TRANSFER PRICING REGULATIONS IN INDIA

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Transfer Pricing Regulations in India
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Includes:

- Use of multiple year data and range concept
- Selection of cases for TP audit
- Base Erosion and Profit Shifting (Action Plan 13)
- List of countries having comprehensive TP regulations
- Analysis of recent TP judgments

PREFACE

India is emerging as the new 'global economic hotspot' according to the International Monetary Fund. The Indian economy is estimated to have grown at 7.6% in Financial Year ('FY') 2015-16 and is expected to grow at 7% to 7.75% in FY 2016-17, making it the fastest growing major economy in the world. For this purpose, it is imperative that India's cross border and transfer pricing regime is investor friendly and reduces potential and frivolous litigation.

The Indian Transfer Pricing (TP) Regulations have evolved over the years, from the Finance Act, 2001 that introduced for the first time detailed TP Regulations in India to the implementation of Base Erosion and Profit Shifting (BEPS) Action Plan 13 in the Finance Budget of 2016. The Indian regulations have been perceived to be one of the most aggressive regimes in the world. The number of cases in dispute has been steadily increasing. The Finance Ministry with a view to reduce cases under audit and to reduce litigation has introduced certain far reaching measures in the recent past to move away from a quantitative basis for selection of cases for transfer pricing audit to a risk based system. This is expected to reduce the cases under audit and thus reduce litigation. Further, the Central Board of Direct Taxes (CBDT) has introduced the range concept and use of multiple year data, these steps are expected to reduce unnecessary litigation and bring about a stable transfer pricing regime.

The Safe Harbour Rules (SHR) though introduced with the intention of reduction of litigation and compliance burden have met with limited success owing to limited coverage primarily for Information Technology (IT), IT enabled Services (ITeS), Auto Ancillary sector and Research & Development (R&D) centres as well as due to high markups / margins prescribed in the same. The Advance Pricing Agreement (APA) provisions has proved to be a step in the right direction and about 580 APAs have been filed and 59 APAs have already been concluded. Further, in order to reduce compliance burden for the small and medium taxpayers the minimum limit for applicability of domestic transaction has been increased to INR 20 Crores.

The Organisation for Economic Co-operation and Development (OECD's) BEPS project was initiated in 2013 at the request of the Group of 20 major economies (G20). The BEPS project resulted in a series of proposals for revising international tax standards, and several of its key final recommendations were delivered in 2015. BEPS project has focused

on guidance associated with cross-border transfer pricing.

The BEPS project was not devised with an intention to eliminate the ability of corporations to lower their overall tax rate. However, the intention of the BEPS project is to limit or eliminate the ability of corporations to achieve this result by engaging in transfer pricing practices that allocate profits to jurisdictions that have little to no substance . The OECD issued its final report on Action Plan 13, in 2015 which sought to re-examine transfer pricing documentation. As a result of this work, two key reforms have emerged from the BEPS project: the so-called 'Master File' report and 'Country-by-Country Reporting' (or CBCR) template. Both aim to provide local taxing authorities with a more global view of the MNEs operating in their jurisdiction. Many countries (such as Australia, Canada, Germany, South Korea, Spain, and the United Kingdom) have implemented CBCR in their domestic law. India has implemented the BEPS Action Plan 13 in the Budget of 2016, which will be effective from Assessment Year 2017-18. With this development, India has joined the global stage. The Indian TP Regulations thus have reached maturity and now are in line with the world.

In this publication we have endeavoured to elucidate in a comprehensive manner the whole gamut of the transfer pricing regulation in India and the recent developments in this field. This publication should not be viewed as an exhaustive book but may be considered as a guide to understand the subject from a business perspective and identify areas of potential exposure and manner in which the exposure can be minimised.

Happy Reading!

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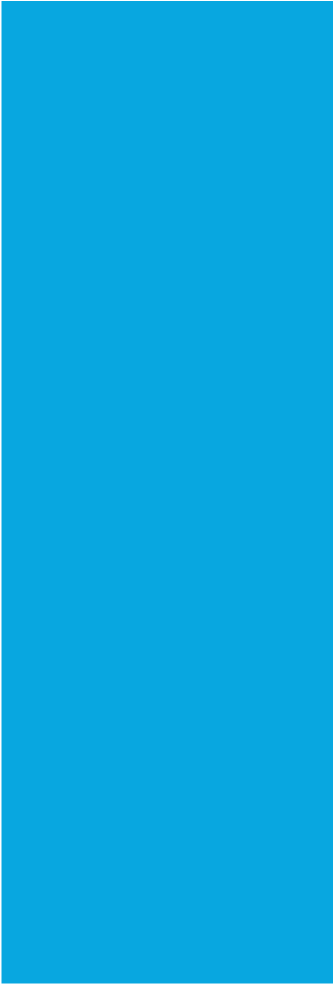
RECENT DEVELOPMENTS



Chapter 1 What Has Changed?

1.1 Use of Multiple Year Data and Adoption of Range Concept

On 19 October 2015, CBDT issued a notification releasing the rules for the use of range and multiple year data in line with the announcement made by Finance Minister to align the Indian Transfer Pricing Regulations with international best practices.

The Rules are applicable with effect from 1 April 2014 and would apply for both international transactions as well as Specified Domestic Transaction (SDT)from FY 2014-15 prospectively.

Use of multiple-year data

In case where the Resale Price Method (RPM), Cost Plus Method (CPM) or Transactional Net Margin Method (TNMM) is used as most appropriate method for determination of the arm's length price (ALP) of international transaction / SDT entered into or after 1 April 2014, comparability will be conducted based on:

- Data relating to current year or
- Data relating to the financial year immediately preceding the current year, if the data relating to the current year is not available at the time of furnishing the return of income

However, it has been provided that during the assessment proceedings, if the current year data becomes available, the same shall be considered irrespective of the fact that such current year data was not available at the time of furnishing the return of income.

Adoption of the range concept – Rule 10CA

The concept of range is applicable in case of all methods except the Profit Split Method (PSM) and Other Method. The steps to be followed for constructing the range are as under:

- A minimum of six comparables would be required

- Where the comparable uncontrolled transaction of an enterprise has been identified based on current year data and the enterprise has undertaken the same or similar transactions in the two preceding financial years, three-year data of these comparables would be considered. In certain circumstances, data of two out of three years could also be used. Additionally, single year data can be used, provided that the data is for the current year in which the tested transaction is undertaken or a year prior to the current year in the case of non-availability of data for the current year.

- The data set using multiple year data is required to be computed based on the weighted average of the prices derived .

- The weighted average of the three-year data of each comparable would be used to construct the data set.

- An arms' length range beginning from 35th percentile of the dataset and ending on the 65th percentile will be considered.

- If the transaction price falls within the range, then the same shall be deemed to be the ALP. If the transaction price falls outside the range, the ALP shall be taken to be the median of the data set.

The arithmetic mean of prices along with the permitted variation of 1% (in case of wholesalers) / 3% (in all other cases) would continue to apply in the case of PSM and Other method. It would also apply in cases where the numbers of comparables are less than six.

For details, refer Chapter 7

1.2 Country-by-Country Reporting

With a view to align the existing Indian Transfer Pricing Regulations pertaining to maintenance of documentation, the Finance Act, 2016 has adopted Action 13 of the Action Plan on BEPS ('BEPS Action Plan 13') for Transfer Pricing Documentation and Country-by-Country ('CbC') reporting by introducing an amendment to section 92D and inserting a new section 286 to the Income-tax

Act, 1961 ('the Act'). These provisions will be effective from the assessment year 2017-18 (financial year commencing 1 April 2016) and subsequent assessment years.

The CbC report requires each Multinational Enterprise (MNE) to provide key financial information on an aggregate country basis with an activity code for each member of the MNE. CbC report is a new concept for the international tax world and represents the biggest change to the existing Guidelines. The provision of the CbC report to the tax authorities is a 'minimum standard' requirement, and the report makes clear that countries participating in the BEPS project are expected to commit to and adopt this measure. It will provide tax authorities with global information for the purposes of risk assessment.

The reporting provision shall apply in respect of an international group having consolidated revenue, based on consolidated financial statements, exceeding the threshold. The current international consensus is for a threshold of €750 million equivalent in local currency. This threshold in Indian currency would be equivalent to INR 5,395 Crores (at current exchange rates).

The report would contain aggregate information in respect of revenue, profit & loss before income-tax, amount of Income-tax paid and accrued, details of capital, accumulated earnings, number of employees, tangible assets other than cash or cash equivalent in respect of each country or territory along with details of each constituent's residential status, nature and detail of main business activity and any other information as may be prescribed. This shall be based on the template provided in the OECD BEPS report on Action Plan 13, the prescribed date for filing the CbC report will be the due date of filling of return of income for the relevant assessment year for which the report is being furnished;

An entity in India belonging to an international group shall be required to furnish CbC report to the prescribed authority if the parent entity of the group is resident:

- In a country with which India does not have an arrangement for exchange of the CbC report; or

- Such country is not exchanging information with India even though there is an agreement; and
- This fact has been intimated to the entity by the prescribed authority.

If an international group, having parent entity which is not resident in India, had designated an alternate entity for filing its report with the tax jurisdiction in which the alternate entity is resident, then the entities of such group operating in India would not be obliged to furnish report if the report can be obtained under the agreement of exchange of such reports by Indian tax authorities.

For details, refer Chapter 12.

1.3 Change In Assessment Procedure

CBDT vide instruction 3/2016 dated 10 March 2016 has issued guidelines for implementation of transfer pricing provisions by replacing instruction no 15/2015. The said guidelines are applicable for both international transaction as well as SDT. The key features of the guidelines are as under:

All cases selected under Computer Assisted Scrutiny Selection (CASS) system or under the compulsory manual selection system on the basis of transfer pricing risk parameters have to be mandatorily referred to the TPO by the AO after obtaining approval of the Principal Commissioner of Income-tax (PCIT) or Commissioner of Income-tax (CIT).

For cases, having international transaction and SDT, selected for scrutiny on non-transfer pricing risk parameters, the same shall be referred to the Transfer Pricing Officer (TPO) only in the following circumstances:

- Where the taxpayer has entered into an international transaction or SDT, however the taxpayer has not filed the accountant's report i.e. Form No. 3CEB or has not disclosed all the international transactions or SDT's in the Form No. 3CEB so filed.
- Where there has been a transfer pricing adjustment of INR 10 crores or more

in an earlier assessment year (AY) which has been upheld by the judicial authorities or is pending in appeal.

- Where, in the search and seizure or survey operations, findings have been recorded by the investigation wing or assessing officer (AO) regarding transfer pricing issues.

In other situations, the AO shall provide an opportunity of being heard to the assessee before referring the case to the TPO. In case, the assessee objects to the reference, the AO shall pass a speaking order for either accepting or rejecting of objections and take the prior approval of PCIT or CIT before making reference to the TPO.

After receiving reference from AO, the TPO shall serve a notice on the taxpayer requiring him to produce or cause to be produced, any evidence on which taxpayer may rely in support of the computation made by him of the ALP in relation to the international transactions /SDTs.

If any other international transaction/SDT not reported in Form No. 3CEB comes to the notice of the TPO during the course of assessment proceedings, the provision of section 92CA shall also apply to such transactions. This is pursuant to the insertion of sub-section (2B) in section 92CA by Finance Act, 2012 with retrospective effect from 1 June, 2012.

The Chennai Tribunal In the case of **Ford India (P.) Ltd. vs. DCIT** [2013] 34 taxmann.com 50 held that the TPO can consider international transactions not reported by the assessee but coming to his notice during proceedings before him

The TPO shall pass a speaking order incorporating the relevant documents like data used, reasons for arriving at certain price and the applicability of method.

For administering the TP regime in an efficient manner, AO has no power to determine ALP in respect of cases which are not referred to the TPO and must record in the body of assessment order, due to board instruction on this matter, the transfer pricing issues has not been examined at all.

For details, refer Chapter 11.

1.4 Change in Time-Limit for Completion of Assessment

The Finance Act, 2016 has substituted section 153 of the Act with effect from 1 June, 2016 with regard to time limit for completion of assessment. The said time limit is changed from three years to thirty-three months from the end of the relevant assessment year i.e, the time limit for completion of assessment is reduced by three months. Resultantly, transfer pricing assessment is now required to be completed by end of October. (E.g. TP assessment for AY 2013-14 will have to be completed by 31 October 2016).

For details, refer Chapter 11.

1.5 Current Status of Advanced Pricing Agreement ('APA') Scheme

Since the notification of APA scheme, approximately 580 applications for APA have been filed and about half of these contain a request for roll-back provisions. As on 31st March, 2016, CBDT had signed a total of 59 APAs of which 3 are bilateral and 56 are unilateral.

For details, refer Chapter 14.

1.6 Update on Mutual Agreement Procedures ('MAP')

A Framework Agreement was recently signed with United States under the MAP provision of the India-US Double Taxation Avoidance Convention (DTAC). This is a major positive development. About 200 past transfer pricing disputes between the two countries in Information Technology Services (ITS) i.e. Software Development and Information Technology enabled Services (ITeS) segments have been resolved under this Agreement during the year 2015.

For details, refer Chapter 14.

1.7 Introduction of Direct Tax Dispute Resolution Scheme

The Finance Act, 2016 has introduced the Direct Tax Dispute Resolution Scheme 2016 as per the scheme assessee's with tax arrears and specified tax has the option to settle the case by paying tax, interest and penalty as under:

- Where the appeal is pending before the CIT(Appeals), pay tax arrears along with interest up to date of assessment and no penalty where tax arrears are less than INR 10,00,000 whilst 25% penalty where tax arrears exceed INR 10,00,000.

- Where appeal is pending before any appellate authorities and tax was determined pursuant to retrospective amendments, only tax amount to be paid and immunity from interest, penalty and prosecution.

Chapter 2 Important Issues Under Litigation

2.1 Marketing Intangibles

2.1.1 Issues

In case of an international transaction between taxpayer and associated enterprises (AE) under which the taxpayer incurred Advertising Marketing Promotion (AMP) expenses towards marketing intangibles legally-owned by the AE; the issue herein pertains to allow ability of such AMP expenses in the hands of the taxpayer, considering the commercial rational or the legal ownership. According to the tax Authorities, what is relevant under the Transfer Pricing Regulations is **legal ownership** of intangibles.

2.1.2 Judicial pronouncements

The said issue was examined by the Special Bench of Delhi Tribunal in the case of **L.G. Electronics India Private Limited** [2013] 29 taxmann.com 300, wherein, the Tribunal did not deny that there can be no economic ownership of a brand, however, it was opined that the same exists only in a commercial sense. Regarding AMP expenses, the Tribunal held that that it needs to be found out as to how much AMP expenses an independent enterprise behaving in a commercially rational manner would have incurred. On such comparison, if the result is that the taxpayer had incurred expenses proportionately more than that incurred by independent enterprises behaving in a commercially rational manner, then it becomes eminent to re-characterize the transaction of total AMP expenses with a view to separate the transaction of brand building or the foreign AE. The Tribunal further concluded that the transaction of brand building by the taxpayer for foreign AE is in the nature of the 'provision of service' requiring a mark-up. Moreover, the Tribunal also endorsed the use of **bright line test** in order to determine the transaction value of such AMP expenses.

The Tribunal also provided broad guidance on various factors that need to be considered while ascertaining whether an intangible is created and determining the value of the international transaction of foreign brand building / logo promotion through such AMP expenses.

Recently, the Delhi High Court in case of **Sony Ericsson Mobile Communications India Pvt. Ltd.** [2015] 55 taxmann.com held that AMP expenses incurred by assesee subsidiary of multinational enterprise can be categorised as an international transaction subject to transfer pricing. It also held that marketing and distribution are inter connected and intertwined functions and bunching of inter-connected and continuous transactions is permissible, provided the said transactions can be evaluated and adequately compared on aggregate basis. It also concluded that it would be illogical and improper to treat AMP expenses as a separate transaction using bright line test. The court also recognised the concept of economic ownership of trade name or trade mark is acceptable in international taxation as one of the components or aspects for, determining transfer pricing. The High Court has further stated that economic ownership would arise only in cases of long term contracts and where there is no negative stipulation of denying economic ownership.

A contrary view was held by the Delhi High Court in case of **Maruti Suzuki Ltd.** (ITA No. 110/2014), wherein it concluded that the AMP expenses incurred by assesse cannot be considered as an international transaction and therefore no transfer pricing adjustment can be made on account of AMP expenses. It also held that bright line test is not permitted by the law relying on the Sony Ericsson judgment.

The other judicial pronouncements in context of AMP expenses are as under

- **Reebok India Co. Vs. Adl. CIT** [2013] 35 taxmann.com 578 (Delhi Tribunal)
- **Panasonic Sales & Services Private Limited Vs. ACIT** [2013] 34 taxmann.com 276 (Chennai Tribunal)
- **Whirlpool of India Ltd. Vs. DCIT** [2014] 30 ITR 29 (Delhi Tribunal)
- **Diageo India (P) Ltd. Vs. DCIT** [2013] 34 taxmann.com 284 (Mumbai Tribunal)

2.1.3 Precautionary measure

The necessity of transfer pricing adjustment for AMP expenses may arise where

there is influence of an AE in advertising and marketing function of the Indian affiliate. It is advisable for the taxpayer to evaluate the TP policy in light of detailed analysis of roles / responsibilities undertaken, risks borne / reward reaped. Also, a robust documentation including legal contracts etc. has to be maintained by the taxpayer.

2.2 Issuance of Guarantee on Behalf of the AE

2.2.1 Issues

The Indian tax authorities are of the view that the Indian entity must charge guarantee fees for the guarantee given in respect of the borrowings of AEs.

In the absence of any guarantee fees charged to AEs, the tax authorities may take stand that Indian entities provided an intra-group service to its AE by issuing the corporate guarantee to the loans taken by their AEs abroad, the latter are obliged to pay a service charge to the Indian entity. Accordingly, Indian entity should charge guarantee fee for provision of guarantee service.

2.2.2 Judicial pronouncements

The Delhi Tribunal in the case of **Bharti Airtel Limited Vs. ACIT** [2014] 43 taxmann.com 150 noted that Explanation to section 92B states that it is merely clarificatory in nature in as much as it is 'for the removal of doubts', and therefore, one has to proceed on the basis that it does not alter the basic character of definition of 'international transaction' under section 92B. Therefore, the Tribunal viewed that the said Explanation has to be read in conjunction with the main provisions, and in harmony with the scheme of the provisions, under section 92B. The Tribunal observed that under the scheme of the Act, any transaction including capital financing, guarantees, business restructuring / re-organization can be regarded as an 'international transaction' only if such a transaction has a bearing on the profits, income, losses or assets of an enterprise (either immediately or in future). The Tribunal further noted that such an impact in the future has to be certain (and not contingent) for covering a transaction in the definition of international transaction. The Tribunal noted that the corporate

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guarantees issued by the taxpayer to the bank on behalf of its AE did not have any implication on the profits, income, losses or assets of the taxpayer. It also observed that the AE had not taken any borrowing from the bank based on the taxpayer's guarantee.

The Bombay High Court in case of **Everest Kanto Cylinders Ltd** [2015] 58 taxmann.com 254 held that no comparison can be made between guarantees issued by commercial banks as against a corporate guarantee issued by holding company for benefit of its AE, a subsidiary company, for computing ALP of guarantee commission. The Court further stated that the considerations which apply for issuance of a corporate guarantee are distinct and separate from that of bank guarantee and cannot be compared.

