



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

## Reference to and Proceedings before TPO, Valuation Officer and DRP

**Bhavesh P. Dedhia  
Bipin M. Dodhia**

16<sup>th</sup> January 2016



	Maturity	Current	One-day change
6.700	Jan. 30, '18	1461	-286
5.875	May 10, '12	3820	-270
6.750	March 15, '12	786	-180
7.625	Nov. 30, '12	949	-131
5.750	Sept. 8, '11	953	-116
7.995	June 1, '36	781	-101
6.875	Feb. 1, '14	684	
5.500	Nov. 15, '12		

Share price	Oct.	Nov.	Dec.	Jan.
Grand price				
Last week	1702	1702	1702	1702

-13.8%	37.6%
16.9%	36.1%
2.7%	-17.4%
8%	17.9%
	1.9%
	10.2%

# Current Transfer Pricing Landscape

# Transfer Pricing in News... Winds of change...

## THE HINDU

Updated: October 8, 2015 23:17 IST

### Vodafone wins transfer pricing tax dispute case

*Bombay HC sets aside tax demand of Rs. 3,700 crore*

## THE ECONOMIC TIMES

You are here: [ET Home](#) > [News](#) > [Economy](#) > [Policy](#)

Search for News, Stock Quotes & NAV's

Govt resolves transfer pricing disputes covering a decade through APA

## Business Standard

### Govt inks 11 pacts to sort transfer-pricing issues

The advance pricing pacts were signed with investment advisory and shipping services companies, among others

## Business Standard

### Transfer pricing rules with wider ambit soon

Changes in I-T Act likely to curb tax evasion by multinational companies

Dilasha Seth | New Delhi  
January 11, 2016 Last Updated at 23:59 IST

## Business Standard

### The BEPS effect: Is India ready?

Apart from MNC subsidiaries, about 155 Indian companies are likely to qualify for country-by-country reporting

Sudipto Dey  
October 18, 2015 Last Updated at 21:35 IST

# Transfer Pricing Litigation Scenario in India

Statistics of TP Audit Adjustments till date

## HIGH-PITCHED ADJUSTMENTS

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

Source : Annual Report 2014-15 – Ministry of Finance

**Reference and  
proceedings before the  
TPO and Valuation  
Officer**

# Guidance on implementation of Transfer Pricing Provisions (Instruction No. 15)

- **Reference to the Transfer Pricing Officer (TPO)**

- Quantum on transactions not to be a criteria for referring cases to TPOs – risk parameters to be considered
- If there is an income or potentiality of an income arising and/or being affected, the Assessing officer (AO) to record his satisfaction in the following 3 situations before proceeding to determine the ALP or making a reference to the TPO,
  - Accountants Report (AR) has not been filed by the taxpayer
  - AR has been filed but international transaction(s) has not been reported
  - Taxpayer has made qualifying remarks in the AR – regarding impact on income of taxpayer

## Typical Scenario

1. Transaction relating to issue of Equity Shares
2. Transaction not taxable in India
3. Transaction taxable but exempt as per treaty

# Guidance on implementation of Transfer Pricing Provisions (Instruction No. 15)

- **Procedural requirements**

- Taxpayer objection to applicability of TP provisions should be considered and specifically dealt with by the AO, before making a reference to the TPO
- AO to provide an opportunity of hearing to the taxpayer
- TPO's - Additional/Joint CIT to be assigned not more than 50 cases

- TPOs to maintain database in prescribed format providing information e.g. Transfer Price and MAM declared by the taxpayer and determined by the TPO
- The above guidance would be applicable mainly in case of International Transactions and to SDTs till such time separate guidance is issued for SDTs

- ***DCIT V/s. M/s Tata Consultancy Services Ltd. (ITA No. 7513/M/2010)***

*“54.....The AO erred in not himself examining the issue of TP and with the approval of the Id. CIT, made a reference to the TPO u/s 92CA(1) of the Act; that the AO as well as the Id. CIT(A) failed to apply their mind to the TP Report filed by the assessee, or to any other material or information or document furnished. The TPO made an adjustment which was incorporated by the AO in the assessment order. Thereby, the AO as well as the Id. CIT(A) did not discharge necessary respective judicial functions conferred on them under sections 92C and 92CA of the Act”*

