the Indian company incurs expenses which benefit the foreign AE, the Indian company should be reimbursed for such expenses.
- TPO used the ratio of AMP/Sales referred to as Bright Line Test (BLT) to compute the compensation which Indian AE should have recovered.

Update on AMP Issue in India



AMP expenses

View of SC/ HC

Ruling	Observations
Toshiba India Pvt Ltd [TS-309-SC-2017-TP]	<ul style="list-style-type: none">· SC admits SLP filed by Revenue against Delhi HC judgment in the case of the assessee on marketing intangibles issue· HC had upheld ITAT decision rejecting application of bright line test in line with Delhi HC decision in Sony Ericsson case
Sony Ericson (Delhi HC) (2015)	<ul style="list-style-type: none">· Held that incurring of AMP expenses constitute an international transaction· Reject the application of Bright Line Test
Maruti Suzuki India Limited (Delhi HC) (2015)	<ul style="list-style-type: none">· HC held that mere incurrence of AMP expenditure cannot be considered as an international transaction. The HC also held that the AMP transfer pricing adjustment is not tenable in view of the provision of Chapter X of the Income-tax Act, 1961.
Bausch & Lomb Eyecare (India) Pvt Ltd (Delhi HC) (2015)	<ul style="list-style-type: none">· HC held that merely because there is an incidental benefit to the foreign AE, it cannot be said that the AMP expenses were incurred for promoting the brand of the foreign AE. The HC deleted the addition since the revenue was not able to show the existence of an international transaction involving AMP expenses between the Assessee and its AE.



Base erosion

The concept and issues

- The income of the foreign AEs in the nature of interest, royalty and fee for technical services is taxable in India
- Considering the fact that such income is taxable in India, the same needs to comply with the arm's length standard as enunciated in the Indian transfer pricing regulations
- Apropos filing of the Accountant's report in Form no. 3CEB and maintenance of the TP documentation is mandatory in the case of foreign AEs (earning income by way of interest, royalty and fee for technical services)
- A recent issue which came up for consideration: Whether foreign AE can provide an interest free loan to an Indian taxpayer, who is incurring losses at the net level?
- The prime contention of the Indian taxpayer was that charging of interest, would reduce the overall tax base in India and hence no charge of interest is warranted

Base erosion

Views of ITAT

Ruling

Instrumentarium Corporation Limited, Finland(ITA No. 1548 and 1549/Kol/2009, AY 2003-04 and 2004-05)

Observations

- Exemption from the TP provisions apply only in cases where the TP adjustment results in reducing the taxable profit or enhancing the losses of the taxpayer
- In the instant case, since the Indian taxpayer is in losses and specifically has not claimed any deduction for interest expense, there is no real tax base erosion in India
- Further, there is no provision for allowing a corresponding deduction of the TP adjustment (made for the foreign AE) in the hands of the Indian taxpayer
- Tax base erosion would have taken place only in situation **where the Indian taxpayer would have actually been allowed interest expense, which is not the fact of the case**
- Hence the foreign AE should have earned an arm's length interest on the loan granted to the Indian taxpayer

Deemed International Transaction

The concept and issues

- The definition of “deemed international transaction” provides that a transaction of an enterprise with a third party shall be deemed to be an international transaction with the Associated enterprise if there exists a prior agreement in relation to the said transaction or the terms of the said transaction are determined in substance between the AE and the third party. [Section 92B(2)]
- There had been ambiguity as to whether ‘deemed international transactions’ would cover a case where both the contracting entities are Indian residents.
- Clarification provided by the Finance Act 2014 that deemed international transactions would also cover cases where both the contracting parties are residents
- The amendment is effective from 1 April 2015

Deemed International Transaction

Views of ITAT

Ruling	Observations
SwarnandharaIJMII Integrated Township Development Co. Pvt. Ltd. (ITA No. 53/Hyd/2014) AY 2006-07	<ul style="list-style-type: none">· “The legal fiction created in respect of the specified transaction can be used only for the purpose of examining whether such transaction constitutes an 'international transaction' under Section 92B(1). In case Section 92B(1) is not attracted, the fiction under Section 92B(2) ceases to operate. In our opinion, the impugned transaction between the assessee and IJMII does not fall under Section 92B(2)”.
IJM (India)Infrastructure Ltd. Hyderabad (ITA No. 43/Hyd/2014) AY 2009-10	<ul style="list-style-type: none">· Transaction between assessee and PE not international transaction as PE to be treated as resident in India.· As per the requirement of Sec. 92B(1), at least one of the parties to transaction needs to be non-resident to treat a transaction as international transaction. ITAT also held that provisions of Sec. 92B(2) were also not applicable. Thus, ITAT held that transfer pricing provisions were not applicable.
Kodak India Pvt. Ltd (ITA No. 7349/Mum/2012) AY 2008-09	<ul style="list-style-type: none">· “When we read the deeming provision of section 92B(2), we cannot slip out of the definition of international transaction, that too, when the deeming provision, itself says, “for the purposes of sub section (1)”.....· ...This, transaction, cannot be presumed to be international transaction... we hold that there was no international element involved in the sale of imaging segment by the assessee of its business to CarestreamHealth Ltd. and hold it was a purely a domestic transaction.”

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