2.2.3 Precautionary measure

Considering that the chargeability of fees on corporate guarantee provided by the taxpayer to its foreign AE is a subject matter of litigation and pursuant to the amendment in section 92B to include guarantees, it is therefore advisable to charge guarantee fees on such guarantees provided, at ALP. Reference can be drawn from the rates prescribed under the SHR.

2.3 Charging Notional Interest for Delay in Realisation of Sales Proceeds from AEs

2.3.1 Issues

In case of excessive credit period allowed to AEs and delay in realization of sales proceeds from AEs as compared to non AEs, the tax authorities are of the view that by giving excess credit period to AEs and delay in realizing sales proceeds from AEs as compared to non AEs, the Indian entity is passing the benefits of prolonged credit to its AE. Accordingly, an adjustment should be made in respect of excess credit allowed to AE debtors by charging notional interest from AEs on excess amount outstanding or extended credit period.

2.3.2 Judicial pronouncement

The Bombay High Court in the case of **Indo American Jewellery Ltd** [2014] 44

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taxmann.com 310 affirmed the view of the Tribunal that if there is complete uniformity in the act of the taxpayer in not charging interest from both the AE and non AEs debtors for delay in realization of export proceeds, then no notional interest is to be charged on the exports proceeds received belatedly from the AEs.

The Delhi Tribunal in case of **Kusum Healthcare Pvt Ltd.** (ITA No. 6841/Del/2014) held that when the underlying transaction of sales to AE has been held to be at arm's length based on the working capital adjusted arm's length margin under TNMM, no further TP adjustment for interest on outstanding receivables is warranted.

2.3.3 Precautionary measure

Finance Act, 2012 has widened the definition of international transaction under Section 92B with retrospective effect from AY 2002-03 to cover overdue receivables within the definition of 'international transaction'. However, the High Court decision passed after the said amendment to the definition of international transaction under section 92B did not consider the implication of such amendment in the specific case.

Nevertheless, in order to avoid adjustment or litigation on this account, it is advisable that there is no excess credit allowed / prolonged credit period extended to AE debtors as compared to non AE debtors. It is advisable to maintain robust documentation to prove that the excess credit, if allowed to AE debtors is due to specific business reasons and not with the intention of passing any benefits to AEs.

2.4 Economic Adjustments

2.4.1 Issues

There may be certain circumstances wherein comparables identified may require adjustments for differences in working capital, risk profile of entities, capacity utilisation, etc. for determining the ALP. Such adjustments are referred to as comparability adjustments or, economic adjustments in common parlance.

Economic adjustments have been a subject matter of litigation in India.

2.4.2 Judicial pronouncements

The Chennai Tribunal in case of **Mando India Steering Systems Pvt Ltd** [2014] 45 taxmann.com 160 was of the view that underutilisation of production capacity in initial years is a vital factor and cannot be ignored when determining the ALP of a controlled transaction.

The Pune Tribunal in case of **Amdocs Business Services Private Ltd.** [2012] 26 taxmann.com 120 allowed economic adjustments on account of under utilisation of capacity, startup cost and also for excess depreciation as taxpayer had charged excess depreciation at rates higher than the comparable companies.

The Pune Tribunal in case of **Demag Cranes & Components (India) (P.) Ltd.** [2012] 17 taxmann.com 190 held that working capital is a factor which influences price in open market and, therefore, requisite adjustment on account of working capital has to be made while determining arm's length operating margin of comparables. It also held that TP adjustments should be made on proportionate basis (i.e. on proportionate sales relating to the impugned international transaction) and not the entire sales.

The Mumbai Tribunal in the case of **Petro Aradite Pvt. Ltd** (ITA No.3782/Mum/2011: [2013] 35 taxmann.com 590) discussed and explained a methodology for making capacity adjustment in detail. It held that if the fixed overheads allocation or absorption of comparables was brought to the level of taxpayer, it would nullify the effect of difference in capacity utilisation on the profit margin. Thus, the Tribunal held that the adjustment on account or difference in capacity utilisation can be made by absorbing or allocating fixed overheads such as depreciation at the same level as that of the taxpayer. It also held that such absorption or allocation of fixed overheads would be more appropriate on operating cost instead of sales to eliminate the effect of differences in profit margin or difference in stock of finished goods, if any between the taxpayer and the comparables.

In a recent decision the Delhi Tribunal in the case of **Claas India Pvt. Ltd.** [TS-371-ITAT-2015], has not only accepted the need for a capacity utilisation adjustment but has in fact treaded a step further and addressed two critical questions in relation to this adjustment, viz., whether the adjustment should be made to the tested party or to comparables? And how the adjustment be calculated?

With regard to the first part, the Tribunal held that the difference in the percentage of capacity utilisation of the tax payer vis-à-vis comparables should be given effect to in the operating profit of comparables by adjusting their respective operating costs.

With regard to the methodology the Tribunal explained that capacity utilisation adjustment can only be granted with respect to the fixed costs. Any adjustment upward/downward needs to be made to the fixed cost of comparables while comparing to that of the taxpayer.

2.4.3 Precautionary measure

In view of the above, it is advisable that the claim on account of capacity utilisation should be supported with evidence. E.g., certificate from expert, etc.
Further, in absence of capacity utilisation data the taxpayer needs to maintain detailed breakup of fixed costs to support the claim for capacity utilisation adjustment.

Chapter 3 Countries Having Comprehensive Transfer Pricing Regulations

3.1 Evolution of Transfer Pricing Regulations

Transfer Pricing has been in practice in United States (US) since the 1920s. US and the OECD played a phenomenal role in evolution of transfer pricing practices across the world. US was the first country to adopt a comprehensive transfer pricing legislation in 1968. OECD issued the first draft of the transfer pricing Guidelines in 1995 which is regarded as the most important document in drafting transfer pricing legislation and its interpretation.

In 1995, only 3 Countries (US, Australia & South Africa) were having transfer pricing Regulations. However, since then there has been steep increase in number of countries adopting TP regulations with over 80 countries having TP regulations. Some of the countries in which the domestic transfer pricing regime exists, besides India, include Australia, South Africa, China, Brazil, France, Russia and United Kingdom. As a result, it is important to design an appropriate global transfer pricing policy and approach keeping in view not only the Indian regulations but other countries where the entity has associated enterprises and with whom the entity has international transactions.

3.2 Countries Having Comprehensive Transfer Pricing Regulations

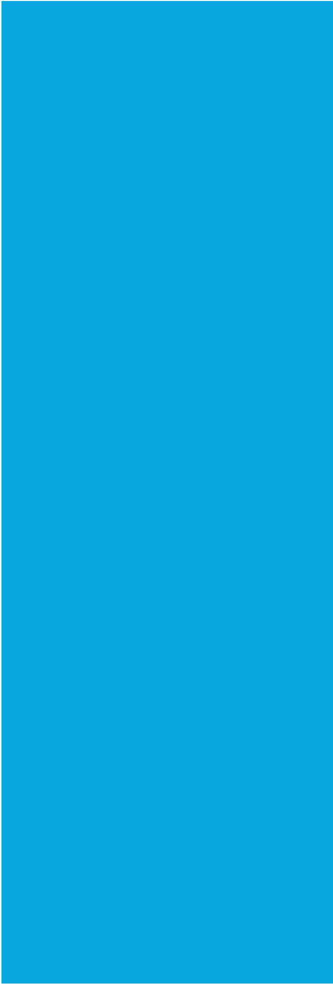
In the below table, we have enlisted the countries having a comprehensive transfer pricing regime in place.

Australia	Chile	Ecuador
Argentina	China	Egypt
Austria	Colombia	El Salvador
Belgium	Cost Rica	Estonia
Belarus	Croatia	Finland
Brazil	Czech Republic	France
Bulgaria	Congo republic	Germany
Republic of Cameroon	Denmark	Greece
Canada	Dominican Republic	Guatemala

Georgia	Mongolia	South Africa
Ghana	Malaysia	Spain
Hong Kong	Mexico	Sweden
Hungry	Netherland	Sri Lanka
Iceland	New Zealand	Switzerland
India	Nigeria	Taiwan
Indonesia	Norway	Thailand
Ireland	Oman	Turkey
Israel	Peru	Tanzania
Italy	Philippines	Ukraine
Japan	Poland	United Kingdom
Kazakhstan	Portugal	United States
Kenya	Qatar	Uruguay
Korea	Romania	Uganda
Kuwait	Russia	Venezuela
Latvia	Saudi Arabia	Vietnam
Lithuania	Singapore	Zambia
Luxembourg	Slovenia	Zimbabwe

Section B

INTRODUCTION TO TRANSFER PRICING



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Chapter 4 Overview Of Transfer Pricing

4.1 Background And Recent Developments

4.1.1 In the midst of an uncertain global economic outlook, India is emerging as the new 'global economic hotspot' according to International Monetary Fund. The Indian economy is estimated to have grown at 7.6% in FY 2015-16 and is expected to grow at 7% to 7.75% in FY 2016-17, making it the fastest growing major economy in the world. For this purpose, it is imperative that India's cross border and transfer pricing regime is investor friendly and reduces potential and frivolous litigation. The Indian transfer pricing regime had been considered to be one of the most aggressive in the world with spate of litigation. A slew of measures have been taken by the government in the recent past leading to introduction of range concept, use of multiple year data in benchmarking, etc. Further, at a global level as part of G20, India was involved in the BEPS project. In the Budget of 2016 the finance minister introduced BEPS Action Plan 13 which includes provision for requirement of country by country reporting for companies with consolidated revenue of more than Euro 750 million which are applicable from AY 2017-18. In addition, the Indian government signed about 59 bilateral / unilateral APA[1] with taxpayers and 180 cases were resolved using MAP for resolving tax disputes.

4.1.2 The Finance Act, 2001 introduced for the first time detailed TP Regulations in India and a separate mechanism for reporting and assessment of international transactions between associated enterprises. The relevant provisions are contained in he Act - Sections 92 to 92F and 94A of the Act and Rules 10A to 10THD of the Income-tax Rules, 1962 ('the Rules'). In addition to applicability of TP Regulations to international transactions, the transfer pricing provisions were further extended to cover SDT with effect from FY 2012-13 vide section 92BA of the Act.

4.1.3 The TP provisions in India are in existence for almost 15 years and have generated considerable controversies – including retrospective amendments. The latest estimates suggest that the tax authorities have made an upward adjustment to the income of the assessee to the tune of more than INR 2700 billion[2] (US$ 40

1 Source : tp.taxsutra.com

2 Source : tp.taxsutra.com

billion) since inception of TP Regulations in India. The Finance Minister also highlighted in his budget speech that the overall tax demand of more than INR 5.5 lakh crores is under dispute and litigation. It is understood that roughly 50% of the above tax demand relates to transfer pricing disputes (based on 10 TP Audit cycles). Indian tax has been ranked 2nd amongst toughest tax authorities in the world.

Transfer Pricing Regulations in India follow the internationally accepted principles for determination of ALP. It is therefore important to understand the fundamentals of TP Regulations so as to ensure its effective compliance in India.

4.1.4 Transfer Pricing – Meaning and Purpose

Transfer Pricing refers to the price charged by one member of multinational organisation to another member of the same organisation for the provision of goods or services or the use of a property, including intangible property. Transfer Pricing is significant for both taxpayers and tax administrations, because it affects the allocation of profits from intra-group transactions, which impacts the income and expenses reported, and therefore taxable profits of related companies that operate in different taxing jurisdictions.

The OECD Guidelines defines Transfer Prices as the 'prices at which an enterprise transfers physical goods and intangible property or provides services to associated enterprises'.

Transfer Pricing is based on the principle of arms length price which refers to the price that an independent party would be willing to pay to another independent party for a product, service or intangible. Thus, the term Transfer Pricing refers to determination of price of goods, services and intangible transactions between associated enterprises that belong to the same group.

The Chennai Tribunal in the case of **Iljin Automotive Private Ltd. v. Asstt. CIT** [2011] 16 taxmann.com 225 explained the concept of 'transfer pricing' as 'Transfer pricing may mean manipulation of prices in relation to international transaction between the parties which are controlled by the same interest.'

The expression 'Transfer Pricing' is neither used nor defined in the Act except as part of the expression 'Transfer Pricing Officer'.

The object and purpose of transfer pricing provisions, according to OECD Guidelines, is as under:

- Conditions made or imposed between two enterprises in their commercial or financial relations;
- Such conditions differ from those which would be made between independent enterprises; and
- The purpose of transfer pricing provisions is to tax any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued.

The profits derived by enterprises carrying on business in India can be controlled by the multinational group, by manipulating the prices charged and paid in such intra-group transactions, thereby, leading to erosion of tax revenues.

Domestic Transfer Pricing Regulations are relevant under two situations:

- Transactions between loss-making and profit-making related entities; and
- Transactions between two related units (of the same taxpayer) having differential tax rates.

Transfer Pricing Regulations, therefore, are intended to prevent:

- In case of international transactions, revenue loss arising to a country from shifting of profits from high to low tax jurisdictions and protect the tax base of the country from erosion.
- In case of SDT, from shifting of expenses or income between related enterprises / inter-unit, resulting in erosion of tax base of India.

A statutory framework leading to computation of reasonable, fair and equitable

profits and tax in India, in the case of international transactions and SDT, is therefore needed.

4.1.5 Applicability of Transfer Pricing Regulations

An assessee / the taxpayer are required to comply with Indian TP provisions in following circumstances:

a. It enters into an international transaction with its associated enterprise.

b. It enters into a transaction where one of the parties to the transaction is a person located in a Notified Jurisdictional Area ('NJA'). Till date Cyprus has been notified as an NJA under section 94A of the Act.

c. It enters into a SDT.

The working of Chapter X of the Act pertaining to international transactions is as under:

- Income arising from an international transaction between AEs shall be calculated having regard to ALP calculated according to the Most Appropriate Method ('MAM') of the six methods specified in section 92C of the Act.

- The actual prices charged / paid shall be disregarded and substituted by the ALP and difference will be added to the income of the assessee, except in the following two cases:

  - Where the application of ALP results in reduction of income chargeable to tax in India;

  - An arms' length range beginning from 35th percentile of the dataset and ending on the 65th per centile will be considered. If the transaction price falls within the range, then the same shall be deemed to be the ALP. If the transaction price falls outside the range, the ALP shall be taken to be the median of the data set.

- The arithmetic mean of prices along with the permitted variation of 1% (in case of wholesalers) / 3% percent (in all other cases) would continue to apply in the case of PSM and Other method. In other cases, it would also apply in cases where the numbers of comparables are less than six.

Chapter 5 International Transactions – Provisions And Definitions

5.1 Broad Structure of Indian TP Regulations

Particulars	Relevant Sections	Relevant Rules
Coverage	Section 92	–
Definitions	Section 92A, 92B, 92BA and 92F	Rule 10A
Methods	Section 92C(1) to 92C(2B)	Rules 10AB, 10B and 10C
Documentation	Section 92D	Rule 10D
Accountant's' Report	Section 92E	Rule 10E
Penalties	Sections 271AA, 271BA, 271G and Explanation 7 to Section 271(1) , section 270A	–
Administrative	Sections 92C(3), 92C(4) and 92CA,144C	Income-tax (DRP) Rules, 2009
Safe Harbour Rules ('SHR')	Section 92CB	Rules 10TA to 10TG
Advance Pricing Agreement ('APA')	Section 92CC,92CD	Rules 10F to 10T
Transaction with person located in notified jurisdictional area	Section 94A	–
BEPS	286	Yet to be notified

5.2 Provisions of Section 92

5.2.1 As per section 92(1) of the Act, it is required that any income arising from an international transaction / SDT is to be computed having regard to the ALP.

It is also provided that allowance for expenses should also be determined having regard to the ALP (E.g.: Imports from AEs).

5.2.2 Further, it is provided that where two or more associated enterprises enter into an International Transaction / SDT for mutual agreement or arrangement for the

allocation or apportionment of, or any contribution to, any cost or expenses incurred between two or more AEs in connection with a benefit, service or facility provided or to be provided by one or more enterprises is to be determined having regard to the ALP.

(E.g.: If contribution is made by the Indian subsidiary towards the cost of centralized R & D activity conducted by the US parent company for the benefit of all subsidiaries, then the same needs to be determined having regard to the ALP).

5.2.3 It is to be noted that the provisions are not intended to be applied in case determination of ALP reduces the income chargeable to tax or increases the loss as the case may be – Section 92(3). If income as per books of accounts is higher than ALP, then no adjustment can be made to reduce taxable income.

This may be due to the fact that TP Regulations aims to protect erosion of India's tax base. (CBDTs Circular No. 8/2002)

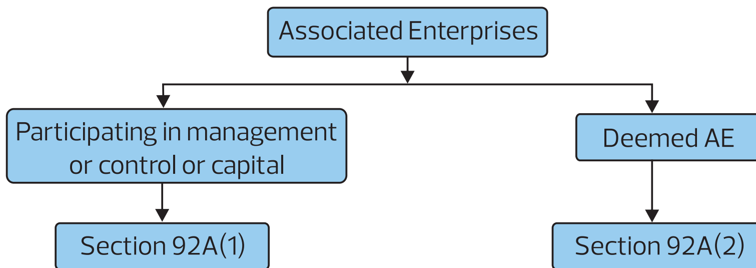
5.2.4 In case where the income is not subject to tax in India pursuant to the provisions of the tax treaty, the TP provisions may still be applicable. In case of **Castleton Investment Limited** [AAR No.999 of 2010, dated 14 August 2012], the Authority for Advance Ruling (AAR) held that the transfer of shares in an Indian company by a Mauritius holding company to Singapore company as a part of internal re-structuring is not liable to capital gains tax under Article 13(4) of India-Mauritius tax treaty. However, it ruled that as per section 92 of the Act, TP provisions are applicable to any income arising from international transactions and that the word 'income' has wide connotation. Thus AAR concluded on facts that the TP provisions are mandatory and applicable for correct determination of gains accruing from international transactions, even though share transfers are not taxable under the tax treaty.

5.2.5 The Mumbai High Court in the order case of **Vodafone India Services Pvt Ltd** (Writ petition no. 871 of 2014) held that the transaction of issue of shares was a capital account transaction, and consequently the share premium if any ought to be a capital receipt. The transfer pricing provisions permit a transaction to be re-quantified but not to be re-characterised. Hence there was no question of

transaction resulting in income taxable in India, since no income arises from the said international transaction. Therefore, TP provisions do not apply to the issue of shares transaction. The applicability of this verdict after introduction of section 56 whereby issue of shares can result in taxable income under certain circumstances needs to be examined.

5.3 Definitions

5.3.1 Associated Enterprise ('AE') – International Transactions



- The term 'Associated Enterprise' is defined in a broad manner. As per section 92A(1), 'AE' in relation to other enterprise means an enterprise:

  a) Which participates, directly or indirectly or through one or more intermediaries, in the management or control or capital of the other enterprise; or

  b) In respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.

- Further, section 92A(2) provides certain circumstances in which two enterprises shall be deemed to be AEs, if at any time during the year:

  a) one enterprise holds, directly or indirectly, at least 26% of voting

power in other enterprise

b) any person or enterprise holds, directly or indirectly, at least 26% voting power in each of such enterprises

c) one enterprise advancing of loan of at least 51% of the book value of the total assets of other enterprise.

d) one Enterprise providing guarantees not less than 10% of total borrowing of other enterprise.

e) more than 50% of Board of Directors or one or more executive directors of one enterprise are appointed by other enterprise;

f) same person appoints more than 50% of BOD or one or more executive directors of two or more enterprises,

g) one Enterprise is wholly dependent on use of intangibles owned by other enterprise such as patents, copyright, trademark or any other business or commercial rights, etc,

h) 90% or more raw material and consumables required is supplied by the other enterprise or person specified by such enterprise and the prices & other conditions are influenced by the other enterprise

i) the goods manufactured or processed by one enterprise are sold to the other enterprise or person specified by it and the prices and other conditions are influenced by other enterprise;

j) common control by individual or his relative or jointly in two or more enterprises;

k) common control by Hindu Undivided Family ('HUF') or its member or its relative in two or more enterprises,

l) 10% or more interest in a firm, Association of Persons ('AOP') or Body of Individual ('BOI'),

m) there exists between the two enterprises, any relationship of mutual interest as may be prescribed. (However till date, nothing has been prescribed in this regard).