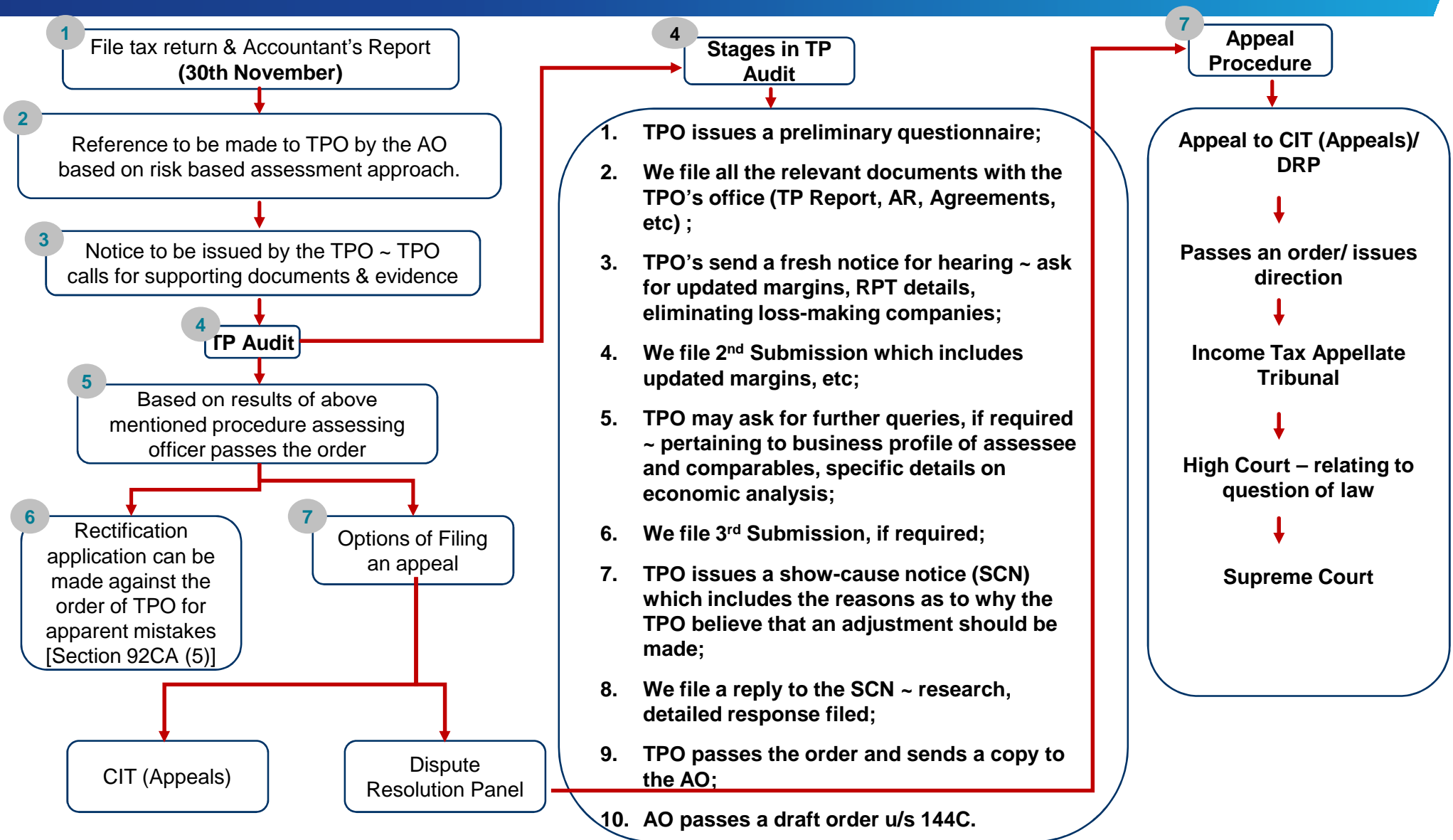


# Reference to Transfer Pricing Officer

- S 92CA (1) – if AO considers it necessary or expedient so to do, he may refer the computation of arm's length price to the TPO with the previous approval of the Commissioner – prima facia view
- S. 92CA (2) TPO to serve notice on the Assessee requiring him to produce evidence in relation to arm's length price computed
- S. 92CA(2A) and (2B) – TPO can *suo motto* take cognizance of the transaction not reported by the Assessee or nor referred by the AO
- S 92CA(3) provides that the TPO after taking into account the material available with him shall, by an order in writing, determine the arm's length price in accordance with s 92C(3).
- S 92CA(3A) Time limit for passing an order - 60 days prior to the date of limitation referred in S. 153.
- S. 92CA(4) Provides that on receipt of the order of the TPO, the AO shall proceed to compute the total income of the assessee in conformity with the ALP as determined by the TPO.
- S. 92CA(5) and (6) refers to rectification for mistake apparent from record in TPO's Order
- S. 92CA(7) exercise of power specified under
  - 131(1) - Power regarding discovery, production of evidence, etc.
  - 133(6) - May require any person to furnish information or
  - 133A - Power of Survey



# Audit Process



# Reference to Valuation Officer - Statutory provisions

- Pursuant to the Supreme Court's direction in case of CIT, Delhi v. Bharti Cellular Ltd. [2010] 193 Taxman 97 (SC)
- *“We are directing CBDT to issue directions to all its Officers, that in such cases, the Department need not proceed only by the contracts placed before the officers. With the emergence of our country as one of the BRIC countries and with the technological advancement matters such as present one will keep on recurring and hence time has come when Department should examine technical experts so that the matters could be disposed of expeditiously and further it would enable the appellate Forums, including this Court, to decide legal issues based on the factual foundation. We do not know the constraints of the Department but time has come when the Department should understand that when the case involves revenue running into crores, technical evidence would help the Tribunals and courts to decide matters expeditiously based on factual foundation.”*
- **CBDT issued INSTRUCTION No. 5/2011-** The AO/TPO should frame assessments only after **taking opinion of technical/ valuation experts and bringing on record technical evidence in cases involving complex issues of technical nature and substantial revenue**
- **S. 50C** – AO may refer the valuation of the capital asset to a Valuation Officer, if the taxpayer claims that stamp duty valuation is higher than the fair market value (FMV) and such valuation has not been disputed
- **S. 55A** – With a view to ascertaining the FMV of a capital asset, the AO may refer the valuation of capital asset to a Valuation Officer, if AO is of opinion that having regard to the nature of the asset and other relevant circumstances, it is necessary so to do

# Reference to Valuation Officer - Statutory provisions

- **S. 142A** – For the purposes of assessment or reassessment, AO may make a reference to a Valuation Officer to estimate the value, including FMV, of any asset, property or investment whether or not he is satisfied about the correctness or completeness of the accounts of the taxpayer
- **S 269L** - For the purpose of initiating proceedings for the “acquisition of any immovable property” (by Central Government) under certain circumstances (tax evasion or concealment of income), the competent authority (Jt. Commissioner) may require a Valuation Officer to determine the FMV of such property

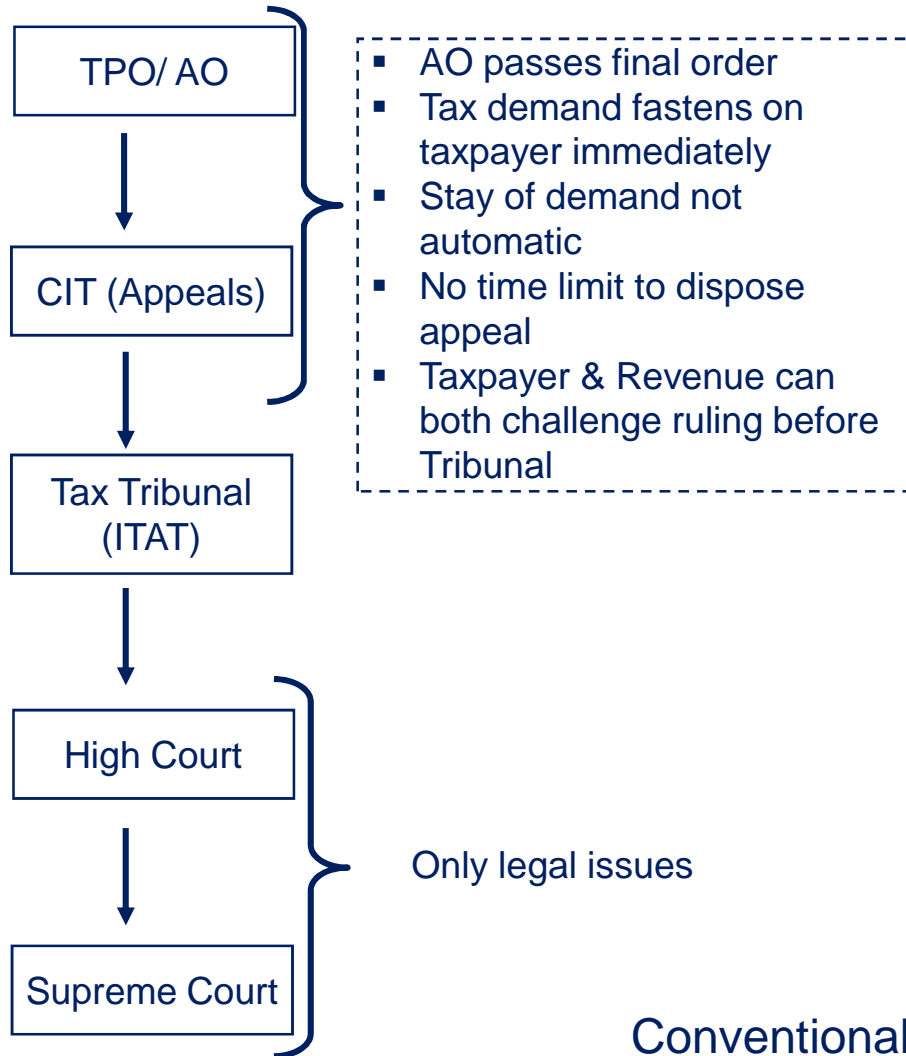
## Reference to Valuation Officer – Procedural aspects (section 16A of the Wealth Tax Act, 1957)

- VO may serve a notice on the taxpayer requiring him to furnish the accounts, records and other relevant documents for the purpose of valuation.
- If the VO is satisfied that the value declared by the taxpayer is correct, then he shall pass an order in writing and send a copy of his order to the AO and the taxpayer.
- If not, he shall serve a notice on the taxpayer intimating the value which he proposes to estimate and give an opportunity to state his objections. After hearing the taxpayer’s contentions and other evidences as may be produced by him, the VO shall pass an order estimating the value of the asset and send a copy of his order to the AO and the taxpayer.
- On receipt of order from the VO, the AO shall proceed to complete the assessment (in relation to the valuation of the asset), in conformity with the order of the VO

**Levy of Wealth Tax in India abolished and removed from 1 April 2015**

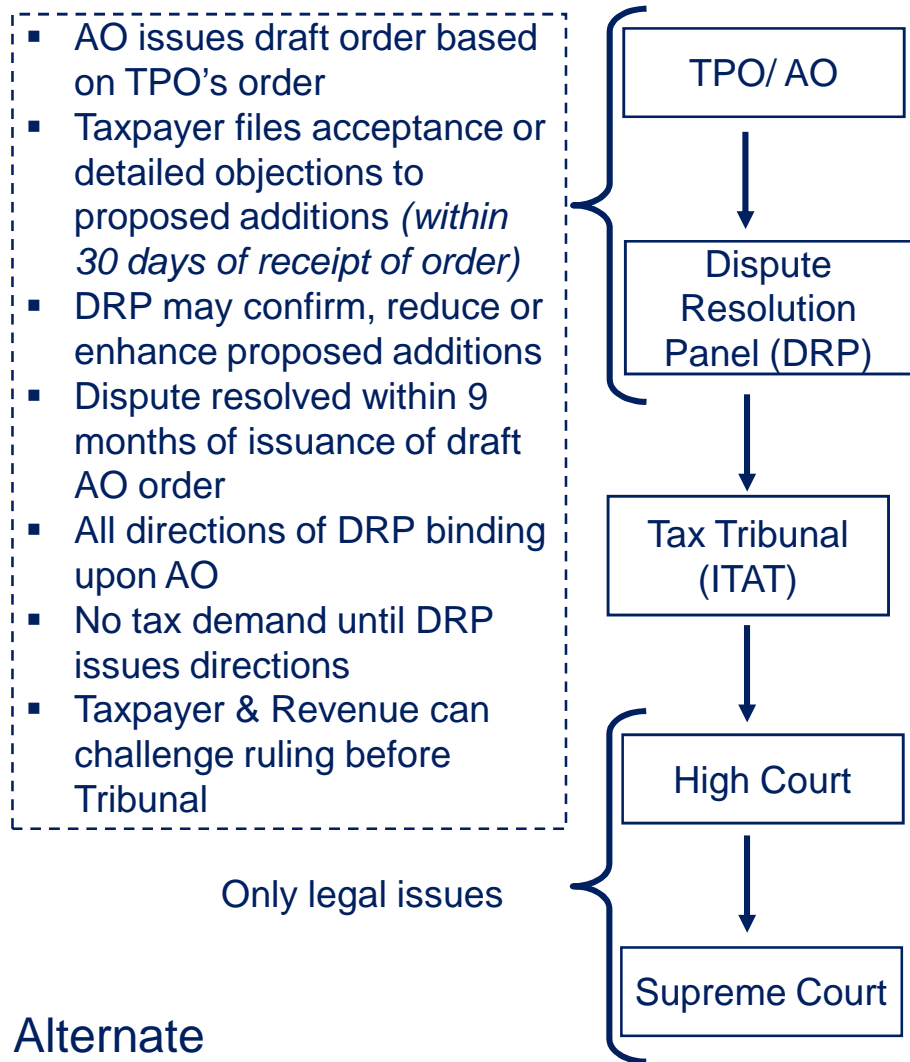
**Reference and  
proceedings before the  
DRP**