Certain issues in definition of AE

- **Whether for International Transactions, the conditions as mentioned in section 92A(1) & 92A(2) above need to be satisfied simultaneously? Or satisfaction of any one condition is sufficient to determine the AE relationship?**

  E.g. if 90% or more raw materials are supplied by other enterprise, condition as per section 92A(2) is satisfied but not as per section 92A(1).

  It appears that both the conditions as specified in sub-section (1) & (2) need to be satisfied since:

  a) The words used in section 92A(2) are **'for the purposes of sub-section (1)'**, it means that sub-section (2) is not independent and it has to be read with sub-section (1).

  b) As per amendment made by the Finance Act, 2002 in section 92A(2) read with the Memorandum which explains that 'mere satisfaction of conditions specified in sub-section (1) shall not make them AEs **unless the criteria specified in sub section (2) are fulfilled.**'

  Based on the above, it appears that conditions of both sub-section (1) & (2) need to be satisfied to establish AE relationship. However, the possibility of the transfer pricing authorities taking a contrary view cannot be negated and therefore litigation cannot be ruled out.

5.3.2 Enterprise

The term 'Enterprise' has been exhaustively defined in section 92F(iii) and the definition is very wide. 'Enterprise' means a person who is, or has been, or is proposed to be, engaged in any of the specified activities whether carried on

directly or indirectly. However, the term "person" is not defined under Chapter X of the Act containing the TP provisions and hence, one has to rely on the meaning of 'person' defined under section 2(31) of the Act.

The term 'Enterprise' also includes Permanent Establishment ('PE') of such person. The term PE for this purpose is defined to include a fixed place of business through which the business of enterprise is wholly or partly carried on.

Thus, branch of a foreign bank in India will be treated as Enterprise. (Fixed place PE)

- **Whether Agency PE, Service PE and Construction PE will be treated as Enterprise?**

  It appears that even Agency PE, Service PE and Construction PE will be treated as Enterprise.

5.3.3 International Transaction

- Section 92F(v) defines "transaction" which includes an arrangement, understanding or action in concert whether or not such arrangement is formal or enforceable by legal proceeding.

- International transaction is defined in section 92B(1) as a transaction between two or more associated enterprises, either or both of whom are non-residents.

  The term 'International Transaction' has been exhaustively defined to mean a transaction, between **two or more AEs**, either or both of whom are **Non Residents**, to include :

  a) purchase, sale or lease of tangible or intangible property; or

  b) provision of services; or

  c) lending or borrowing money; or

  d) any other transaction having a bearing on the profit, income, losses

or assets of such enterprise; and

e) Includes a mutual agreement or arrangement between two or more AE's.

- **Deemed International Transaction**

  In addition to the above, a transaction entered into by an enterprise with **an independent third party** can also be deemed to be an international transaction entered into between two AEs if either of the following condition is satisfied:

  a) There is a prior agreement in relation to the relevant transaction between such independent third party and the AE; or

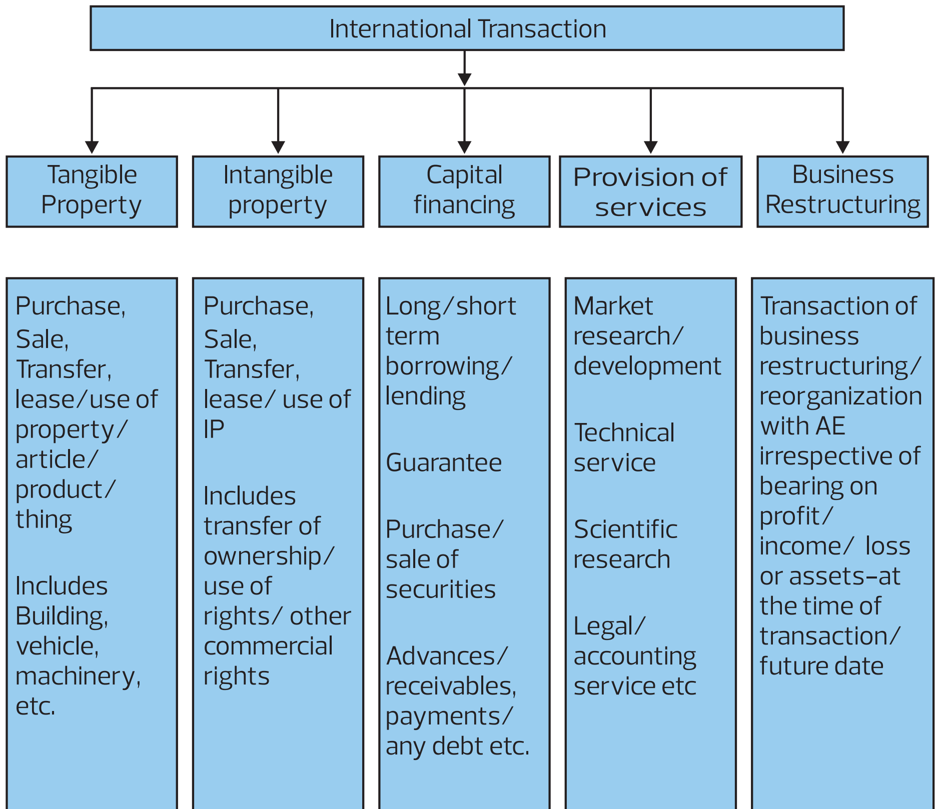
  b) The terms of the relevant transaction are determined in substance between such independent third party and the AE.

- **Example of Deemed International Transaction**

  Global Supply agreement entered by US Parent company with unrelated party for supply of raw material to all its global subsidiaries:

  In such case, transaction by Indian subsidiary with unrelated party will be considered as international transaction since the price of such transaction is determined as per agreement between US AE and unrelated party.

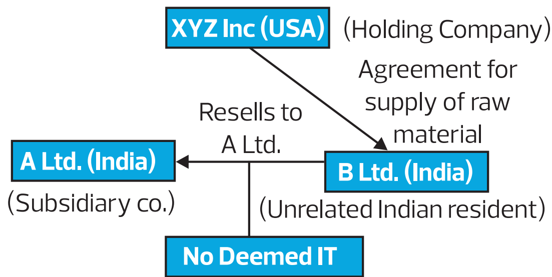
Explanation to section 92B



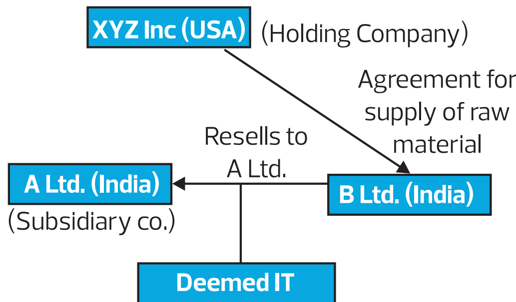
– **Extended Scope of Section 92B(2) according to Finance(No. 2) Act 2014**

Finance(No. 2) Act 2014 has amended the section 92B(2) on deemed international transaction to provide that the transaction between a tax payer and the other person, even if such person is a resident, is deemed to be an international transaction if either there is a prior agreement between the AE & such other person or the terms are determined in substance between such other person and the AE.

Prior to Finance (No.2) Act 2014



W.e.f. Finance (No. 2) Act 2014



The transaction between two domestic companies subject to fulfilling the condition of having agreement or terms thereof determined in substance by the AE could also be regarded as 'international transaction'. Thus, to this extent the impact of judicial precedents in cases of **Kodak India (P.) Ltd.** Vs. ACIT [(2013) 37 taxmann.com 233 (Mum)] and **Swarnandhra IJMII Township Development Co. (P.) Ltd.** Vs. Dy.CIT [2013] 32 taxmann.com 395 (Hyd.–Trib.) seems to be diluted

5.3.4 Arm's Length Price ('ALP')

Section 92F(ii) defines Arm's Length Price as "a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions"

The ALP denotes the price which is applied or proposed to be applied

- In a Comparable transaction
- Between unrelated independent entities
- In uncontrolled conditions
- Usually corresponding to fair market price.

5.3.5 Transaction with person located in Notified Jurisdictional Area

Having regard to lack of effective exchange of information with such country or territory outside India, the Central Government by notification in Official Gazette specifies such country or territory as Notified Jurisdictional Area ('NJA'). If an assessee enters into a transaction with any person located in NJA then–

- All the parties to the transaction shall be deemed to be AE; and
- Any transaction with these parties shall be deemed to an international transaction.

All the such transaction will be subject to Transfer Pricing Regulations in India and all compliance requirements, including maintenance of documents under TP Regulations will be applicable and the person shall not be entitled to the benefit of second proviso of section 92C(2) of the Act i.e. application of variation of +/- 3% / 1%,as the case may be.

Cyprus was notified under section 94A by the Central Government as a NJA in November 2013. As such, if an assessee enters into a transaction with a person in Cyprus, then all the parties to the transaction shall be treated as AEs and the transaction shall be treated as an international transaction resulting in application of Transfer Pricing Regulations.

Chapter 6 Specified Domestic Transactions

6.1 Evolution of Domestic TP Regulations

The scope of TP was widened from FY 2012-13 by extending the same to be SDT. The genesis of the above lies in the judgment of the Supreme Court in the case of **CIT vs. Glaxo SmithKline Asia (P) Ltd.** [(2010) 195 Taxman 35 (SC)].

In case of domestic transactions between related parties, the under-invoicing of sales and over-invoicing of expenses ordinarily will be revenue neutral in nature, except in two circumstances, having tax arbitrage such as where one of the related entities is:

i. loss making; or
ii. liable to pay tax at a lower rate

and the profits are shifted to such entity.

Some of the countries where domestic transfer pricing regulations are already in force are Australia, Brazil, China, France, Russia, South Africa and United Kingdom.

6.2 Meaning of Specified Domestic Transaction – Section 92BA

SDT in case of an assessee means any of the following transactions, ***not being an international transaction,*** namely:

i. any expenditure in respect of which payment has been made or is to be made to a person referred to in section 40A(2)(b);

ii. any transaction referred to in section 80A;

iii. any transfer of goods or services referred to in sub-section (8) of section 80-IA;

iv. any business transacted between the assessee and other person as referred to in section 80-IA(10);

v. any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of section 80-IA(8) or section 80-IA(10)

are applicable; or

vi. any other transaction as may be prescribed.

6.3 Threshold Limit and Coverage

All the transactions covered under the above 6 limbs of section 92BA will be regarded as SDT only if the **aggregate value of all transactions** in the previous year **exceeds the threshold limit of INR 20 crores (INR 200 million[3])**. If the threshold limit is crossed, TP compliances are required for all the SDTs covered under section 92BA.

Example

(Amount in INR in Crores)

Transactions	ALP	
	Case 1	Case 2
Rent Payment to related party	10	12
Directors' remuneration	6	6
Inter unit transfer under section 80-IA(8)	3	3
Aggregate value of Domestic Transactions	**19**	**21**

In Case 1 above, the aggregate value of domestic transactions is INR 19 crores (lower than the prescribed threshold limit) and therefore the said transactions do not qualify as SDT.

In Case 2 above, the aggregate value of domestic transactions is INR 21 crores (exceeds the prescribed threshold limit) and therefore the above transactions will qualify as SDT.

3 Amended vide Finance Act 2015. Prior to that the limit was INR 5 crores

6.4 Coverage of Domestic Transfer Pricing

Sections	Nature	Transaction with	Earlier methodology
40A(2)(b)	Expenditure	Related party defined	Excessive or unreasonable expenditure disallowed
80A, 80IA(8)	Income or expenditure	Between different business units of same tax payer	Fair Market Value
80IA(10) (Including SEZ)	Profits	Close connection	More than ordinary profits

6.5 Examples of Transactions with the Specified Persons / Tax Holiday Units

6.5.1 Transactions

The Revised Guidance Note issued by ICAI gives an illustrative list of transactions that would be covered by section 92BA as under:

- Purchase of goods, tangible and intangible property
- Availing of services
- Group charges
- Reimbursement of expenses
- Interest payment
- Directors' remuneration, commission, sitting fees
- Salary, training services, marketing expenses
- Rent paid
- Guarantee fee expenditure
- Transfer of goods between eligible unit and non-eligible unit

6.5.2 Specified Persons

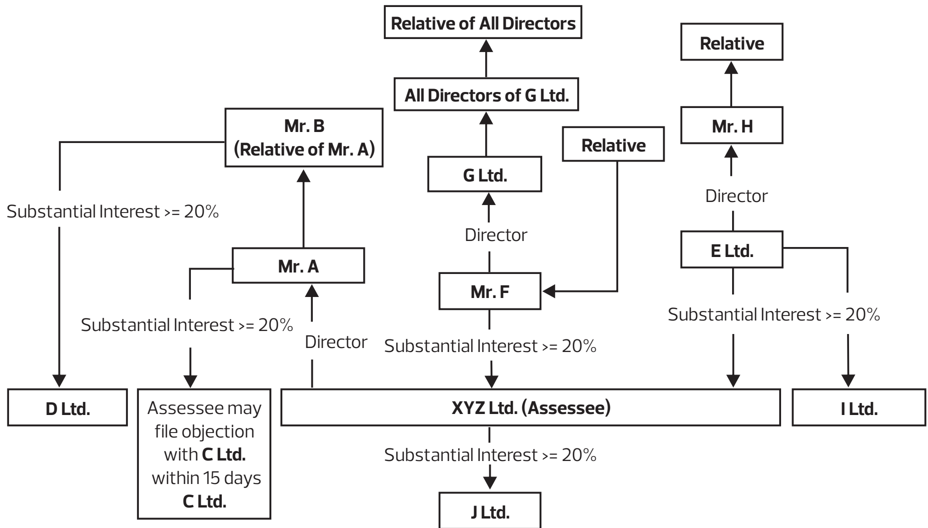
- Related parties as defined in section 40A(2)(b)
- Tax holiday units with other businesses within the same entity
- Any person with whom the course of business is so arranged which results in excessive profits either due to close connection or any other reason

6.6 Payments to Related Parties As Referred to in Section 40A(2)(b)

6.6.1 Persons covered under section 40A(2)(b): Related Party

Sr. No.	Payer / assessee	Payee
1.	Individual	Any relative* [Defined in section 2(41) of the Act to mean husband, wife, brother, sister, lineal ascendant or descendant] *Definition of Relative under section 56(2) is not relevant
2.	Company	Any director or relative of such director
3.	Firm (includes LLP)	Any partner or relative of such partner
4.	AOP	Any member or relative of such member
5.	HUF	Any member or relative of such member
6.	Any Assessee	Any individual having substantial interest in the assessee's business or relative of such individual
7.	Any assessee	A company, Firm, AOP, HUF having substantial interest in the assessee's business or profession or Any director, partner, member or Relative of such director, partner or member or Any other company carrying on business or profession in which the first mentioned company has substantial interest.

6.6.2 Related parties–diagrammatic representation as per revised guidance note issued by ICAI



6.6.3 Meaning of substantial interest

Substantial interest means beneficial ownership of shares with at least 20% of voting rights (in case of a company) or beneficial entitlement of at least 20% of the profits of such business or profession (in any other case).

6.6.4 Whether indirect shareholding covered?

Section 92A(2)(a) and (b) (which defines the term AE for the purpose of international transactions) uses the phrase "directly or indirectly". The said phrase is not used in section 40A(2)(b). However, in terms of CBDT Circular No.6-P, dated 6 July 1968, the circular sets out the categories of the persons, payments to whom fall within the purview of Section 40A(2), mentions that such persons would include inter alia –

"(c) persons in whose business or profession the taxpayer has a substantial interest **directly or indirectly.**"

However, Explanation to Section 40A(2) deems a person to have substantial interest if such person is 'beneficial owner' of shares carrying not less than 20% of voting power.

As per the Revised Guidance Note issued by ICAI, the expression "beneficial owner" needs to be construed in contrast to "legal owner" and not in the context of determining indirect ownership of shares. Hence, the emphasis is on covering the real owner of the shares and not the nominal owner. This proposition is also supported by legal jurisprudence which states that in a multi-tier structure, a parent cannot be regarded as the beneficial owner of shares in a downstream subsidiary merely because it owns the shares of the intermediate subsidiary companies. It is important to respect the fact that the entities are separate legal entities.

In a situation where A Ltd. holds 50% in B Ltd. and B Ltd. holds 50% in C Ltd., under ordinary circumstances, A Ltd. cannot be regarded as having beneficial interest in C Ltd. In other words, for purposes of section 40A(2)(b), it maybe appropriate to consider only direct shareholding and not derivate or indirect shareholding.

Position after introduction of definition of the term 'beneficial owner' by Finance Act, 2015

The term 'beneficial owner' has been defined in the Finance Act, 2015 in relation to any asset under section 139 as "an individual who has provided, directly or indirectly, consideration for the asset for the immediate or future benefit, direct or indirect, of himself or any other person."

Based on the above, it appears that beneficial owner could be a person having direct or indirect holding. In view of the same, it is possible that indirect holding may now get covered under the SDT regime. However, an argument can be taken that requirement of voting rights would still have to be satisfied and hence, the new definition of beneficial ownership does not enhance the SDT coverage to indirect holdings.

6.6.5 Whether transaction of an Indian Company with an overseas Company qualifies as a SDT?

If a transaction is an international transaction then it cannot be a SDT. International transaction is defined in section 92B(1) as a transaction between two or more AEs, either or both of whom are non-residents. Hence, a transaction between enterprises which are not AEs is not an international transaction even though one of the enterprises is a non-resident. In view of this, although the definition of a SDT refers to the word 'domestic' suggesting that it is confined to transactions between residents, on a literal reading it can also cover a transaction with a non-resident if the two parties are not AEs as per section 92A of the Act.

The threshold for substantial interest to qualify as 'specified persons', for domestic TP, is 20% or more as compared to the threshold of 26% or more applicable for AE, for international transactions.

E.g., where an Indian Company purchases goods from US Company in which it has 23% equity stake (substantial interest), such transaction will not qualify as an IT amongst AE. Will it qualify as SDT and attract TP provisions?

As per the Revised Guidance Note issued by the ICAI, it will qualify as an SDT and will be subject to TP provisions.

However, on strict interpretation of the Explanatory Memorandum to the Finance Bill, 2012, it appears that to qualify as SDT, the transaction has to be between "resident related parties." Nevertheless, this aspect needs further clarification from CBDT.

6.7 Inter-Unit Transfer of Goods / Services As Covered under Section 80IA(8)

6.7.1 Section 80-IA(8) covers inter-unit transfer of goods and services. It covers transfer of any goods or services to / from the eligible business of the assessee. If the transfer is not at market value, then, for the purpose of deduction, the profits and gains for the eligible business shall be computed as if the transfer had been made at the market value of such goods as on that date.

6.7.2 The definition of market value has been substituted w.e.f. AY 2013-14 to include the ALP as defined in section 92F(ii), where the transfer of such goods or services is SDT as referred to in section 92BA.

6.7.3 The onus to prove that the transfer is at ALP lies with the taxpayer. In case of adjustment made by TPO, no corresponding benefit is available to the extent of that adjustment.