# Conventional v. Alternate Mechanisms



Only legal issues

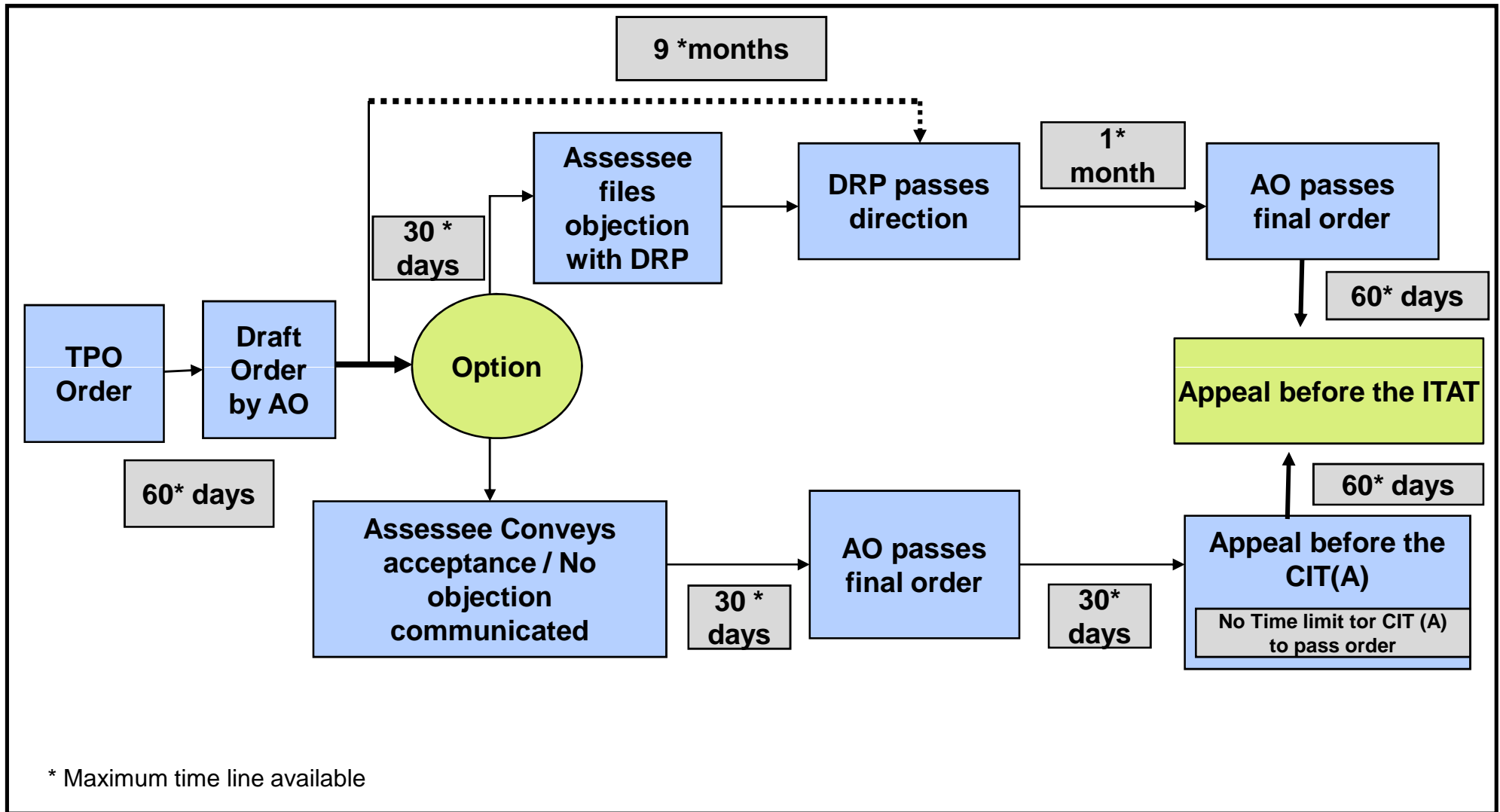
Conventional mechanism



Only legal issues

Alternate mechanism

# DRP Process



# DRP Mechanism – Key Aspects

- Introduced by Finance (No.2) Act, 2009 w.e.f 1 April 2009 . Alternative dispute resolution mechanism for “Eligible Assessee”:
  - **Foreign company** - Transfer pricing adjustment not necessary
  - **Any other person** – If variation in pursuance to order issued by transfer pricing officer
- Objections to be filed against entire Draft Order – both transfer pricing as well as non transfer pricing (i.e. general tax issues)
- Additional evidence (not submitted to the AO) to be filed through a separate application stating the reasons for filing such additional evidence
- No payment of tax till AO issues the Final Order in pursuance of DRP directions



# DRP – Powers and Duties

DRP has powers as are vested in a 'Court' under Code of Civil Procedure, 1908

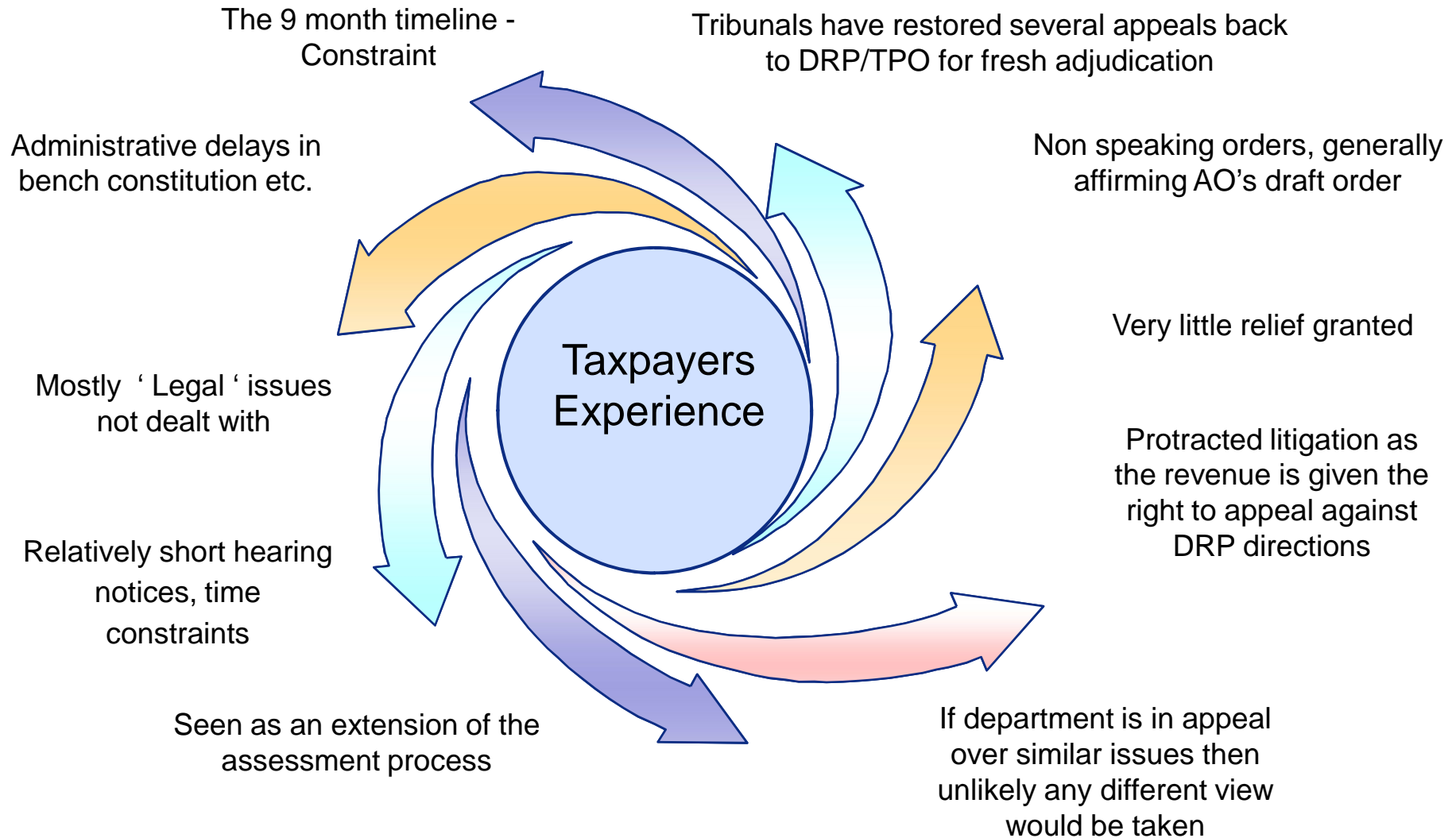
DRP issues directions to confirm, reduce or enhance proposed variation