6.7.4 This section covers income as well as expenditure.

6.8 Business transaction with any other person generating more than ordinary profits – Section 80-IA(10)

6.8.1 Section 80-IA(10) applies to transactions between assessee and any other person which results in excessive profits in the hands of the assessee:

- Either owing to 'Close Connection' with other person; or
- For any other reason.

6.8.2 Initial onus to prove that the transaction produces ordinary profit lies with the taxpayer. There is no guidance available on the meaning of 'close connection'.

6.8.3 This section covers income as well as expenditure.

6.8.4 Unlike section 80A(6) and section 80-IA(8), which apply to internal transfers, this provision is applicable in respect of transactions with close connection.

6.9 Whether Transfers between Eligible Units are SDTs?

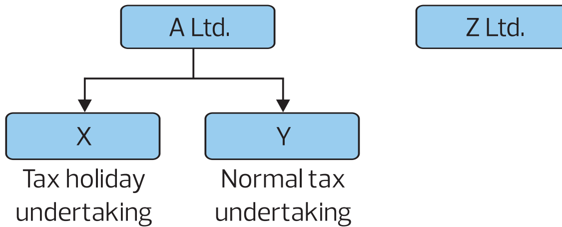
The other sections in Chapter VI-A which make references to eligible units under section 80-IA(8) and 80-IA(10) are 80IAB, 80IB, 80IC, 80ID and 80IE as tabulated below.

Section under the Act	Tax payers covered
10AA	▪ Persons with income from Special Economic Zone ('SEZ') units
80-IA	▪ Infrastructure developers ▪ Telecommunication service providers

80-IA	▪ Developers of industrial park ▪ Producers or distributors of power
80-IAB	▪ Developers of SEZ
80-IB	▪ Small-scale industry engaged in operating a cold storage plant ▪ Industrial undertaking in an industrially backward state as mentioned in VIII Schedule ▪ Multiplex theaters and convention centers ▪ Company carrying on scientific research and development ▪ Eligible housing projects ▪ Eligible hospitals
80-IC and 80-IE	▪ Persons with units in North-eastern states claiming deduction
80-ID	▪ Hotels located in districts having World Heritage site

Transfers between any of the aforesaid eligible unit and another unit eligible for other profit-linked deduction will be covered within the purview of domestic TP.

- **Illustration: Tax Holiday undertaking**



Transactions between	Whether covered under SDT	Requirement
X and Y	Yes	▪ to justify that goods and services transactions are at ALP
Y and Z	No	
X and Z	Yes, if Z is closely connected to A	▪ profits of tax holiday undertaking are 'ordinary profits' having regard to ALP

6.10 Distinction between applicability of Chapter X to International Transactions and Specified Domestic Transactions

International transactions	Specified Domestic Transactions
Applicable to all international transactions irrespective of the amount involved	Applicable to SDTs where aggregate of SDTs exceeds INR 20 crores in a financial year
APA applicable	APA not applicable
Covers several types of transactions including transactions in the nature of capital financing	Restricted to limited transactions E.g.: only payments to related parties under section 40A(2)(b), inter-units transfers of goods and services in case of tax-holiday units, etc.
Applicable to AEs as defined in section 92A	Applicable to related parties as defined in section 40A(2)(b), 80A(6), 80IA(8), 80IA(10), etc.

Chapter 7 Methods And Computation Of Arm's Length Price

7.1 Computation of Arm's Length Price

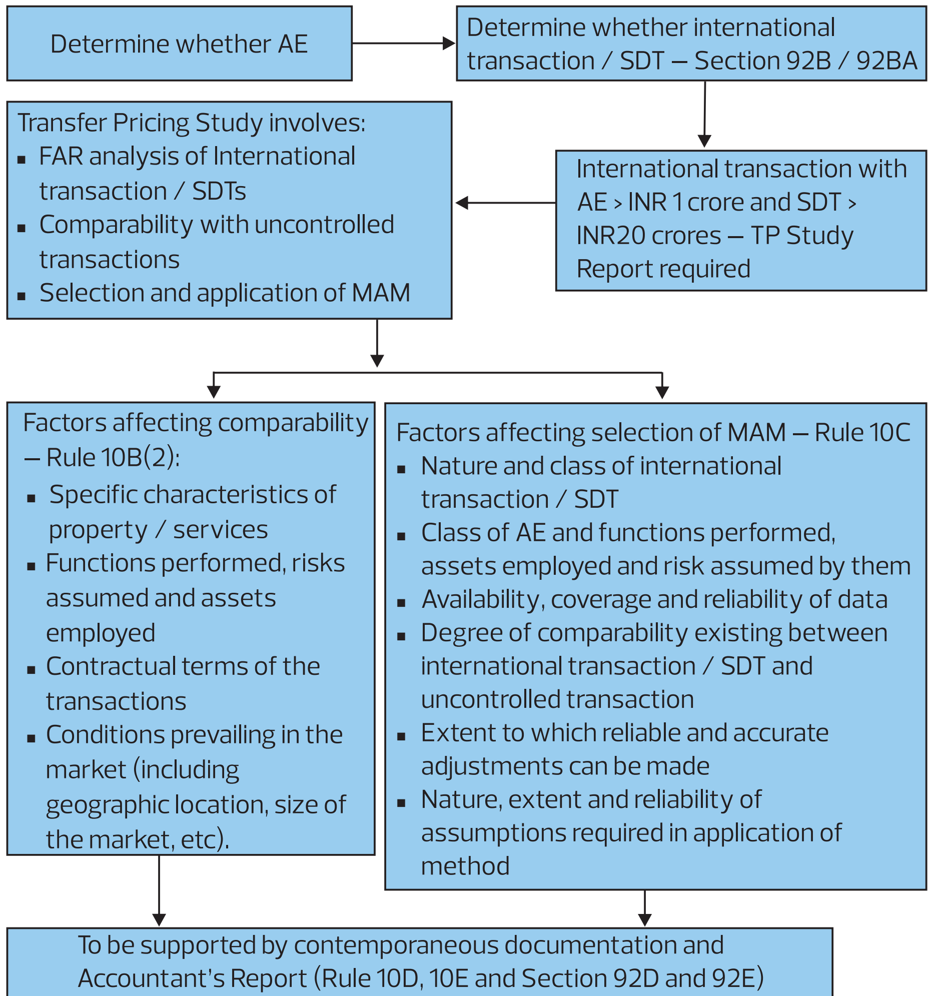
7.1.1 As per section 92(1) of the Act, any income arising from an international transaction shall be computed having regard to the ALP.

7.1.2 It is to be noted that income arising from international transactions need to be computed having regard to ALP and not at ALP. This is because various adjustments for difference on account of Functional, Asset and Risk Analysis ('FAR analysis') of the entities need to be made. Further, Transfer Pricing is not an exact science and it is possible that an enterprise may incur losses due to genuine business reasons. Hence, while determining the ALP, such economic and commercial factors should be considered.

7.1.3 Arm's Length Price [Section 92F(ii)] is defined as:

- A price applied or proposed to be applied
- In a transaction between persons other than associated enterprises
- In uncontrolled conditions.

7.1.4 The following flowchart shows the process of transfer pricing regulations:



7.2 Transfer Pricing Methods

7.2.1 As per Indian TP Regulations, ALP is to be determined by applying one of the following methods being the MAM.

- Comparable Uncontrolled Price Method ('CUP' Method)
- Resale Price Method ('RPM')
- Cost Plus Method ('CPM')

- Profit Split Method ('PSM')
- Transactional Net Margin Method ('TNMM')
- Any Other Method as provided in Rule 10AB of the rules.

7.2.2 Comparable Uncontrolled Price Method

a) The CUP method is the most direct way of analyzing whether the arm's length principle is complied with as it compares the price or value of the transactions.

b) The CUP method compares the price charged for property or services transferred in a controlled transaction to the price charged for property or services transferred in comparable uncontrolled transaction in comparable circumstances.

c) Hence, CUP method requires a relatively high level of comparability to produce reliable results. If reasonably accurate adjustments for differences in comparability cannot be made, it is necessary to select a less direct method.

d) Types of CUP

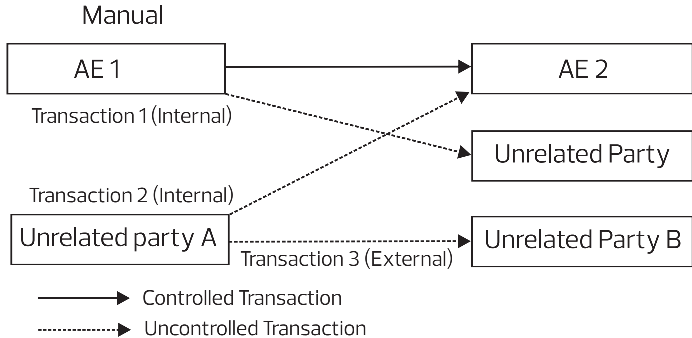
CUP method may be either Internal CUP or External CUP.

- **Internal CUP**: The price paid / charged in a controlled transaction vis-à-vis the price paid / charged in a comparable uncontrolled transaction with unrelated / third party. Internal CUP can be applied wherein the taxpayer or any other AE of the group buys or sells similar goods, in similar quantities and under similar terms from / to an independent enterprise in similar market conditions.

- **External CUP**: Where the price of the controlled transaction is compared to the price of a comparable transaction between third parties.

- Internal CUP is preferable to external CUP due to availability of more reliable and accurate data.

- Illustration of Internal and External CUP as per United Nation (UN) TP Manual



The above figure demonstrates that the transaction of transfer of goods between AE 1 (a goods producer in country 1) and AE 2 (a goods importer in country 2, which resells the goods to dealers in country 2) is a controlled transaction. AE1 is the parent company of AE 2.

In applying the CUP method to determine whether the price charged for goods transferred in this controlled transaction is at arm's length, reference can be made to:

- The price charged for goods transferred in a comparable uncontrolled transaction, if any, between AE1 and Unrelated Party (i.e. Transaction 1);

- The price charged for goods transferred in a comparable uncontrolled transaction, if any, between AE 2 and an unrelated party (i.e. Transaction 2) and

- The price paid for goods transferred in a comparable uncontrolled transaction, if any, between Unrelated Party A and Unrelated Party B (i.e. Transaction 3).

Uncontrolled transactions similar to Transaction 1 and Transaction 2 above

can be referred to as Internal CUP. Uncontrolled transactions similar to Transaction 3 are referred to as External CUP.

e) Requirements for application of CUP method

CUP method requires a very high degree of comparability and similarity in circumstances in terms of:

- Quality of product or service
- Contractual terms (viz. warranties, credit terms, etc.)
- Level of market (retail, wholesale, etc.)
- Market condition
- Business strategies
- Geographical factors (E.g. US and Kenya market cannot be compared)
- Date of transactions (particularly in case of commodities which are subject to price changes on periodic basis)
- Intangible property associated with sale (E.g. Price of branded products cannot be compared to the price of unbranded products)
- Volume discounts, interest free period and exchange rate fluctuations
- Bargaining power
- Associated risks (E.g. Market risk, credit risk, etc.)
- Functions carried out by parties

If the above requirements are fulfilled, then the price at which a controlled transaction is carried out can be compared to the price at which a comparable uncontrolled transaction is carried out.

Under above circumstances, CUP method is the most direct and reliable method for determination of ALP and is to be preferred to all other methods.

f) Adjustments to CUP

- If there are differences between the controlled and uncontrolled transaction that affect price, adjustments need to be made to the price of uncontrolled transaction.

- Indian Transfer Pricing regulations do not provide guidance on different types of adjustments that can be made. Hence, reference can be drawn from OECD Guidelines which provide an illustrative list of different types of adjustments that can be carried out.

- Where it is possible to make reasonable accurate adjustments to the uncontrolled price, (e.g. adjustments for freight and insurance, volume discounts as per standard price list, etc.), adjustments should be made to arrive at ALP.

However, in certain circumstances, where it is not possible to make reasonable accurate adjustments to the uncontrolled price, (e.g. for difference in geographical locations and market conditions of controlled and uncontrolled transactions), CUP method should be rejected and the reasons for rejection of CUP method should be clearly documented in the Transfer Pricing Study Report.

g) Typical Transactions where CUP method can be used:

Examples of situations when CUP method can be used are as follows:

- Transfer of goods

- Provision of services

- Interest on loans

- Royalty payment.
- Transaction dependent on publicly available market quotation (e.g. prices available on commodity exchange)
- Certain industries where CUPs are more prevalent, for instance software development where products are generally licensed to third parties.

h) Strengths of CUP method

- It is not a one sided analysis as the price is arrived at between two parties to the transaction;
- It involves detailed transactional comparison;
- Direct one-to-one comparison;
- Avoids tested party selection; and
- Less susceptible to difference in non-transfer pricing factors.

i) Difficulties in application of CUP Method

CUP method is the most direct and reliable method to determine the ALP and is to be preferred over all other methods. However, its practical application may pose various difficulties as given below:

- CUP method is highly sensitive to product characteristics and accompanying conditions which make its application difficult.
- Every difference that needs to be adjusted might not be supported by sufficient proof by way of documentation. (e.g. Difference in income levels in two countries for which reasonable accurate adjustment cannot be made)
- It is practically very difficult to meet with the high standards of

comparability and make reasonable accurate adjustments.

- Comparable prices are not available in public database and hence are difficult to obtain.

- Internal comparables frequently don't exist and external comparable are difficult to find in practice.

- There is no strict comparability standard with respect to product comparability. Hence, CUP method is very difficult to apply in actual practice.

j) Certain issues in application of CUP method

The CUP method requires very high degree of comparability between controlled and uncontrolled transactions. In case it is possible to make reasonable accurate adjustments for the difference, such adjustments should be made. However, where it is not possible to make reasonable accurate adjustments for the differences, CUP method should be rejected. Certain important issues which generally arise in application of CUP method are explained below:

- **Difference in geographical location and market conditions of AE and Non AE**

  When there are differences in the geographical location and market conditions of AE and Non AE, question arises whether CUP method can be selected as most appropriate method. In this respect, it is to be noted the market conditions prevailing in the controlled transactions should be similar to the uncontrolled transaction. Hence, if there are differences then CUP method cannot be selected as most appropriate method unless reasonable accurate adjustments are made for such differences.

  In this respect, it is to be noted that the Delhi ITAT in the case of **Bharti Airtel Ltd. vs. ACIT** [2014](43 taxmann.com 50), held that

geographical location of market is of no consequence in judging comparability of an uncontrolled transaction for purpose of applying CUP method, unless market conditions, in which uncontrolled transactions have taken place, are materially different vis-à-vis conditions in which international transaction has taken place.

"Unless market conditions, in which uncontrolled transactions have taken place, are materially different vis-à-vis conditions in which international transaction has taken place, and such a difference is on account of geographical location of the market, geographical location of the market is of no consequence in judging comparability of an uncontrolled transaction for the purpose of applying CUP method. The decisive factor, on the basis of which comparability is to be judged, is the state of 'conditions prevailing in the markets in which the respective transactions to the parties operate'. These market conditions could be affected by a number of factors, as the sub-rule itself suggests, including (a) geographical location and size of market; (b) overall economic development and level of competition in the market; and (c) whether the market are wholesale or retail. The true test, therefore, is whether the market in which uncontrolled transactions have taken place are materially different than the market in which controlled transactions have taken place. In a situation in which there are indeed material differences, including, of course, for the reason of geographical location and size of markets, those uncontrolled transactions cannot constitute valid comparables for benchmarking similar transactions between the AEs."

- **Whether Internal CUP should be preferred to external CUP?**

In case of internal CUP, the price that tested party has paid/ charged in a controlled transaction is compared to the price paid/charged in a comparable uncontrolled transaction with a third party whereas in case of external CUP, the price that assessee has paid/ charged in a controlled transaction is compared to the price paid/charged in a

comparable uncontrolled transaction between third parties. Sometimes, question arises whether internal CUP should be preferred to the External CUP.

In case of internal CUP, the data for comparable uncontrolled transaction is entirely available with the assessee and hence, it is more reliable and accurate as compared to the external data. As a result, internal CUP should be preferred to external CUP. Even the OECD guidelines support the same view.

The Mumbai Tribunal in the case of **Gharda Chemicals Ltd. vs. DCIT** [(2010) 35 SOT 406 (Mum)], has held that the internal CUP should be preferred to the external CUP. The relevant extract of the observations is provided hereunder:

"Ordinarily the Internal CUP method should be preferred over the External CUP method as it neutralizes several distinguishing factors, such as the local factors and the economies available or unavailable to the assessee in particular, having bearing over the comparison of price charged from unrelated parties and AE."

- **Whether Independent Quotation can be used?**

One of the issues which often arises under CUP Method is whether for comparability purpose even tender / quotation price can be accepted. Tender or quotation price per se cannot be compared with actual transaction price as there may be difference between quoted price and actual price. Generally, the quotation price is an indicative approximation of the price which could be further fixed, subject to negotiations between parties and data in public domain may not exist of such negotiated prices. Nevertheless, if the actual transaction price is not available, then quoted or listed price can be used or relied upon as secondary evidence. However, in some cases, quoted price can be used for comparability subject to possibility of adjustments required, if any. The prices quoted at commodity

exchanges or published in trade journals, particularly when the product is similar to the one traded between unrelated parties are generally considered reliable as per the trade practice and can be relied upon in the absence of data of actual transaction prices.

Independent quotation can be used as comparable as was held in the case of **CIT vs. Adani Wilmar Ltd.** (2014) 45 taxmann.com 365 (Gujarat). The High Court in its judgement dated 2 April 2014, held that:

"the price quotations of the MPOB would be entitled to its due and full weightage and respect, would not necessarily mean that the other quotations would lose their significance, unless, of course, it is pointed out that such quotations lack basis. In this context, we may recall that the only objections with the TPO to take into consideration the rate quotations of the Oil World were, that were not based in Malaysia and that it was an independent organisation, which had nothing to do with the old price prevailing in Malaysia. When the CIT (Appeals) as well as the Tribunal have accepted the reliability and authenticity of the organisation and its publication of rate-list, such objection of the TPO must be overruled."

However, the Delhi Tribunal in the case of Sinosteel India Pvt Ltd Vs DCIT (2014) 147 ITD 313 (Delhi) has observed that a quotation price in isolation which is not preceded with or succeeded by any actual transaction cannot be considered as CUP.

- **Customs valuation as a comparable**

In case of transactions involving import of goods, the said goods also undergo customs valuation procedure. Taxpayers often contend that the valuation accepted for customs purposes should also be regarded as ALP for the purpose of transfer pricing. However, in practice, the same does not find favour with the department. The Mumbai Tribunal in the case of **Fabula Trading Co. P. Ltd. vs. ITO 8**

[2009] 122 TTJ 335 (Mum) has accepted the use of customs valuation as a CUP. However, the decisions of the Chennai Tribunal in the case of **Mobis India Ltd vs. DCIT 9** [2014] 61 SOT 40 (Chennai) and of the Mumbai Tribunal in the case of **Fuchs Lubricants (India) Pvt. Ltd. vs. DCIT** [2014] 44 taxmann.com 284 (Mum) have both observed that valuation by the Customs authority was as per Customs Rules, and the same were not relevant for the purpose of transfer pricing under Income Tax Rules.

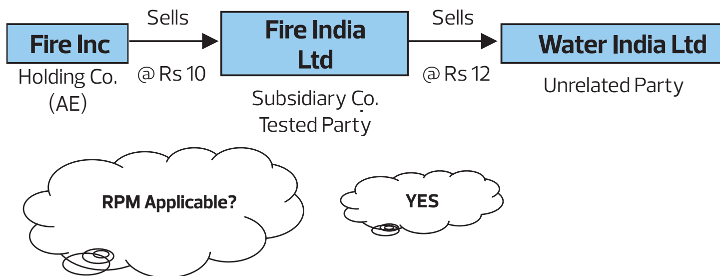
7.2.3 Resale Price Method ('RPM')

a) In RPM, gross profit margin earned in a controlled transaction is compared with the gross profit margin earned in a comparable uncontrolled transaction to determine ALP. RPM is based on the price at which a product is purchased from a related party and resold to an unrelated enterprise.

b) Applicability

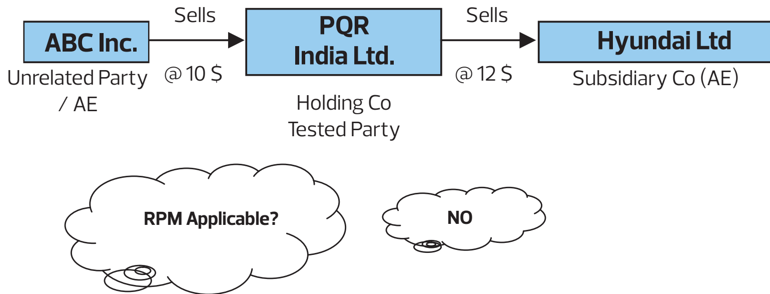
RPM is applicable when the property is purchased or service is obtained from an AE and resold to an unrelated party. In other words, RPM is suitable when the reseller adds relatively little value to the goods and does not alter the goods physically before the resale. Packaging, re-packaging, labeling or minor assembly does not ordinarily constitute physical alteration. In other words, RPM is applicable in case of distributors or service providers and not manufacturers. Refer illustration 1 below:

Illustration 1



It is to be noted that when the goods are purchased from unrelated party / AE and sold to AE, RPM cannot be applied since RPM can be applied only in situation where the goods are purchased from AE and sold to unrelated party. Refer illustration 2 below:

Illustration 2



The Bangalore Tribunal in the case of **Sanyo India Pvt Ltd vs ACIT** (ITA No. 1022 (B) 2012) rejected the department's stand of application of TNMM. The ITAT noted that Sanyo India has imported the goods from its AE and sold it in the domestic market without any value addition. Only work undertaken by Sanyo India on such goods was to repack according to local requirements. It was held that Sanyo India was a full-fledged distributor, who purchased goods from AEs & resold it in the domestic market without any value addition and hence RPM would be most appropriate method.

c) Types of RPM

Like CUP method, RPM can also be applied by way of Internal RPM or External RPM.

- **Internal RPM:** The gross profit margin of controlled transaction is compared with the gross profit margin of comparable uncontrolled transaction of the tested party.

- **External RPM:** The gross profit margin of tested party in controlled transaction is compared with the gross profit margin earned by the independent third party in a comparable uncontrolled transaction.

- **Internal RPM is preferable over external RPM** due to availability of more reliable and accurate data.

d) Requirements for applicability of RPM

- Property is purchased or service is obtained from an AE and resold to an unrelated party.

- Reseller adds relatively little or no value to the goods through physical modification or by using intangible property.

  Limited enhancements such as packaging, repacking, labeling or minor assembly which generally does not add significant value to the goods is acceptable. However, significant value addition through physical modification such as converting rough diamonds into cut and polished diamonds adds significant value to the goods and hence, RPM cannot be applied for such value added activity.

  Similarly, in case if mineral water is imported from AE and sold in the local market by adding the brand name of Indian Company, RPM cannot be applied since there is significant addition in value of goods due to the use of brand name of Indian Company.

- High degree of functional comparability rather than product comparability.

  Detailed comparison of functions performed, risks assumed and contractual terms of controlled and uncontrolled transactions needs to be done and adjustment should be made for the material differences which would affect the gross profit margin. (Example: Adjustment for exchange fluctuation risk, difference in warranty period, etc.)

- Minor difference in the products is acceptable if they are less likely to have effect on the gross profit margin.

E.g. Gross profit margin earned from trading of microwave ovens in controlled transaction can be compared with the gross profit margin earned by unrelated parties from trading in toasters since both are consumer durables and fall within the same industry

- Shorter time gap between purchase and sale. When the time gap between the original purchase and resale is more, the other factors such as changes in market conditions, rate of exchange and change in costs will have to be appropriately considered. (E.g. if sugar is purchased at the time of low demand and sold after 6 months at the time of high demand, RPM would not be applicable).

e) When to use RPM method?

- Distributors / Wholesalers who purchase from AEs.
- Full-fledged manufacturer owning valuable patents or other intangible properties and affiliated sales companies which purchase and resell the products to unrelated customers.

f) Strengths of RPM

- Demand driven method because it is based on the resale price
- Reliable when demand is inelastic

g) Difficulties in application of RPM

The practical application of RPM may pose various difficulties as given below:

- Non availability of gross margin data of comparable companies from public database is the biggest challenge in applying RPM since Companies Act does not mandate disclosure of gross profit margin and Tax Audit Reports which contain gross profit margin data are not available in public database.

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- Differential accounting policies followed across the globe makes application of RPM very difficult.

  E.g.1: Certain companies include exchange loss / gain in purchase / sale whereas some companies show it as part of administrative and other expenses.

  E.g.2: Certain companies include excise duty on purchase in 'Purchase Account' whereas some companies show it under the head of rent, rates and taxes in the financials.

- RPM is unlikely to give accurate result if there is difference in level of market, functions performed or product sold.

  E.g. Gross profit margin of shoe distributor cannot be compared with the gross profit margin of detergent distributor even though both are Fast Moving Consumer Goods since there are huge differences in products which affect the gross profit margin.

- It is difficult to identify whether the comparable companies do or do not employ valuable marketing intangibles in their business. The presence of such intangible may allow the comparable entity to enjoy higher profitability in comparison to other marketing or selling companies who do not possess such intangible. Further the inability to undertake a functional analysis of the comparables hampers the comparability analysis.

h) Certain issues in application of RPM

Generally, RPM is useful in case of distributor who purchases goods from AE and sells to Non AE. However, certain issues which arise during practical application of RPM are as below:

- **Whether RPM can be used when the goods are purchased or services are obtained by an enterprise from non AE and resold or are provided to AE?**

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- Generally, RPM is used when the property is purchased or services are obtained by an enterprise from its AE which is thereafter resold or are provided to the unrelated enterprise. Sometimes, controversy arises as to whether RPM can be used in a reverse situation, viz. when the property is purchased or services are obtained by an enterprise from an unrelated enterprise which is thereafter resold or are provided to an AE.

  In this respect, from the plain reading of Rule 10B(1)(b) of the Rules, it can be observed that RPM is applicable in case the property is purchased or services are obtained by an enterprise from its AE which is thereafter resold or are provided to the unrelated enterprise. Hence, as per the strict interpretation of Rule 10B(1)(b), it appears that RPM can be applied only when the property is purchased or services are obtained by an enterprise from its AE which is thereafter resold or are provided to the unrelated enterprise and not in the reverse situation.

- The Mumbai Tribunal in the case of **Gharda Chemicals Ltd. vs. DCIT** [(2010) 35 SOT 406 (Mum)], rejected RPM on the ground that RPM could be applied only in a case where Indian enterprise purchases goods or obtains services from its AE and not in a reverse case. The relevant extract of the observations of the Tribunal is given below:

  "A bare perusal of sub-rule (b) brings to fore that it is applicable with reference to the property purchased or services obtained by an enterprise from its AE which is thereafter resold or are provided to the unrelated enterprise. It shows that if the Indian enterprise purchases goods or obtains services from its AE in an international transaction, then the ALP shall be determined by adjusting the price at which the property is purchased or services are obtained by the Indian enterprise. In the instant case, we are dealing with a situation in which the property is sold and not purchased by an Indian enterprise from its AE abroad in an international transaction. Ex

consequenti the Resale price method cannot be invoked in the hands of the assessee in India for the determination of ALP. If the situation had been otherwise that the assessee had purchased the goods from its AE situated in USA, then this method could have been invoked for determining the ALP. For these reasons we hold that Resale price method is not even appropriate, what to talk of the "most appropriate method" for determining of ALP in the present international transactions."

- The Mumbai Tribunal in the case of **L'Oreal India P. Ltd. vs. DCIT** (2013) 34 taxmann.com 78 held that since there is no order of priority in selection of methods and RPM is one of the standard method and the OECD guidelines also states that in case of distribution and marketing activities (where goods are purchased from AEs and sold to unrelated parties), RPM is the most appropriate method. The Bombay High Court affirmed the above decision of the Tribunal accepting the taxpayers' use of the RPM for purpose of determination of ALP of its international transactions with respect to distribution activities.

- **Whether close functional similarity between controlled transactions and uncontrolled transactions needs to be proved for the application of RPM as the most appropriate method?**

- In RPM, the comparability is at the gross margin level and hence, RPM requires a high degree of functional comparability rather than product comparability. Hence, a detailed analysis showing the close functional comparability and risk profile of the tested party and comparables should be clearly brought out in the TP Study to justify comparability at gross profit level under RPM.

- The Mumbai Tribunal in the case of **Mattel Toys (I) (P.) Ltd.** (2013) 34 taxmann.com held that the RPM method identifies the price at which the product purchased from the AE is resold to an unrelated party. RPM is mostly applied in a situation in which the reseller purchases

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tangible property or obtains services from an AE, and reseller does not physically alter the tangible goods and services or use any intangible assets to add substantial value to the property or services i.e. resale is made without any value addition having been made. Therefore, in such a situation, the nature of products has not much relevance, though their closer comparable may produce a better result. The focus is more on same or similar nature of properties or services rather than similarity of products. The main reason is that the product differentiation does not materially affect the gross profit margin as it represents gross compensation after the cost of sales for specific function performed. The functional attribute is more important while undertaking the comparability analysis under this method. In the instant case, the assessee is a distributor of toys and gets the finished goods from AE and resells the same to independent parties without any value addition. In such a situation, RPM can be the best method to evaluate the transactions whether they are at ALP.

7.2.4 Cost Plus Method ('CPM')

a) CPM determines ALP of a controlled transaction by reference to the gross profit mark up on the direct and indirect costs of producing products or rendering services that is realized in comparable uncontrolled transactions. Thus, general and administrative expenses, finance cost, etc. should be excluded.

b) The UN TP manual defines CPM as ''The cost plus method begins with the costs incurred by the supplier of property (or services) in a controlled transaction for property transferred or services provided to a related purchaser. An appropriate cost plus mark-up is then added to this cost, to make an appropriate gross profit in light of the function performed, risk assumed, asset used and market conditions.''

c) 'Cost' in CPM means actual costs and not estimated costs. The Mumbai Tribunal in **Reliance Industries Ltd. Vs. Addl. CIT** [2012] 12 taxmann. com

189 held that –

- Actual costs have to be taken to arrive at the correct cost. Only then CPM can be applied.
- CPM does not contemplate estimation of costs.

The Hyderabad Tribunal in the case of **Alumeco India Extrusion Ltd** vs ACIT (2010) ITA No. 1475/2010 rejected the application of TNMM by the department and held that there were significant domestic sales to non-AE of similar product. Therefore, held that internal domestic transaction could be used for benchmarking domestic transactions are similar to the export transactions. The ITAT held that the allegations of TPO that there was incorrect allocation of cost among various segments, was not sufficient to reject CPM. It therefore set aside the TPO's order and directed the TPO to compute ALP using CPM and re-examine cost allocation between Alumeco's domestic, export and job work segment.

d) Applicability

CPM is most useful where:

- Semi-finished goods are sold between the related parties.

  E.g.: A foreign company gives components to Indian subsidiary in semi-finished form for manufacture of TV sets for which it pays the Indian subsidiary a mark-up on cost, plus a certain percentage.

- Where related parties have concluded joint facility agreements, contract manufacturer, a toll manufacturer or a low risk assembler

  E.g.: Where Indian Company manufactures software and supplies to US AE on cost plus basis and US AE sells entire computer system to global AEs on cost plus basis.

- Long-term-buy-and-supply arrangements

E.g.: In practice, many pharma and software MNCs have their manufacturing base in India from where they supply to all AEs worldwide on cost plus basis as per long term contract.

- Rendering of services

  E.g. Indian Company rendering research services to foreign parent company whereby intangibles developed through R & D are owned by foreign company and also the risk of failure of research is borne by foreign company. Indian Company is only compensated on the basis of cost plus mark-up.

e) Types of CPM

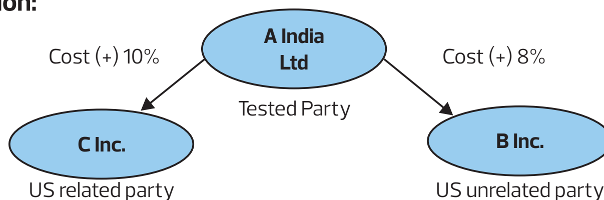
Like CUP and RPM, CPM can also be applied by way of Internal CPM or External CPM.

- **Internal CPM:** The gross profit mark-up on the direct and indirect costs of producing products or services of controlled transaction is compared with the gross profit mark-up of comparable uncontrolled transaction of the tested party.

- **External CPM:** The gross profit mark-up on the direct and indirect costs of producing products or services of tested party in controlled transaction is compared with the gross profit mark-up earned by the independent third parties in a comparable uncontrolled transaction.

- **Internal CPM is preferable over external CPM** due to availability of more reliable and accurate data.

Illustration:



Terms of Agreement (for sale of Refrigerators):

With C Inc.: Direct costs plus 50% (on account of overheads) plus 10% mark-up.

With B Inc.: Direct cost plus indirect costs @ 50% of direct costs plus 8% mark-up.

Since the methodology for computing the cost base is same in both the transactions, CPM is considered as appropriate method, ALP is determined @ cost plus 8%.

f) How does CPM differ from RPM?

- CPM starts by computing the cost of providing the goods or services and adds an appropriate mark-up.
- In contrast, RPM starts from the final selling price and subtracts an appropriate gross profit margin to arrive at purchase price.

g) Requirements for applicability of CPM

- CPM is normally employed in cases involving manufacture, assembly or production of tangible products or provision of services, which are sold / provided to related party.

  As per the Revised Guidance Note issued by ICAI, CPM can be adopted only in cases of supply of property or services to an AE and not when enterprise is in receipt of property or services from an AE.

- It requires a close degree of comparability of the functions performed, assets employed and risks assumed. Adjustment should be made for material differences which affect the gross profit mark-up on the direct and indirect cost of production.
- Broader product differences are allowed if it does not affect the gross profit mark-up on the direct and indirect cost of production.

E.g.: Margin earned on manufacture and sale of toasters can be compared with margin earned on manufacture and sale of irons since both belong to consumer durables industry and thus, less likely to affect the gross profit mark-up on the direct and indirect cost of production.

h) Strengths of CPM

- According to UN TP manual, the strength of CPM is that it is based on internal costs, the information is usually readily available to the MNCs.

i) Difficulties in application of CPM

The practical application of CPM may pose various difficulties as under:

- Existence of material differences with respect to the following makes application of CPM less relevant:
  - Intangibles (E.g. Branded T.V vs. Unbranded T.V.)
  - Cost structure (E.g. labour oriented process vs. highly automated process)
  - Business experience (E.g. 50 year old established player vs. new entrant in market)
  - Management efficiency (E.g. Business / Functions managed by professionals, like MBA, Chartered Accountants, Cost Accountants vs. traditional management)
  - Functions performed (E.g. manufacturer / owner vs. job worker)
  - Products (E.g.: Shoe manufacturer vs. detergent manufacturer)

- Accounting methods (E.g.: Some companies include exchange loss / gain in purchase / sale whereas some companies show it as part of administrative and other expenses)

- The terms 'direct' and 'indirect' cost have not been defined. Hence, industry practice needs to be followed which is different for different companies.

  E.g.: Those companies which disclose service tax on income as part of income will reflect higher gross profit margin as compared to companies which book service tax through a separate liability account.

- Under Companies Act, there is no requirement to distinctly report gross profit margins of companies. Hence, non-availability of gross profit margins from database makes application of CPM difficult in actual practice.

  E.g.: Finding out wages cost for comparables is very difficult since in Profit and Loss account, combined figure of salary, wages and allowance is given. Salary cannot be considered for gross profit margin since it does not relate to a production cost.

- Since the method is based on actual costs, there may be no incentive for the controlled manufacturer to control costs.

j) Following aspects are to be considered while applying CPM

- The cost of production of two transactions must be determined in a consistent manner.

- The tested party margin of gross profit should be calculated on the mark-up earned by comparables.

- Comparables should be similar in various respects to the tested party.

- Internal comparables are preferred for the purpose of analysis.

7.2.5 Profit Split Method ('PSM')

a) PSM evaluates whether the allocation of the combined operating profit or loss attributable to the controlled transaction is at arm's length as compared to the relative value of contribution of each AE to the combined operating profit or loss.

b) Applicability

PSM may be applicable mainly in transactions involving

- transfer of unique intangibles; or
- in multiple inter-related international transactions which can not be evaluated separately.

  Example: Where Indian subsidiary is manufacturing drugs using in-house developed technical knowhow and R & D (intangible) and selling it to US parent company which is selling the same in US using its brand name; PSM can be considered since the Indian Company makes use of intangible in the form of technical knowhow and US Company makes use of intangible in the form of brand name.

c) Method of computing ALP under PSM

ALP under PSM may be computed in the following manner:

- Combined operating profit or loss should be determined for the entities engaged in the controlled transactions and which arises out of such controlled transactions.
- Allocation of the combined profit can be done by any one of the following ways:
  - Contribution Approach / Analysis

- Residual Approach / Analysis

- **Contribution Approach**

  - The combined profit i.e. the total profit from the controlled transactions would be divided between the AEs based on:

    - the reasonable approximation of the division of the profits under the arm's length condition prevailing in similar transactions; and

    - based on the relative value of the functions performed after taking into account assets employed and risks assumed by each AE.

  - The different techniques used in applying Contribution Approach are as under:

    - Capital Investment Approach / Analysis

    - Compensation Approach

    - Bargaining Theory Approach

    - Survey Approach

  - The determination of contribution of each AE under Contribution Approach should be economically justified (else, it becomes Global Apportionment Formula which is not accepted by OECD countries.)

  - It can be difficult to determine the relative value of the contribution that each of the AEs makes to the controlled transactions and the approach will often depend on the facts and circumstances of each case.

- **Residual Approach / Analysis**

  - Under the residual approach, the combined profits of the controlled transactions are allocated in two stages:

    - Towards the basic return appropriate for the type of transactions (which would be without considering the contribution of intangibles or unique product)

    - The residual profit must be split between enterprises in their relative contribution (which is generally based on contribution of intangibles possessed by AEs).

  - The Delhi Tribunal has passed a landmark judgment in the case of **Global One India Pvt. Ltd. ACIT** [(2014) 44 taxmann.com 100 for residual PSM wherein the application of PSM has been dealt with great maturity. The Tribunal not only accepted the purposive interpretation for a meaningful application of Residual Profit Split Method, but also accepted the appellant's alternative argument that if the PSM, as applied by the appellant, did not fall within the strict definition of PSM provided in Rule 10B(1)(d), then the same could be considered as the "Other Method" (sixth method), as provided in Rule 10AB of the Rules, and be applied retrospectively as the insertion of the sixth method could be considered as curative in nature.

d) Factors to be borne in mind while determining ALP under PSM

The following factors should be kept in mind while determining ALP under PSM:

- The combined profit to be split (including losses) should be only that profit arising from controlled transactions under review;

- Allocation of combined profit between AEs should be consistent with

the FAR Analysis of each AE and should be based on the factors agreeable between the third parties;

- Criteria or allocation keys used to split the profit should be reasonably independent of the transfer pricing policy formulation and should be supported reasonably by reliable comparable data;

- In practice, common allocation keys used are assets / capital (operating assets, fixed assets, intangible assets, capital employed) or costs (relative spending and / or investment in key areas such as R & D, engineering, marketing);

- Other allocation keys can be based on incremental sales, headcounts, time spent by certain group of employees, number of servers, data storage, floor space, etc.