To issue directions within nine months from end of month in which draft order is forwarded to taxpayer

DRP cannot set aside proposed variation – Must give final directions to AO on the issue

DRP may not condone delay - No provisions in Sec144C / DRP rules to condone delay in filling of objections

# Taxpayers Experience



# Recent Change in DRP constitution

- CBDT revises Disputes Resolution Panel (DRP) rules w.e.f. 1 January 2015,
- DRP to be set-up 3 headquarters at Delhi Mumbai and Bangalore;
- Each DRP Headquarter to have jurisdiction over multiple states as follows:

Headquarters	Jurisdiction
2 Panel at Delhi	Delhi, Rajasthan, Himachal Pradesh, Jammu and Kashmir, Uttar Pradesh, West Bengal, Bihar, Odisha, North-east states, etc.
3 Panel at Mumbai	Maharashtra, Gujarat, Madhya Pradesh, Chhattisgarh, etc.
2 Panel at Bangalore	Karnataka, Tamil Nadu, Andhra Pradesh, Telangana, Kerala, Goa, etc.

- Rules also prescribed for transferring the case from one jurisdiction to another
- The Panel Members do not hold any additional charge and function throughout the year
- It now has its own infrastructure and staff.

## Reference to DRP vs CIT(A) - A Comparative

Key	DRP	CIT(A)
<b>Constitution</b>	Collegium of three officers of the CIT rank	Only one CIT
<b>Application Process</b>	If the taxpayer chooses this route, he is required to lodge objections within 1 month from receipt of Draft Order	Should file Appeal within 30 days from the receipt of Final AO Order
<b>Time limit</b>	Only 9 months from the date of Draft Order to examine the case, hold hearings and pass directions	No time limit
<b>Demand</b>	No demand till disposal of the matter	Significant portion of demand is required to be paid unless stayed
<b>Pros</b>	Fast track route to the ITAT	Detailed hearings may be granted to the Assessee to represent their case
<b>Form</b>	Form 35A – specific format to be followed for submission	Form 35
<b>Further Appeal</b>	Both taxpayer as well as AO can appeal to ITAT	

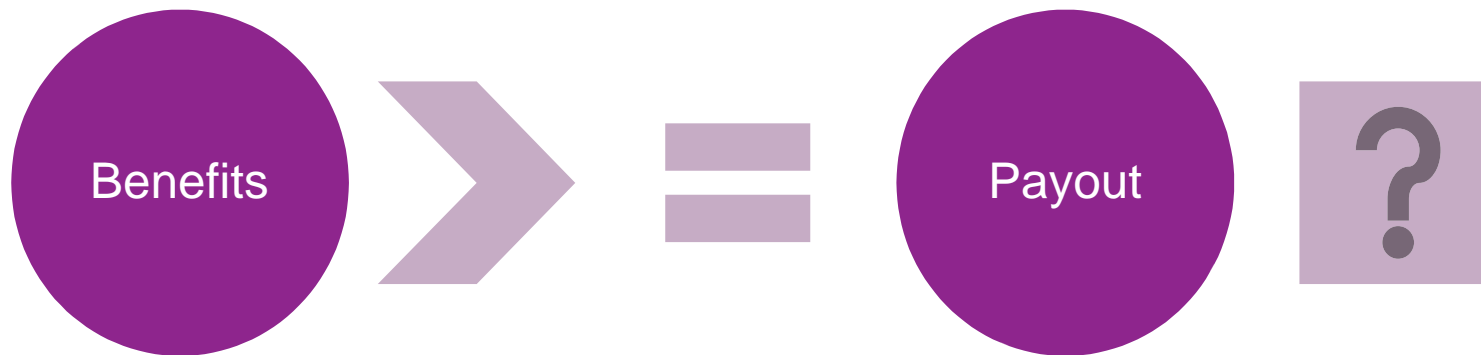
## Key Transfer Pricing Issues

1. *Payment for Intra-group services*
2. *Corporate Guarantee provided to AE overseas*
3. *Range and Multiple Year Data*
4. *Deemed International Transactions*
5. *Income received for back office support services*

# Payment for Intra-group services

## - Approach of Revenue

- 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.



# Management services – Illustrative model documentation

## Documentation requirement specific to certain services

<b>Strategic Planning</b>	<b>Information Technology Support</b>
<ul style="list-style-type: none"><li>• Business Reports / Plans</li><li>• Trainings</li><li>• E-mails</li><li>• Telecon-notes</li><li>• Corporate Governance initiatives</li></ul>	<ul style="list-style-type: none"><li>• IT Security Policy and Manual;</li><li>• Details of trainings received;</li><li>• E-mail system</li><li>• Intranet</li><li>• Servers including Remote Servers</li></ul>
<b>Accounting and Finance</b>	<b>Human Resources</b>
<ul style="list-style-type: none"><li>• Accounting system</li><li>• Accounting manual</li><li>• Business Reporting system</li><li>• Trainings</li></ul>	<ul style="list-style-type: none"><li>• HR Manuals</li><li>• Appraisal and Evaluation</li><li>• Welfare Schemes</li><li>• Trainings</li></ul>
<b>Sales and Marketing</b>	<b>Supply chain Management ('SCM')</b>
<ul style="list-style-type: none"><li>• Details of any marketing strategic inputs</li><li>• Details of sales converted due to marketing assistance</li><li>• Brand and Sales Promotion Material</li><li>• Trainings</li></ul>	<ul style="list-style-type: none"><li>• SCM Manual and Policies</li><li>• Write-up on inventory management</li><li>• Daily distribution plan</li><li>• Demand forecasting and production scheduling</li></ul>



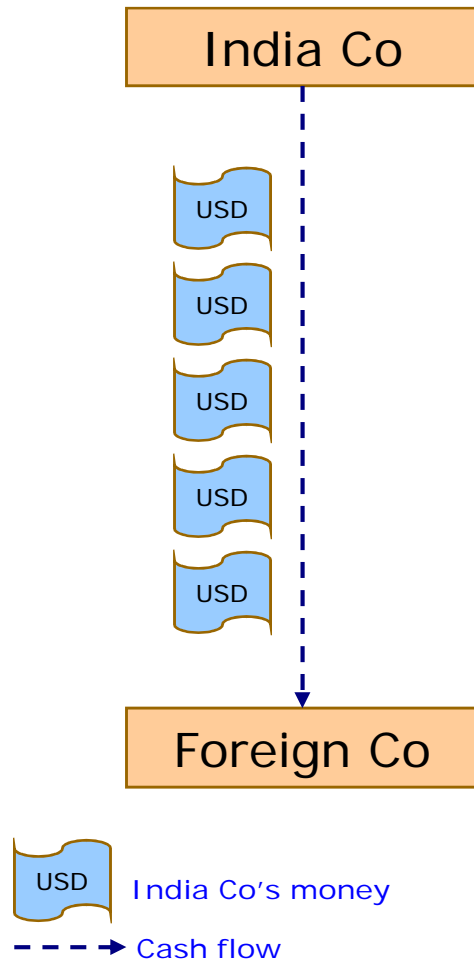
# Corporate Guarantees and Interest on Loans

- 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.
- No charge for guarantee fee on the ground that there is no cost of guarantee
- Comfort Letters are also viewed as an form of Guarantee
- Granting of interest free loans has historically led to tax controversies with the Revenue authorities.

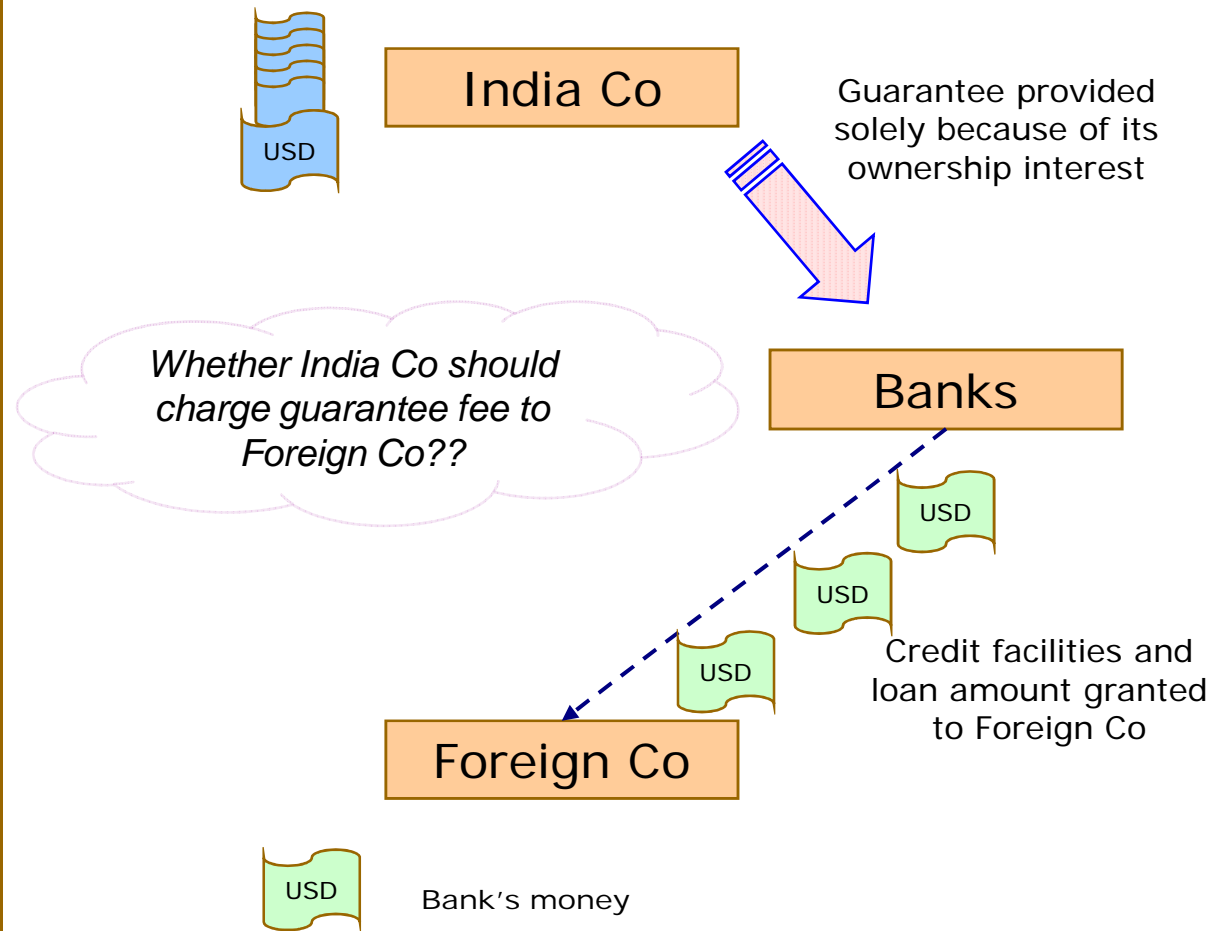


# Corporate Guarantee provided to maximize cash utilization

Option I – To infuse capital



Option II – To maximize cash utilization



# How to determine an arm's length Guarantee fee?

## Taxpayer's Approach

- ✓ If akin to an investor / shareholder activity - no fees attributed
- ✓ If akin to services - fee attribution made
- ✓ Benchmarking fees on basis of mutual agreement / bank quotes