- Asset based or capital based allocation keys can be used where there is a strong correlation between tangible or intangible assets or capital employed and creation of value in the context of the controlled transaction.

- Cost based allocation keys can be used where there is a strong correlation between relative expenses incurred and relative value added.

e) Strengths of PSM

PSM has certain strengths which are given below:

- PSM offers solution for highly integrated operations for which one-sided method would not be appropriate.

- PSM offers solutions where both the parties to the transaction contribute unique intangibles.

- PSM offers flexibility since it takes into account specific, possibly

unique, facts and circumstances of the AEs which are absent in the case of independent third parties by adopting arm's length approach.

- The two-sided approach in PSM ensures that neither party to the controlled transaction is left with an extreme and improbable profit result.

f) Weaknesses of PSM

PSM has certain weaknesses which are given below:

- PSM is difficult to apply in practice.
- AEs and tax authorities face difficulties in accessing information from foreign affiliates.
- It may be difficult to measure combined costs and revenue for all AEs, as it may require stating of books and records on common basis as regards accounting practices, different currencies, etc.
- It may be difficult to identify the operating expenses associated with the international transactions and other activities of AEs.

Note: PSM is not widely used in practice in India.

7.2.6 Transactional Net Margin Method ('TNMM')

a) TNMM examines the net profit margin relative to an appropriate base (e.g. costs, sales, assets) that a tested party realizes from a controlled transaction with the net profit margin earned from comparable uncontrolled transactions (Internal TNMM) or with that of an uncontrolled party engaged in a comparable uncontrolled transaction (External TNMM).

b) Applicability

TNMM is generally considered as a method of last resort and is applied when it is not possible to apply any other methods as mentioned earlier to

determine ALP.

The UN TP manual offers the following guidance on the use of TNMM:

- TNMM is usually applied with respect to broad comparable functions rather than controlled transactions.

- TNMM is mostly applied to the party performing routine manufacturing, distribution or other functions that do not involve control over intangibles.

- TNMM may be more attractive if the data on gross margins are less reliable due to accounting differences between the tested party and the comparable companies.

c) Certain features of TNMM

- TNMM compares net margins by using certain ratios (PLIs) to express net profit as a % of a given base which commonly includes operating cost, operating income, total assets, operating expenses, etc.

- TNMM is similar to RPM and CPM to the extent that it involves a comparison of margins earned in a controlled situation with margins earned from comparable uncontrolled situations.

- However, TNMM differs from RPM and CPM to the extent that it involves comparison of margins at net profit level as against at gross profit level.

d) Strengths of TNMM

TNMM has certain strengths which are as follows:

- TNMM requires comparability at a broad functional level and product differences are acceptable provided it does not materially affect the net profit margin.

- Operating profit margins are less affected by transactional differences as is the case with price while applying CUP Method.

- It is necessary to examine the financial indicator of only one of the AEs (i.e. the tested party.)

- It is not necessary to restate the books and records for all participants on a common basis or to allocate costs as is the case with PSM.

- The differences in functions performed between enterprises are often reflected in variation in operating expenses. Consequently, enterprises may have wide range of gross profit margins but it may still earn broadly similar level of net profits.

- Because TNMM is applied to the least complex entity, it can be used even though one of the related parties hold intangible assets for which comparable return cannot be determined.

- TNMM is applicable to either side of the controlled transaction (i.e. related party manufacturer or the distributor).

e) Weaknesses of TNMM

TNMM has certain weaknesses which are as follows:

- Difficulty in ascertaining revenue and operating expenses (i.e. segmental results) related to the controlled transactions to establish the net profit indicator.

- Difficulty in making reasonable accurate adjustments in cases where factors like difference in working capital, risks assumed, etc. have an influence on the net margins of the taxpayer vis-à-vis third parties.

- Difficulty in determining the corresponding adjustment, particularly where the controlled transactions are both on the purchase as well as sales side.

f) Certain issues in application of TNMM

TNMM is widely used in actual practice. However, certain issues arise in application of TNMM which are as below:

- **Whether TNMM requires comparison of profit earned from an international transaction or the entity level profits?**

  Rule 10B(1)(e) of the Rules mentions that net profit margin realized by an enterprise from an international transaction should be computed and compared with uncontrolled transactions. Hence, on plain reading of Rule 10B(1)(e), it appears that under TNMM, profit attributable to international transactions should be compared and not the profits at entity level.

  In this respect, it is to be noted that the Mumbai Tribunal in the case of **UCB India Pvt. Ltd.** vs. ACIT (2009-121-ITD-131-MUM) held that TNMM refers to only net profit margin realised by an enterprise from an international transaction or a class of such transaction, but not operational margins of enterprises as a whole. The relevant extract of the observations of the Mumbai Tribunal is given below:

  "Section 92C(1) refers to arm's length price in relation to an international transaction. Rule 10B(1)(e) read with section 92C deals with TNMM, and it refers to only net profit margin realized by an enterprise from an international transaction or a class of such transaction, but not operational margins of enterprises as a whole."

  Further, the Mumbai Tribunal has also taken similar view in the following cases:

  - **ACIT vs. M/s Tej Diam** (2010-TII-27-ITAT-MUM-TP)
  - **ACIT vs. M/s Twinkle Diamond** (2010-TII-09-ITAT-MUM-TP)

  Hence, if there are transactions with AEs and non AEs, it would be

necessary to prepare segmental Profit and Loss account of AE and non AE segment and comparison should be made of the profit attributable to the AE segment.

- **Whether internal TNMM should be preferred to external TNMM?**

In case of internal TNMM, ALP is determined by comparing the net profit margin of the tested party from controlled transaction with net profit margin earned from comparable uncontrolled transactions whereas in case of external TNMM, ALP is determined by comparing the net profit margin of the tested party with the net profit margin of an uncontrolled party engaged in a comparable uncontrolled transaction. Sometimes, controversy arises as to whether Internal TNMM is preferable over External TNMM.

In case of Internal TNMM, all the information for the controlled and uncontrolled transactions is available with the assessee whereas in case of External TNMM, the assessee has to rely on the external data which may not be reliable. Hence, Internal TNMM should be preferred to External TNMM. Even the OECD guidelines support the similar view.

The Delhi Tribunal in the case of **Abhishek Auto Industries Ltd. vs. DCIT** (2010-TII-54-ITAT-DEL-TP), held that the internal comparables are more reliable than the external comparables and tends to reduce the scope of making any adjustment to the ALP. The relevant extract of the observations of the Delhi Tribunal is given below:

"The next proposition of using internal comparables also in our view helps the case of the assessee, to take it outside the scope of making any adjustment. Apart from relying on the judgments cited by the appellant, in our opinion, the best comparability can be of the transactions of the tested party itself."

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The Delhi Tribunal further, in the case of **Birlasoft (India) Ltd. vs. DCIT** (2011-TII-41-ITAT-DEL-TP), has reiterated the preference of internal comparables over external comparables. The relevant extract of the observations of the Delhi Tribunal is given below: "...the assessee was justified in undertaking internal benchmarking analysis on standalone basis by placing on record working of operating profit margin from international transactions with AEs and transactions with unrelated parties undertaken in similar functional and economic scenario, and the same should be the basis for determination of arm's length price in respect of international transactions undertaken with the associated enterprise. In the light of the facts of the present case as discussed above, we therefore, hold that the Transfer Pricing Officer had no mandate to have recourse to external comparables when, in the present case, internal comparables were available, which could be applied for determining the arm's length price of international transactions with AEs."

7.2.7 Other Method as prescribed by CBDT – Rule 10AB

a) CBDT inserted Rule 10AB, vide notification No. 18/2012 dated 23 May 2012, notifying the "Other Method" apart from the 5 methods already prescribed. This rule is made effective from 1 April 2011, relevant to AY 2012-13.

b) The introduction of the Other Method as the sixth method allows the use of 'any method' which takes into account (i) the price which has been charged or paid or (ii) would have been charged or paid for the same or similar uncontrolled transaction, (iii) with or between non AEs, under similar circumstances, considering all the relevant facts.

c) As per Revised Guidance Note issued by ICAI the various data which may possibly be used for comparability could be:

- Third party quotations;
- Valuation reports;

- Tender / Bid documents;
- Documents relating to negotiations;
- Standard rate cards;
- Commercial and economic business models; etc.

d) According to Revised Guidance Note issued by ICAI, Rule 10AB does not describe any methodology but only provides an enabling provision to use any method that has been used or may be used to arrive at price of a transaction undertaken between non AEs. Hence, it provides flexibility to determine the price in complex transactions where third party comparable prices or transactions may not exist.

e) This particularly is useful in cases where the application of 5 specific methods is not possible due to reasons such as difficulties in obtaining comparable data due to uniqueness of transactions such as intangibles or business transfers, transfer of unlisted shares, sale of fixed assets, revenue allocation / splitting, guarantees provided and received, etc.

However, it would be necessary to justify and document reasons for rejection of all other 5 methods while selecting the 'Other Method' as the most appropriate method. The OECD Guidelines also permit the use of any Other Method and state that the taxpayer retains the freedom to apply methods not described in OECD Guidelines to establish prices, provided those prices satisfy the arm's length principle.

- **Illustrations as per Revised Guidance Note issued by ICAI**

A. AE1 Ltd. is an Indian Company. AE1 Ltd. owns certain registered patents which it has developed by undertaking research and development. It is a subsidiary of AE2 Ltd., a foreign company. AE1 Ltd. has sold its registered patents to AE2 Ltd. for INR 50 crores. The price has been determined based on a valuation report obtained from an independent valuer.

The sale of patents is a unique transaction and AE1 Ltd. or AE2 Ltd. has not entered into similar transactions with third parties and hence no internal or external CUP is available. AE1 Ltd. may select 'Other Method' as the most appropriate method and use the independent valuation report for comparability purposes.

B. An Indian Company ('I Co.') buys back its equity shares issued to its foreign AE ('AE Co'). I Co. obtains a valuation report from an external firm identifying the FMV of these shares. I Co. purchases the shares at the value determined in the valuation report. This value denotes a price that would have been charged if a third party would have bought the same shares. Hence, I Co. could use Rule 10AB and rely upon the valuation report to demonstrate this transaction to be at arm's length.

C. In case of cost allocation arrangements a taxpayer benefits from certain services provided by a central entity of the group and has to pay a portion of the total cost incurred by the service provider. These costs are generally allocated on the basis of allocation keys like headcount, time spent, revenues, etc. and a third party outside the group may not have the capability to provide identical services. Hence, in the absence of comparable prices or transactions, Rule 10AB may be applied and the cost allocation arrangement could be justified appropriately.

- The Bangalore Tribunal in the case of **Tally Solutions Pvt. Ltd. Vs. DCIT** [(2011) 14 taxmann.com 19] dealt with the complex subject of valuation of intellectual property rights. The Tribunal held that Excess Earning Method ('EEM') is an appropriate method to determine the arm's length price of transaction of sale of intangible property and this method can be considered equivalent to the CUP method. Valuation of a property based on recognized principles and international practices has been given acceptance for determination of ALP by the Tribunal.

7.2.8 The Most Appropriate Method

Rule 10C(1) provides that the method to be selected should satisfy two conditions:

- It should be the one best suited to facts and circumstances of each international transaction / SDT; and
- It provides the most reliable measure of the arm's length price.

7.2.9 Concept of Most Appropriate Method

- As per Indian TP regulations, ALP in relation to an international transaction / SDT shall be determined by any of the prescribed methods, being the most appropriate method.
- Indian TP regulations do not provide any hierarchy or priority for selection of most appropriate method.
- Most appropriate method is that method which, under the facts and circumstances of the transaction under review, provides the most reliable measure of an arm's length result.
- Each method needs to be tested on its merits depending on the nature of international transaction, availability of reliable comparable data, extent to which reasonable adjustments can be made, etc.

7.2.10 Factors to be considered while selecting the Most Appropriate Method

Following factors should be considered while selecting the MAM:

- The nature and class of international transaction / SDT.
- The class of AEs and the FAR analysis of AEs.
- Availability of the reliable data necessary for the application of the method.
- Degree of comparability existing between international transaction / SDT and uncontrolled transaction and between the enterprises entering into

such transactions.

- The extent to which reliable and accurate adjustments can be made for differences between international transaction and uncontrolled transaction.
- The nature, extent and reliability of the assumptions required to be made in application of the method.

7.2.11 Benefit of Proviso to section 92C(2) of the Act

a) New proviso inserted by the Finance Act, 2012

The Indian Transfer Pricing regulation prescribes than no adjustment should be made if the value of international transaction / SDT is within the tolerance band as prescribed in Proviso to section 92C(2) of the Act.

The Finance Act 2012 amended the tolerance band for FY 2012-13 (AY 2013-14) and onwards. The tolerance band would be 1% to be applicable in case of wholesale trader and 3% tolerance band for others.

b) Use of multiple year data and adoption of range concept

On 19 October 2015, CBDT issued a notification releasing the rules for the use of range and multiple year data in line with the announcement made by Finance Minister to align the Indian Transfer Pricing Regulations with international best practices.

The Rules are applicable with effect from 1 April 2014 and would apply for both international transactions as well as SDT from FY 2014-15 prospectively.

Use of multiple-year data

In case where the RPM, CPM or TNMM is used as MAM for determination of the ALP of International Transaction/SDT entered into or after 1 April 2014, comparability will be conducted based on:

- data relating to current year; or

- data relating to the financial year immediately preceding the current year, if the data relating to the current year is not available at the time of furnishing the return of income

However, it has been provided that during the assessment proceedings, if the current year data becomes available, the same shall be considered irrespective of the fact that such current year data was not available at the time of furnishing the return of income.

Adoption of the range concept – Rule 10CA

The concept of range is applicable in case of all methods except the Profit Split Method and Other Method. The steps to be followed for constructing the range are as under:

- A minimum of 6 comparables would be required
- Where the comparable uncontrolled transaction of an enterprise has been identified based on current year data and the enterprise has undertaken the same or similar transactions in the 2 preceding financial years, three-year data of these comparables would be considered. In certain circumstances, data of two out of three years could also be used. Additionally, single year data can be used, provided that the data is for the current year in which the tested transaction is undertaken or a year prior to the current year in the case of non-availability of data for the current year.

▪ The data set using multiple year data is required to be computed based on the weighted average of the prices derived using the following as weights depending upon the transfer pricing methodology used:

  - The weighted average of the three-year data of each comparable would be used to construct the data set.
  - The weighted average computation will involve aggregation of the numerator and denominator of the chosen profit level

indicator for all the years for every comparable individually and the dataset will accordingly be constructed.

- An arms' length range beginning from 35th percentile of the dataset and ending on the 65th per centile will be considered.
  - If the value arrived is not a whole number, the value shall be rounded off to the next higher value shall be considered so as to cover at least 35%/65% of the value below it.
  - If these values are whole numbers, then the value shall be the arithmetic mean of such value and the immediately succeeding value in the dataset
- If the transaction price falls within the range, then the same shall be deemed to be the ALP. If the transaction price falls outside the range, the ALP shall be taken to be the median of the data set.

The arithmetic mean of prices along with the permitted variation of 1% (in case of wholesalers) /3% (in all other cases) would continue to apply in the case of PSM and Other method. It would also apply in cases where the numbers of comparables are less than six.

The above rules regarding allowability of multiple year data and range concept have been summarised below:

<table>
<tr><th rowspan="2">Method</th><th rowspan="2">Use of multiple year data</th><th colspan="3">Range concept applicability</th></tr>
<tr><th>1 comparable</th><th>2–5 comparable</th><th>6 or more comparables</th></tr>
<tr><td>CUP</td><td>X</td><td>X</td><td rowspan="4">X –Arithmetic mean of all values with benefit of variation from mean as notified by CBDT</td><td>■</td></tr>
<tr><td>RPM</td><td>■</td><td>X</td><td>■</td></tr>
<tr><td>CPM</td><td>■</td><td>X</td><td>■</td></tr>
<tr><td>TNMM</td><td>■</td><td>X</td><td>■</td></tr>
<tr><td>PSM</td><td colspan="4">Not applicable</td></tr>
<tr><td>OM</td><td colspan="4">Not applicable</td></tr>
</table>

The computation mechanism is explained by way of illustrations below:

Illustration 1: Where the data set comprises 7 data points (arranged in ascending order) and the percentiles computed are not whole numbers.

Percentile	Formula	Result	Value to be selected
35th	Total no. of data points in dataset *35% = [7 * 35%]	2.45	3rd value*
65th	Total no. of data points in dataset *65% = [7 * 65%]	4.55	5th value*
Median	Total	3.50	4th value*

* Value referred to here is the place value in the data set as arranged in ascending order.

Illustration 2: Where the data set comprises 20 data points (arranged in ascending order), and the percentiles computed are whole numbers.

Percentile	Formula	Result	Value to be selected
35th	Total no. of data points in dataset * 35% = [20 * 35%]	7.00	Mean of 7th & 8th value
65th	Total no. of data points in dataset * 65% = [20 * 65%]	13.00	Mean of 13th & 14th value
Median	Total no. of data points in dataset * 50% = [20 * 50%]	10.00	Mean of 10th & 11th value

* Value referred to here is the place value in the data set as arranged in ascending order.

Illustration 3: The data of the current year is available in respect of enterprises A, C, E, F and G at the time of furnishing the return of income by the assessee and the data of the financial year preceding the current year has been used to identify comparable uncontrolled transactions undertaken by enterprises B and D . Further, if the enterprises have also undertaken comparable uncontrolled transactions in earlier years as detailed in the table, the weighted average and dataset shall be computed as below:

Sr. No.	Name	Year 1	Year 2	Year 3 [Current Year]	Aggregation of OC and OP	Weighted Average (OP/OC)
1.	A	OC = 100 OP = 12	OC 150 OP = 10	OC = 225 OP = 35	Total OC = 475 Total OP = 57	12%
2.	B	OC = 80 OP = 10	OC 125 OP = 5		Total OC = 205 Total OP = 15	7.31%
3.	C	OC = 250 OP = 22	OC 230 OP = 26	OC = 250 OP = 18	Total OC = 730 Total OP = 66	9%
4.	D		OC 220 OP = 22		Total OC = 220 Total OP = 22	10%
5.	E			OC = 100 OP = (–) 5	Total OC = 100 Total OP = (–)5	(–)5%
6.	F	OC = 160 OP = 21	OC 120 OP = 14	OC = 140 OP = 15	Total OC = 420 Total OP = 50	11.9 %
7.	G	OC = 150 OP = 21	OC 130 OP = 12	OC = 155 OP = 13	Total OC = 435 Total OP = 46	10.57%

From the above, the dataset will be constructed as follows:

Sr. No.	1	2	3	4	5	6	7
Values	(–)5%	7.31%	9%	10%	10.57%	11.9%	12%

If during the course of assessment proceedings, the data of the current year is available and the use of such data indicates that B has failed to pass any qualitative or quantitative filter or for any other reason the transaction undertaken is not a comparable uncontrolled transaction, then, B shall not be considered for inclusion in the dataset. Further, if the data available at this stage indicates a new comparable uncontrolled transaction undertaken by enterprise H, then, it shall be included. The weighted average and dataset shall be recomputed as under:

Sr. No.	Name	Year 1	Year 2	Year 3 [Current Year]	Aggregation of OC and OP	Weighted Average (OP/OC)
1.	A	OC = 100 OP = 12	OC 150 OP = 10	OC = 225 OP = 35	Total OC = 475 Total OP = 57	12%
2.	C	OC = 250 OP = 22	OC 230 OP = 26	OC = 250 OP = 18	Total OC = 730 Total OP = 66	9%
3.	D		OC 220 OP = 22	OC = 150 OP = 20	Total OC = 370 Total OP = 42	11.35%
4.	E			OC = 100 OP = (–) 5	Total OC = 100 Total OP = (–)5	(–)5%
5.	F	OC = 160 OP = 21	OC 120 OP = 14	OC = 140 OP = 15	Total OC = 420 Total OP = 50	11.9%
6.	G	OC = 150 OP = 21	OC 130 OP = 12	OC = 155 OP = 13	Total OC = 435 Total OP = 46	10.57%
7.	H	OC = 150 OP = 12		OC = 80 OP = 10	Total OC = 230 Total OP = 22	9.56%

From the above, the dataset will be constructed as follows:

Sr. No.	1	2	3	4	5	6	7
Values	(–)5%	9%	9.56%	10.57%	11.35%	11.9%	12%

7.2.12 Tested Party

a) Tested Party means the party from whose perspective the international transaction / SDTs is tested for the determination of arm's length price.

b) Indian TP Regulations do not prescribe any criteria for selecting the tested party. However, the following parameters can be used for selection of the tested party:

- Tested party should functionally be the least complex of the transacting parties.
- There should be availability of reliable comparable data that requires fewest and most reliable adjustments.
- The tested party should ideally not own any intangibles or own fewer intangibles.

c) Out of the above, availability of reliable comparable data that requires fewest and most reliable adjustments is the most important factor to be considered for selection of the tested party since an entity may be performing the least complex functions and may not be owning intangibles, but if the reliable comparable data is not available for such entity, such entity cannot be selected as the tested party.

d) In certain judicial pronouncements as under, it was held that even foreign entity can be selected as the tested party if the above conditions are fulfilled.

- **Onward Technologies Limited vs. DCIT** [(2013) 35 taxmann.com 584 – Mumbai Tribunal
- **General Motors India (P.) Ltd. vs. DCIT** [2013] 37 taxmann.com 403 – Ahmedabad Tribunal
- **Development Consultants Pvt. Ltd. vs. DCIT** [(2008) 23 SOT 455 – Kolkata Tribunal

e) The tested party should be selected based on the criterion as mentioned above and the reasons for selection of tested party should be adequately documented in the TP Study. If foreign entity is selected as the tested party, then the assessee must ensure that the reliable comparable data is available for furnishing the same before the tax authorities and an in-depth FAR analysis of the tested party and the comparables is done.

7.2.13 Profit Level Indicator ('PLI')

a) PLIs are the ratios that measure the relationship between the profits and other attributes like costs or sales or resources like capital employed or assets employed to determine the arm's length price.

b) In assessing the financial performance of the comparable companies, it is important to use appropriate PLIs (i.e. measures that reflect the fact that these companies are predominantly engaged into). The choice of PLIs depends upon a number of factors, including the nature of the activities, the reliability of the available data with respect to the comparable companies and the extent to which the PLI is likely to produce an appropriate review of an arm's length result.

c) Overview of most commonly used PLIs are:

PLI	Computation	Uses
Return on Assets (ROA)	Operating profit divided by the operating assets (normally only tangible assets)	Generally in case of capital intensive manufacturers
Return on capital employed (ROCE)	Operating profit divided by capital employed which is usually computed as the total assets minus cash and investments	Generally in case of capital intensive manufacturers
Operating Profit Margin (OPM)	Operating profit divided by Operating Income	When amount payable to AE for purchase from AE or

PLI	Computation	Uses
		services received from AE
Operating Cost Margin (OCM)	Operating profit divided by Operating Cost	When amount receivable from AE for exports to AE or services rendered to AE
Return on total costs (ROTC)	Operating profit divided by total costs	When amount receivable from AE for exports to AE or services rendered to AE
Return on cost of goods sold	Gross profit divided by cost of goods sold	Distribution activities
Berry Ratio	Gross profit divided by operating expenses	Intermediary activities such as logistic industry / courier industry wherein taxpayer is performing intermediate activity.

d) The selection of PLI depends on the method which is selected as the most appropriate method. The following table summarises the different PLIs used in different methods:

Method	PLI
CUP method	No PLI since price is compared
RPM	Gross Profit/Sales
CPM	Gross Profit/Direct and Indirect Cost of Production
PSM	Generally, Operating margin
TNMM	Generally, Operating margin
Other Method	'Would be price'

Chapter 8 Comparability Analysis

Comparability analysis is an important link between ALP and operation of transfer pricing methods. The analysis is helpful to identify comparables and assess the degree of comparability of international transactions / SDTs.

The OECD TP Guidelines defines 'comparability analysis' as 'A comparison of a controlled transaction with an uncontrolled transaction or transactions.'

According to Rule 10A(ab), 'uncontrolled transaction' means a transaction between enterprises other than AEs, whether resident or non-resident. When an uncontrolled transaction has been entered into, it could be said that it has been contracted under 'uncontrolled conditions'. An uncontrolled transaction can be between:

- A resident and a non-resident; or
- A resident and a resident; or
- A non-resident and a non-resident.

8.1 Indian TP Regulations

8.1.1 As per Indian TP Regulations, an uncontrolled transaction shall be comparable to an international transaction / SDT if:

- None of the differences, if any, between the transactions being compared, or between the enterprises entering into such transactions are likely to materially affect the price or cost charged or paid in, or the profit arising from, such transactions in the open market; or
- Reasonably accurate adjustments can be made to eliminate the material effects of such differences.

8.1.2 The following factors should be taken into account while conducting comparability analysis of an international transaction / SDT with an uncontrolled transaction:

- The specific characteristics of the property transferred or services provided in either transaction;

- The functions performed, taking into account assets employed or to be employed and the risks assumed, by the respective parties to the transactions;
- The contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions;
- Conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical location and size of the markets, the laws and government orders in force, costs of labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail.

8.2 Database

Indian Database

To search comparable companies in India, generally three public databases are available:

The commonly used Indian database is 'Prowess'[4], 'Capitaline Plus'[5] and 'ACE TP'[6] which contain robust data of more than 30,000 companies, which are also relied upon by the Indian tax authorities.

4 Prowess is a database of the financial performance of Indian companies from Centre for Monitoring Indian Economy Pvt Ltd. (CMIE)

5 Capitaline is a digital corporate database of Indian listed, unlisted and subsidiary Companies providing fundamental and market data

6 ACETP Online is a Indian database application for comparing company financial information of Indian business entities for transfer Pricing.

Foreign Database

There are number of foreign database available for analysis. The commonly known databases are One Source[7], Lexis-Nexis[8], Royaltystat[9], Standard & Poor's Research – North American Database, ORBIS[10], OSIRIS[11], Amadeus[12], KTMINE, Bloomberg, Loan Connector etc. Mostly foreign databases are not generally used by taxpayer because it does not have information of Indian companies.

To ensure comparability of companies in public database with the tested party, various quantitative and qualitative filters are applied. These are explained below:

8.3 Certain Filters Applied in Conducting the Comparability Analysis

The following filters are generally applied while conducting comparability analysis:

8.3.1 Selection of the industry

The first step involves identifying the industry in which the tested party operates. E.g. a company engaged in manufacture of drugs shall primarily conduct its search in pharmaceutical industry.

8.3.2 Selection of the financial period

The Finance Minister in his budget speech 2014 had provided for the usage of multiple year data. The CBDT in October 2015 published a notification[13] releasing the final rules for the use of range concept and multiple year data.

- **Range concept**
  - The range concept is applicable for all the methods except for PSM & Other Method.

7 https://tax.thomsonreuters.com/products/brands/onesource/onesource-transfer-pricing/
8 http://www.lexisnexis.com/
9 https://www.royaltystat.com/
10 https://orbis.bvdinfo.com/
11 https://osiris.bvdinfo.com/
12 http://amadeus.bvdinfo.com
13 CBDT Notification No 83/2015 dated 19 October 2015

- The range concept can be applied only if six or more comparables are available. If numbers of comparable are less than six then the arithmetic mean concept will be applicable.

- The arm's length range shall constitute of the values falling between the 35th & the 65th percentile of the dataset that are arranged in ascending order. In case if the price at which the international transaction / SDT has taken place, falls outside the arm's length range, the median value of the dataset shall be considered to be ALP.

▪ **Multiple year**

The data to be used for a comparability analysis relates to the 'financial year' in which the international transactions / SDT was entered into or data relating to a period not more than two years prior to such financial year. The term 'financial year' has been replaced by the term 'current year'.

Further, it has been mentioned that where RPM, CPM or TNMM is used as MAM for the determination of ALP of international transaction / SDT entered on or after 1 April 2014, comparability will be conducted based on

- Data relating to current year or

- Date relating to financial year immediately preceding the current year if data relating to current year is not available at time of furnishing return of income

- Multiple Year data will be considered for computation of ALP irrespective of the fact whether the range concept is applicable or not.

However it has also been provided that, during the assessment proceedings if the data relating to current year becomes available, the same shall be considered irrespective of the fact that such current year data was not available at the time of furnishing of return of income.

8.3.3 Turnover filter

The turnover filter is to be applied to ensure that only the companies which are operating at the similar level of activity as the tested party are selected as comparables. As such a suitable range of turnover has to be considered.

8.3.4 Manufacturing/trading filter

This filter is applied to ensure that the companies selected are engaged in the same function as the tested party. E.g. If the tested party is a manufacturing company, companies having income mainly from manufacturing activity to be considered.

8.3.5 Negative net worth filter

The companies having negative net worth in the year in which the international transaction/SDT is entered should be rejected since companies having negative net worth are considered to be abnormal in nature. E.g. If the international transactions / SDT has taken place in FY 2014-15, companies having negative net worth in FY 2014-15 should be rejected.

8.3.6 Companies incurring consistent losses / high profit making

The companies which have incurred consistent losses say for more than 2 years should be rejected since consistent loss making companies are not considered as having normal business operations. E.g. If the international transaction/SDT has taken place in FY 2014-15, companies incurring losses in FY 2012-13, 2013-14 and 2014-15 may be rejected. The Indian tax authorities tend to reject loss-making companies but do not follow the same approach for high profit making companies. With the introduction of the range concept, some of these issues automatically may be addressed.

8.3.7 Related party transactions

As per the Indian TP Regulations, comparison is to be made with the companies having uncontrolled transactions. Therefore, companies having significant related party transactions should be rejected. E.g. Companies having related party

transactions more than, say, 25% of total revenue may be rejected.

8.3.8 Functionally non-comparable

Finally, companies which are functionally not comparable to the tested party or companies for which sufficient information is not available regarding business activity should be rejected.

After applying the above filters, companies which are obtained would be the companies which are functionally comparable to the tested party.

8.4 Adjustments for Comparability Analysis:

8.4.1 To ensure comparability of an international transaction / SDT with an uncontrolled comparable transaction, many adjustments may have to be made such as adjustments for difference in working capital, risk profile of entities, capacity utilisation, etc.

8.4.2 The Indian TP Regulation explicitly require that adjustments to prices/margins should be made to enhance the reliability of comparability analysis for the computation of ALP, yet they give limited guidance on the methodology to be adopted. Hence, guidance can be obtained from OECD guidelines, US TP regulations and Indian Judicial rulings.

8.4.3 Under Rule 10B(3) of the rules, an uncontrolled transaction shall be comparable to an international transaction if:

- None of the differences, if any ,between the transaction being compared, or between the enterprises entering into such transactions are likely to materially affect the price or cost charged or paid in, or the profit arising from, such transactions in the open market; or
- Reasonable accurate adjustments can be made to eliminate the material effects of such differences.

Indian courts have held the view that economic adjustments, wherever required,

should be made to enhance comparability. The OECD has emphasized that one of the two conditions that should be met is that reasonably accurate adjustments can be made to eliminate the material effects of differences between the tested party on the one hand & comparables on the other. It has been emphasized that comparability adjustments should be considered if (and only if), they are expected to increase the reliability of the results.

8.4.4 Further, the Indian courts have consistently taken a view that adjustments should be made for differences in working capital, risk profile of entities, capacity utilisation, etc. In this respect, it is important to note that in Mumbai Tribunal in the case of **Maersk Global Centres (India) (P.) Ltd. Vs. ACIT** [2014] (43 taxmann.com 100) it was held that a relatively equal degree of comparability can be achieved by taking into consideration the functional profile of the tested party and comparing the same with the entities selected as potential comparables on broad functional analysis taken at ITES level. The principal functions performed by the tested party should be identified and the same can be compared with the principal functions performed by the entities already selected to find out the relatively equal degree of comparability. If it is possible by this exercise to determine that some uncontrolled transactions have a lesser degree of comparability than others, they should be eliminated. The examination of controlled transactions ordinarily should be based on the transaction actually undertaken by the AE and the actual transaction should not be disregarded or substituted by other transaction.

8.4.5 Further, the Delhi Tribunal, in the case of **Mentor Graphics (Noida) P. Ltd. v. DCIT** [2007](109 ITD 101)(TDEL), has allowed adjustment on account of differences in working capital, risk profile, etc. The relevant extract of the observation of the Delhi Tribunal is given below:

"27. After the selection of the comparables.................. Depending on facts of the case, final set of comparables may need to eliminate differences by making adjustments for the following:

(a) working capital.

(b) adjustment for risk and growth.

(c) adjustment of Research and Development ('R&D') expenses..............''

8.4.6 Further, the Bangalore Tribunal in the case of **Philips Software Centre Private Ltd. v. ACIT** [2008](119 TTJ 721) (TBAN) has held as under:

''(ix) Adjustment needs to be made to the margins of the comparables to eliminate differences on account of different functions, assets and risks. More specifically, adjustment needs to be made for:

(a) Differences in risk profile

(b) Difference in working capital position

(c) Differences in accounting policies''

8.4.7 Working capital adjustment

Working capital adjustments should be utilised when a tested party exhibits different working capital intensities relative to a set of comparables. This is illustrated through two key areas of working capital adjustments:

i. Inventory and accounts receivable adjustments; and

ii. Accounts payable adjustments

If our tested party, a distributor for illustrative purposes, has a lower intensity of accounts receivable or inventories to sales relative to a set of comparables, then this would imply that the comparables in question were providing its' customers with a valuable function that should be compensated through higher prices. To correct for the fact that the given comparables are performing more value added functions than the tested party, the returns given by the comparables must be adjusted downward in order to assign the tested party with an accurate profit margins. If, on the other hand, the comparables in question have higher levels of accounts payable to sales relative to our tested party, then this would suggest that these comparables were receiving a valuable financing function from their suppliers and would likely be charged a higher price. In order to improve

comparability, the returns given by the comparables must be adjusted upward in order to assign the tested party with a more reliable return. The OECD Guidelines on page 329 provides an illustration of working capital adjustment, the same maybe referred to in order to carry out an adjustment.

8.4.8 Risk adjustment

The need for risk adjustment is based on the fundamental principle that the profits in the market place are a function of the risk assumed. This implies that two enterprises with different risk profiles would have different profitability levels. Adjustment for differences in the risk profile is one of the most complex and highly debatable issues.

The OECD guidelines recognize the need for adjustments on account of differences in risk profile. In this regard, the relevant extract of OECD Guidelines is given below:

"1.45 Controlled and uncontrolled transactions and entities are not comparable if there are significant differences in the risks assumed for which appropriate adjustments cannot be made. Functional analysis is incomplete unless the material risks assumed by each party have been considered since the assumption or allocation of risks would influence the conditions of transactions between the associated enterprises. Usually, in the open market, the assumption of increased risk would also be compensated by an increase in the expected return, although the actual return may or may not increase depending on the degree to which the risks are actually realised.

1.46 The types of risks to consider include market risks, such as input cost and output price fluctuations; risks of loss associated with the investment in and use of property, plant, and equipment; risks of the success or failure of investment in research and development; financial risks such as those caused by currency exchange rate and interest rate variability; credit risks; and so forth.

1.47 The functions carried out (taking into account the assets used and the risks assumed) will determine to some extent the allocation of risks between the

parties, and therefore the conditions each party would expect in arm's length transactions . For example, when a distributor takes on responsibility for marketing and advertising by risking its own resources in these activities, its expected return from the activity would usually be commensurately higher and the conditions of the transaction would be different from when the distributor acts merely as an agent, being reimbursed for its costs and receiving the income appropriate to that activity. Similarly, a contract manufacturer or a contract research provider that takes on no meaningful risk would usually expect only a limited return.

1.48 In line with the discussion below in relation to contractual terms, it may be considered whether a purported allocation of risk is consistent with the economic substance of the transaction. In this regard, the parties' conduct should generally be taken as the best evidence concerning the true allocation of risk. If, for example, a manufacturer sells property to an associated distributor in another country and the taxpayer's contract indicates that the distributor assumes all exchange rate risks, in relation to this controlled transaction, but the transfer price appears in fact to be adjusted so as to insulate the distributor from the effects of exchange rate movements, then the tax administrations may wish to challenge the purported allocation of exchange rate risk for this particular controlled transaction.".

The Bangalore Tribunal in the case of **Philips Software Centre Pvt Ltd V. DCIT** ITA No. 218(BNG)/08, [TS-8-ITAT-2008] provided an adjustment for differences in risk profile by comparing the prime lending rate with the risk free bank rate and provided the difference as an adjustment factor to the taxpayer. Hence, though the need for carrying out necessary adjustment was recognized, the decision applied a "rule of thumb" calculation rather than a scientific analysis or model.

Based on current experience the most commonly used model to effect a holistic "market" risk adjustment is the Capital Asset Pricing Model ('CAPM') wherein beta coefficient has been used as a measure of the market risk.

In almost all cases, the Tribunal has accepted the requirement to make adjustment

for differences in risks, there is no clarity on the underlying methology for computation of the adjustment. However, the Delhi Tribunal in the case of **Motorola Solutions India Private Limited v/s ACIT** (ITA No 5637) has accepted CAPM as a valid methodology for undertaking risk adjustment and has advised the Tax authority to use expert advice in order to arrive at an appropriate framework for application of CAPM.

8.4.9 Capacity utilisation adjustment

The OECD Transfer Pricing Guidelines, prescribe the making of adjustments to eliminate differences in capacity utilisation or idle capacity adjustments. Also, Rule 10B (1)(e)(iii) of the Rules, net profit margin arising in comparable uncontrolled transactions is meant to be adjusted to take into account material differences, if any, between the international transaction/SDT and the comparable uncontrolled transaction or between the enterprises entering into such transactions.

Capacity under-utilisation by enterprises is a factor affecting net profit margin because lower capacity utilisation results in higher per unit costs, which, in turn, results in lower profits at a transactional or unit level.

Though the need for capacity adjustment has been appreciated there is at present no authoritative guidance in respect of the same. The Indian tax authorities generally do not allow these adjustments. The main argument of the tax authorities is that reliable information to show that capacity is underutilised viz-a-viz comparables is not available. In a recent decision the Delhi Tribunal in the case of **Claas India Pvt. Ltd.** [TS-371-ITAT-2015], the Tribunal has not only accepted the need for a capacity utilisation adjustment but has in fact treaded a step further and addressed two critical questions in relation to this adjustment, viz.,

(i) whether the adjustment should be made to the tested party or to comparables?