## Tax Department's Approach

- ✓ Insistence on arm's length compensation for giving guarantee, as AE avails benefit in form of reduced interest rates and favourable terms
- ✓ Domestic interest rates are used as potential benchmarks
- ✓ Information available in the website of Indian banks generally considered
- ✓ Guarantee fee in range of 3 to 5 percent considered resulting in TP adjustments

Non availability of specialized database, complex inter-company loan instruments and implicit element of guarantee from parent company – A challenge

Corporate guarantees issued by holding company on behalf of its subsidiary in case of lack of subsidiary's core strength to raise bank finance does not amount to services and no arm's length adjustment can be done – *Micro Ink Ltd. v. Addl. CIT [2015] 63 taxmann.com 353 (Ahmedabad – Trib.)*

# Final Rules for use of Range Concept and Multiple Year Data

## - Overview

Following are some of key features of the Final Rules:

- A minimum of six comparables would be required in the dataset for applying the concept of range. In absence of six or more comparables, the arm's length price shall be the arithmetical mean
- An arm's length range beginning from the 35th percentile of the dataset (arranged in ascending order) and ending on the 65th percentile would be considered
- The price in respect of comparable uncontrolled transactions shall be determined using the weighted average of the prices/data points for;
  - the Current Year and preceding two financial years; or
  - two financial years immediately preceding the Current Year (but not including the Current Year as the same may not have been available)
- Comparability factors need to be analyzed for current year before accepting any company as a comparable. If a company is not comparable for current year, it would be rejected from the dataset. Accordingly, if during the assessment, based on current year data (which may be then available – even if not available at the time of benchmarking), any company is considered as not comparable then that company will be removed from the dataset, irrespective of the fact that such company was comparable in the immediately preceding years
- New comparables can be added during the assessment based on the data available at that point of time
- As a result of the last 2 points, ambiguity / uncertainty with regard to arm's length margin will continue to exist in transfer pricing assessments

# Final Rules for use of Range Concept and Multiple Year Data

## - *Applicability*

Methods	Applicability of	
	Multiple year data	Range Concept
CUP	x	✓
CPLM	✓	✓
RPM	✓	✓
PSM	x	x
TNMM	✓	✓
Other Method	x	x

# Final Rules for use of Range Concept and Multiple Year Data

## - Illustration

As per TP Study at the time of filing Return of income

Step 1: Computation of weighted average

SL	Name	Year1		Year2		Year3 [Current Year]		Aggregation		Weighted Average (OP/OC %)
		Operating Cost	Operating Profit	Operating Cost	Operating Profit	Operating Cost	Operating Profit	Operating Cost	Operating Profit	
1	A	100	12	150	10	225	35	475	57	12.00%
2	B	80	10	125	5			205	15	7.32%
3	C	250	22	230	26	250	18	730	66	9.04%
4	D			220	22			220	22	10.00%
5	E					100	-5	100	-5	-5.00%
6	F	160	21	120	14	140	15	420	50	11.90%
7	G	150	21	130	12	155	13	435	46	10.57%

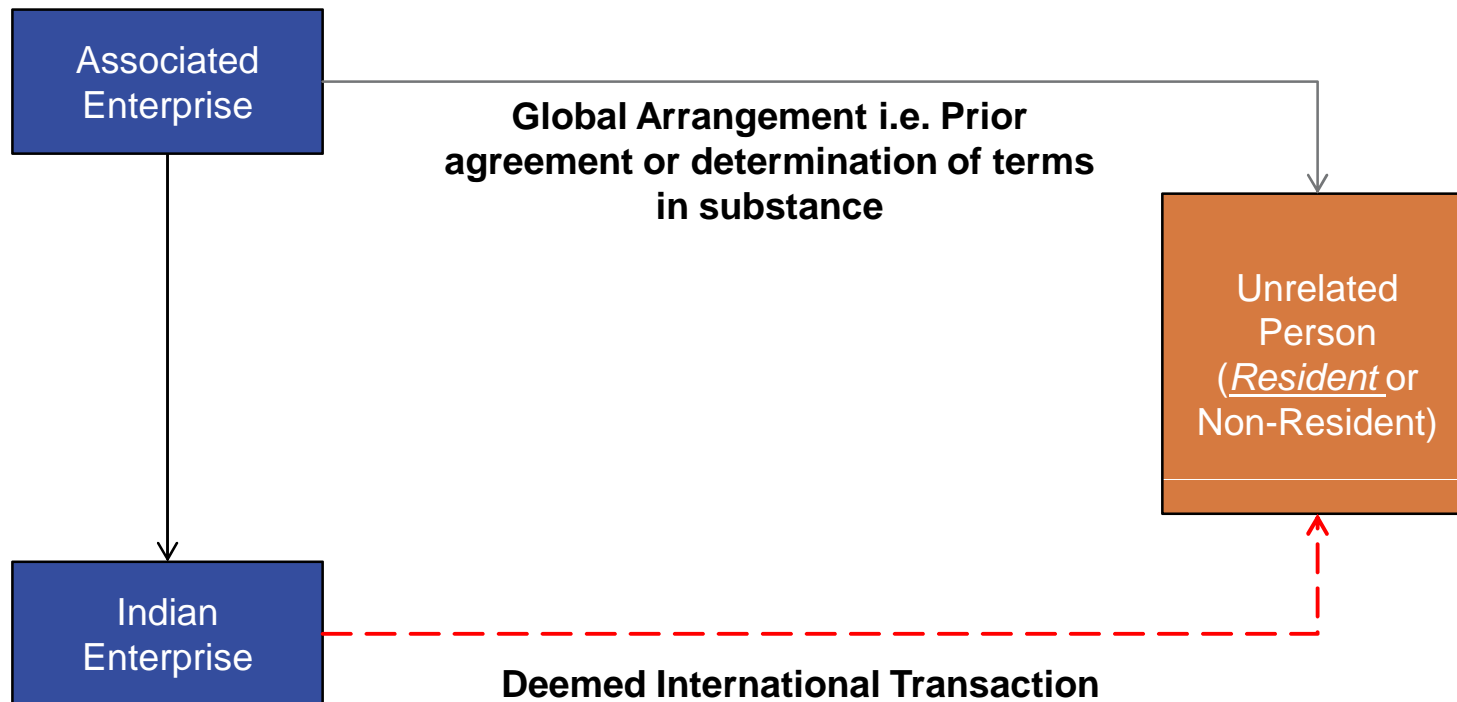
Step 2: Arrange the data in ascending order

Observation No.	1	2	3	4	5	6	7
Name	E	B	C	D	G	F	A
Weighted Average	-5.00%	7.32%	9.04%	10.00%	10.57%	11.90%	12.00%

Observations	7	Statistical position		
Data place of the thirty-fifth percentile	$7 \times 0.35$	2.45	3rd	==>> C
Data place of the sixty-fifth percentile	$7 \times .65$	4.55	5th	==>> G
<b>Range</b>	<b>9.04% to 10.57%</b>			
<b>Median</b>	$7 \times 0.5$	3.5	4th	==>> D
	<b>10%</b>			

# Section 92B(2) - Deemed International Transactions

## - Overview

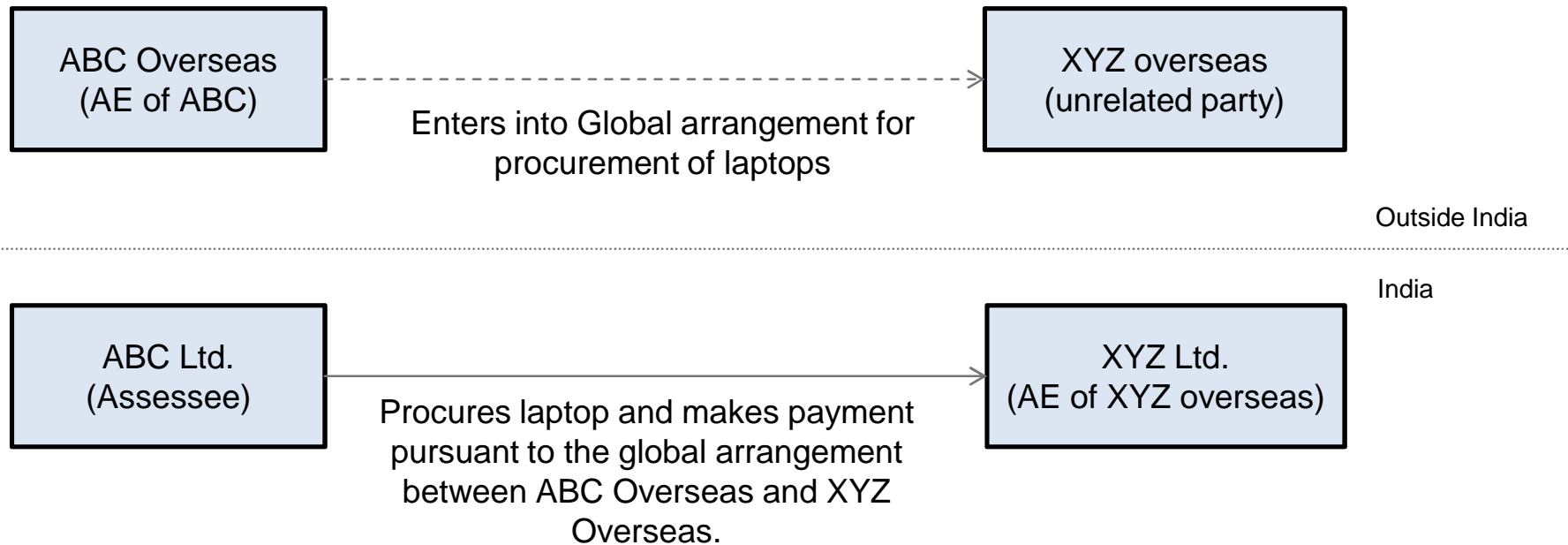


Transactions with unrelated parties whether resident or non-resident to be reported as Deemed International Transactions under Section 92B(2) of the Act



# Section 92B(2) - Deemed International Transactions

## - Case Study



# Income received for back office support services

## - *Key Issues*

- Captive Service providers – a cost plus arrangement with mark-up between 10 to 20 percent
- Revenue authorities applying mark-up in the range of 25 percent 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 Infosys BPO Limited; Acropetal Technologies Limited; Accentia Technologies Limited; eClerx Services Limited; etc.*)
- Economic adjustments for working capital considered only selectively and Risk adjustment normally not allowed
- Loss making comparables usually rejected
- Stringent Filters applied: 75 percent export turnover filter, different accounting year end, diminishing revenue, etc.
- 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

# Income received for back office support services

## - Key Judicial Precedent

***Maersk Global Service Centres (India) Private Limited vs. Asst. Commissioner of Income Tax [2014] 43 taxmann.com 100 (Mumbai - Trib.) (SB)***

- The principal functions / activities of the tested party should be identified.
- The range of services rendered by the ITeS sector is so wide that a classification of all services, either low end or high end may not always be possible.
- The comparability exercise can be split into two steps in order to attain a relatively equal degree of comparability:
  - Step 1: Select the potential comparables at the ITeS - sector level by applying the broad functionality test;
  - Step 2: From the broad ITeS set, eliminate comparables that undertake significantly different 'functions' as carried out by the taxpayer, for ensuring relatively equal degree of comparability.
- SB noted that companies primarily engaged in high end support services cannot be compared to the Assessee mainly engaged in providing low end support services.

Delhi High Court in case of ***Ramgreen Solution Pvt. Ltd. ([2015] 60 taxmann.com 355 (Delhi))*** largely reiterate above points with additional observation that where services rendered are clearly in nature of lower end ITeS such as Call Centre not involving domain knowledge then the inclusion of KPO service provider is not warranted at the threshold itself while conducting Transfer Pricing study.

# Key Points for success in Transfer Pricing audits in India



- Detailed Functions-Assets-Risks analysis
- Proactive Planning
- Agreements / contracts should exist for transactions between Associated Enterprises
- Price setting mechanisms to be documented
- Localization of Global Transfer Pricing policies
- Documentation should completely describe search methodology, basis for inclusion / exclusion of comparables, etc.
- 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

# Thank You

Bhavesh Dedhia

Bipin Dodhia