Accordingly, the Tribunal based on a reading of Rule 10B(1)(e)(iii)in juxtaposition to sub-rules (2) & (3) of Rule10B, held that the net operating profit margin of comparable companies should be adjusted in such a manner

so as to bring both the international transaction and comparable cases on the same pedestal, to ensure a meaningful and effective comparison.

(ii) how to compute the adjustment?

The Tribunal stated that the adjustment is called for only in respect of fixed operating costs as variable operating costs remain unaffected due to any under or over utilisation of capacity; it stated that fixed operating costs have to be proportionately scaled up or down by considering the percentage of capacity utilisation by the assessee and comparable. The judgment explains the adjustment in detail by way of an illustration.

The Mumbai Tribunal in the case of **Petro Aradite Pvt Ltd** (ITA No. 3782/Mum/2011: [2013] 35 taxmann.com 590) discussed and explained a methodology for making capacity adjustment in detail. It held that if the fixed overheads allocation or absorption of comparables was brought to the level of taxpayer, it would nullify the effect of difference in capacity utilisation on the profit margin. Thus the Tribunal held that the adjustment on account or difference in capacity utilisation can be made by absorbing or allocating fixed overheads such as depreciation at the same level as that of the taxpayer. It also held that such absorption or allocation of fixed overheads would be more appropriate on operating cost instead of sales to eliminate the effect of differences in profit margin or difference in stock of finished goods, if any between the taxpayer and the comparables.

In view of the above, it would be advisable to make adjustments for difference in working capital, risk profile of entities, capacity utilisation and functions, etc. on a reasonable basis and furnish the calculation of the same before the tax authorities (if required) rather than doing it on adhoc basis.

8.5 Certain Issues while Conducting Comparability Analysis

Certain important issues which have arisen while conducting comparability analysis are explained below:

8.5.1 Certain issues in applying turnover filter

Certain issues which generally arise while applying turnover filter are – whether the turnover filter is necessary, whether upper and lower limit is required to be given in turnover filter, what should be the upper and lower limits, etc.

Indian TP Regulations require that the comparable companies should be functionally comparable to the tested party. Accordingly, a view may be taken that very large companies can also be considered as comparable to the tested party having small business if the companies are functionally comparable to the tested party. Application of turnover filter while conducting benchmarking analysis has been a subject matter of controversy and litigation, particularly in case of service-oriented companies, especially in the ITES/software segment. There have been conflicting decisions by the Tribunal on appropriateness of use of turnover filter in the context of service-oriented companies. In some cases, it has been held that there is a direct nexus between the level of operations and the profitability because of economies of scale. There are also conflicting observations as provided by Mumbai Tribunal, in case of **Capgemini India P Ltd.**, the Tribunal observed that the concept of "economy of scale" is relevant for manufacturing and not for service-oriented companies and that there is no linear relationship between margin and turnover of comparables. Similar observations have been made by Mumbai Tribunal in case of **Wills Processing Services (I) Pvt. Limited.**

The Bangalore Tribunal in the case of **LG Soft India (P.) Ltd. vs. DCIT** [2013] 35 taxmann.com 202 held that the size of the comparable is an important factor in comparability. The Revised Guidance Note issued by ICAI has observed that the transaction entered into by a INR 1000 crores company cannot be compared with the transaction entered into by INR 10 crores company and the two most obvious reasons are the size of the two companies and related economies of scale under which they operate. The TPO's range had resulted in selection of companies as comparable such as Infosys Technologies Limited which was 150 times bigger than that of the assessee. The earlier Bench of the same Tribunal in the case of **Genisys Integrating Systems (India) (P.) Ltd. v. Dy. CIT** [2012]] 20 taxmann.com 715 relying on Dun and Bradstreet's analysis had held that turnover range of INR 1 crore

to INR 200 crores is appropriate.

The Mumbai Tribunal in the case of **DCIT vs. M/s Indo American Jewellery Ltd** (2010-TII-24-ITAT-MUM-TP), accepted the contentions of the assessee that the companies having a very low or very high turnover as compared to the turnover of the assessee cannot be selected as comparables.

The Mumbai Tribunal in the case of **DHL Express (India) Private Limited vs. ACIT** [2011] taxmann.com 40 (Mum) held that it is a universal fact that there are lot of differences between the large businesses and small businesses operating in the same field. In case of small business economies of scale are not available and therefore generally less profitable.

Further the Bombay High Court in the case of **CIT vs Pentair Water India (P.) Ltd.** [Tax Appeal No. 18 of 2015, dated 16-9-2015] had affirmed an order of the Tribunal where large companies having huge turnover were to be excluded.

In view of the above judicial decisions and considering the fact that economies of scale do play an important role in determining the profitability of the company, a reasonable turnover range should be applied considering the turnover of the tested party and the availability of the comparable data.

8.5.2 Whether a company having nominal related party transactions should be rejected?

The Indian TP Regulations require comparison with companies engaged in comparable uncontrolled transactions. Accordingly, as per the strict interpretation of the law, companies having even a single rupee of related party transactions should be rejected. However, it is generally observed that most of the companies have atleast nominal related party transactions. Hence, question arises as to whether companies having even nominal related party transactions should be rejected.

The Bangalore Tribunal in the case of **LG Soft India (P.) Ltd. vs. DCIT** [2013] 35 taxmann.com 202 , **24/7 Customer.com (P) Ltd v/s Dy CIT** [2013] 140 ITD 344/

[2012] 28 taxmann.com 258 and **Misys Software (I) (P) Ltd v/s Deputy Commissioner of Income-tax, Circle 12 (1)** [2015]56 taxmann.com 332, allowed an entity having related party transactions not exceeding 15% of total revenue as uncontrolled.

While giving the pronouncement the Bangalore followed the decision of Tribunal in the case of **Sony India (P.) Ltd. (supra)** and the relevant extract of the observations of the Tribunal is given below:

"We are further of the view that an entity can be taken as uncontrolled if its related party transactions do not exceed 10 to 15% of total revenue. Within the above limit, transactions cannot be held to be significant to influence the profitability of the comparables. For the purpose of comparison what is to be judged is the impact of the related party transactions vis-à-vis sales and not profit since profit of an enterprise is influenced by large number of other factors ...."

The Mumbai Tribunal in the case of **Willis Processing Services (India) (P.) Ltd.**2013] 30 taxmann.com 350 ruled that 0% related party transaction is an impossible situation and therefore, it is practically not possible to find out a comparable having no related party transaction.

In practice, generally it is difficult to find comparable companies not having even a single rupee of related party transactions. Hence, depending on the extent of availability of the comparable data, the percentage for related party transactions may be determined. In the absence of sufficient comparable data, related party transactions upto 25% of total revenue may be considered as insignificant.

8.5.3 Whether very high profit making companies / loss making companies can be considered as comparable companies?

It is commonly observed that assessee generally rejects very high profit making companies and tax department rejects loss making companies from the list of comparables. However, question arises as to what is correct- Whether very high profit making companies / loss making companies can be considered as comparable companies?

Further, it is a well-accepted fact that "Higher the risk, higher the returns". Hence, question arises as to whether it is correct to compare a captive service provider which functions in a risk mitigated environment with companies that assume high amount of risk.

Indian TP Regulations require that the comparable companies should be functionally comparable. Accordingly, one may take a view that very high profit making companies and loss making companies should also be considered as comparable if the companies are functionally comparable to the tested party.

The Mumbai Tribunal in the case of **Maersk Global Centres (India) (P.) Ltd. Vs. ACIT** [2014] (43 taxmann.com 100) I ruled that after taking into consideration guidance provided in OECD Guidelines and on analyzing the decisions rendered in Division benches of Tribunals on this issue after taking into consideration inter alia the TP Regulations in India, it can be said that the potential comparables cannot be excluded merely on the ground that their profit is abnormally high as the matter in such case would require further investigation to ascertain the reasons for unusual high profit and in order to establish whether the entities with such high profit can be taken as comparables or not.

The Delhi Tribunal further, in the case of **Adobe Systems India Pvt. Ltd. vs. ACIT** (2011-TII-13-ITAT-DEL-TP), held that exclusion of companies showing super normal comparable profits as compared to other comparables is quite correct.

The Mumbai Tribunal in the case of **Capgemini India (P.) Ltd. vs. ACIT**, [2013] 33 taxmann.com 5 held that the comparable cases cannot be rejected only on the ground of extremely high profit or loss and in case if the companies satisfy the comparability criteria, and do not involve any abnormal business conditions, the same cannot be rejected only on the ground of loss or high profit. The OECD guidelines also provide that loss making uncontrolled transactions should be further investigated and it should be rejected only when the loss does not reflect the normal business conditions, thus, the comparable could not be rejected on the sole basis of loss.

Further, in the case of **Brigade Global Services Pvt. Ltd. vs. ACIT** [2013] 33 taxmann.com 618 (Hyderabad – Trib.], the Bench of Hyderabad Tribunal held that only companies incurring 'abnormal / continuous' losses to be excluded from list of comparables, comparable incurring loss in ordinary course of business can be considered.

In view of the above, it would be sensible to look into the functional aspects of the companies. If the margin earned by the uncontrolled company is on the extreme low or extreme high side, it would be advisable to do an in depth analysis for the reasons of such extreme margins and if such extreme margins are due to abnormal reasons, such company may be rejected. In short, the decision has to be taken based on the FAR analysis of the company and the relevant economic and commercial factors responsible for the outcome rather than merely looking at the outcome or profitability.

9.1 Indian Transfer Pricing Regulations prescribe robust documentation requirements. As per the Indian TP Regulations, every person who has entered into an international transaction / SDT shall require to keep or maintain document in respect thereof. As per Rule 10D(2), if the aggregate value of International transaction exceeds INR 1 crore , assessee is mandatorily required to keep and maintain the prescribed information and documents. In a case where the aggregate value as recorded in the books of accounts, of international transactions entered into by the assessee does not exceed INR 1 crore (INR 10 million), the information and documents as specified is not required to be maintained. In case of SDTs, if the aggregate value of transactions is INR 20[14] crores (INR 200 million) or more, the assessee is mandatorily required to keep and maintain prescribed documentation. However, the assessee shall be required to substantiate, on the basis of material available with him, that the income arising from international transactions / SDT entered into by him has been computed in accordance with section 92 of the Act.

9.2 Mandatory Documentation

The Indian transfer pricing regulations provide for 13 items of mandatory documents and additional 7 items of supporting documentation which inter alia include:

- Organisation structure of the assessee, details of shares or other ownership interest, details in respect of the AEs, the ownership linkages, profile of multinational group, etc.;
- Industry analysis
- Description of international transactions / SDTs – (includes details of the nature of transaction, value, quantity, names of the parties involved, method used etc.);
- FAR Analysis: detailing the functions performed, assets used and the risks borne by each party to the transactions;

14 Inserted by Finance Act 2015 w.e.f 1-4-2016

- Economic and market analysis, forecasts, budgets or any other financial estimates prepared by the assessee;
- A record of uncontrolled transactions taken into account for analyzing their comparability with the international transactions or SDTs;
- A record of the analysis performed to evaluate comparability of uncontrolled transaction with the relevant international transactions or SDTs;
- Description of the methods considered for determination of the ALP and selection of the most appropriate method: including forecasts, budgets or financial estimates; and
- Details of assumptions, policies, negotiations, adjustments, etc., which have critically affected the determination of ALP.
- Any other information, data or document, including information or data relating to the associated enterprise, which may be relevant for determination of the ALP and
- The above details are generally contained in the TP Study Report prepared by the assessee.

9.3 Time Limit for Maintenance of Documentation

The documentation should be retained for a period of 8 years from the end of the Assessment Year to which the transaction relates. During the assessment proceedings, the Transfer Pricing Officer (TPO) may require assessee to furnish any of the information and documents specified under the TP Regulations within a period of 30 days from the date of receipt of notice issued to the assessee and such period may be further extended, but not exceeding 30 days.

9.4 Furnishing of Return of income and Accountant's report

Every person who has entered into an international transaction / SDT with AEs is required to obtain a report in Form No. 3CEB from a Chartered Accountant and

furnish the same to the tax authorities on or before the due date i.e. 30 November each year. The due dates prescribed are the same due dates which are prescribed for submitting income tax returns. From AY 2013-14 and onwards, online filing of Form No. 3CEB has been made mandatory.

9.5 Certain Issues on Maintaining the Documentation

9.5.1 Documentation should be 'contemporaneous' and to be kept by 'due date'

Indian Transfer Pricing Regulations require that the information and documentation maintained by the taxpayer should be contemporaneous and should exist latest by the due date of filing of return of income.

Oxford dictionary defines the term 'contemporaneous' as "Existing or occurring in the same period of time". Hence, one can take a view that while conducting the benchmarking process, the data of comparables should relate to the same period in which the international transactions / SDTs have taken place and that the benchmarking process should be completed latest by the due date of filing of return of income.

9.5.2 Whether all the documents stated in Rule 10D are required to be maintained by the assessee?

The Indian TP regulations require the taxpayer to maintain a prescribed set of information and documentation to prove that the international transactions entered by the taxpayer are at ALP. However, the question arises as to whether the taxpayer is required to maintain each and every document prescribed in Rule 10D.

In this respect, it is to be noted that in the case of **Cargill India Pvt. Ltd. vs. DCIT** (2008-TIOL-94-ITAT-DEL), the Delhi Tribunal held that only documentation which has a bearing on the international transaction are required to be maintained and taxpayer cannot be penalized for not maintaining all the documents stated in Rule 10D if they are not relevant for determining the ALP of the international transactions undertaken by the taxpayer.

In view of the above, it is important that the assessee should maintain robust documentation to prove that the international transactions entered with the AEs are at arm's length price. The primary burden to prove that the international transactions are at arm's length price is on the assessee.

9.6 Furnishing of Report in Respect of International Group – BEPS Action Plan – 13

To meet with the commitment to BEPS initiative of OECD and G-20, the Finance Act, 2016 has included the provision for requirement of CbC reporting for companies with consolidated revenue of more than Euro 750 million.

A three-tier structure has been mandated consisting of:

- A master file containing standardised information relevant for all MNE group members;
- A local file referring specifically to material transactions of the local taxpayer and
- A CbC report containing certain information relating to the global allocation of the MNE's income and taxes paid together with certain indicators of the location of economic activity within the MNE group.

It has inserted section 286 in the Income-tax Act to provide a specific reporting regime in respect of CbC reporting and also the master file. The CBDT may issue the detailed rules in respect of the same in due course of time.

Chapter 10 Penalties

Indian TP Regulations prescribe stringent penalties for various defaults which is summarised below:

Sections under IT Act	Particulars of Default	Quantum of Penalty
271G	Failure to furnish information or documents as required by section 92D(3)	2% of the value of international transaction / SDT for each such failure
Section 271GB Non-furnishing of Report	(a) Default not more than one month	INR 5,000 per day
	(b) Default more than one month	INR 15,000 per day for period exceeding 1 month
	(c) Default even after service of order levying penalty under either (a) or (b) above	INR 50,000 per day continuing default beyond the date of service of penalty order
Section 271GB Timely non-submission of information and documents before prescribed authority	(a) timely non-submission of information before prescribed authority when called for	INR 5,000 per day
	(b) Default even after service of order levying penalty under (a) above	INR 50,000 per day continuing default beyond the date of service of penalty order
Section 271AA Inaccurate Information in Report	(a) the entity knows of the inaccuracy at the time of furnishing the report but does not inform the prescribed authority; or	INR 5,00,000
	(b) the entity discovers the inaccuracy after the report is furnished and fails to inform the prescribed authority and furnish	

Sections under IT Act	Particulars of Default	Quantum of Penalty
	correct report within a period of 15 days of such discovery; or	
	(c) the entity furnishes inaccurate information or document in response to notice of the prescribed authority.	
271BA	Failure to furnish accountant's report as required by section 92E	INR 100,000
271(1)(C)	Concealment of particulars of income or furnishing inaccurate particulars thereof.	Minimum – Amount of tax sought to be evaded; Maximum – 3 times the minimum; in addition to tax, if any, payable
271AA	Failure to keep and maintain information and documents as required by section 92D(1) and (2). Fails to report such transaction which he is required to do so; or Maintains or furnishes an incorrect information or document	2% of value of each international transaction / SDT

Chapter 11 Transfer Pricing Assessment Procedure

11.1 Reference to Transfer Pricing Officer

11.1.1 Section 92CA(1) provides that where any person being the assessee, has entered into an international transactions or SDTs in any previous year, and the assessing officer considers it necessary or expedient so to do, he may with the prior approval of the Principal Commissioner or Commissioner, refer the computation of ALP in relation to the said international transactions / SDTs to the TPO.

11.1.2 CBDT vide instruction 3/2016 dated 10 March 2016 has issued guidelines for implementation of transfer pricing provisions by replacing instruction no 15/2015. The said guidelines are applicable for both international transaction as well as SDT. The key features of the guidelines are as under:

11.1.3 All cases selected under Computer Assisted Scrutiny Selection (CASS) system or under the compulsory manual selection system on the basis of transfer pricing risk parameters have to be mandatorily referred to the TPO by the AO after obtaining approval of the PCIT or CIT.

11.1.4 For cases, having international transactions / SDT, selected for scrutiny on non-transfer pricing risk parameters, the same shall be referred to the TPO only in the following circumstances:

- Where the taxpayer has entered in to and international transactions / SDT, however the taxpayer has not filed Form No. 3CEB or has not disclosed all the international transactions / SDT in the report so filed.
- Where there has been a transfer pricing adjustment of INR 10 crores or more in an earlier assessment year which has been upheld by the judicial authorities or is pending in appeal.
- Where, in the search and seizure or survey operations, findings have been recorded by the investigation wing or AO regarding transfer pricing issues.

11.1.5 In other situations, the AO shall provide an opportunity of being heard to the assessee before referring the case to the TPO. In case, the assessee objects to the reference, the AO shall pass a speaking order for either accepting or rejecting of

objections and take the prior approval of PCIT or CIT before making reference to the TPO.

11.1.6 After receiving reference from AO, the TPO shall serve a notice on the taxpayer requiring him to produce or cause to be produced, any evidence on which taxpayer may rely in support of the computation made by him of the ALP in relation to the international transaction / SDTs.

11.1.7 If any other international transaction / SDT not reported in Form No. 3CEB comes to the notice of the TPO during the course of assessment proceedings, the provision of section 92CA shall also apply to such transactions. This is pursuant to the insertion of sub-section (2B) in section 92CA by Finance Act, 2012 with retrospective effect from 1 June, 2012.

The Chennai Tribunal In the case of **Ford India (P.) Ltd. vs. DCIT** [2013] 34 taxmann.com 50 held that the TPO can consider international transactions not reported by the assessee but coming to his notice during proceedings before him

11.1.8 The TPO shall pass a speaking order incorporating the relevant documents like data used, reasons for arriving at certain price and the applicability of method.

11.1.9 For administering the TP regime in an efficient manner. AO has no power to determine ALP in respect of cases which are not referred to the TPO and must record in the body of assessment order that the transfer pricing issues has not been examined at all.

Order of the AO / TPO

11.1.10 The TPO shall determine the ALP and send a copy of his order in writing to the AO and to the assessee. 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 determined by the TPO. The AO shall, thereafter forward the draft assessment order ('draft order') to the assessee for his objections.

11.1.11 The assessee can opt to accept the draft order issued by the AO within 30 days of the receipt of the draft order and file appeal before CIT(Appeal) within 30 days of

the receipt of final order from the AO. Alternatively, the assessee can file his objections against the draft order before the Dispute resolution Panel ('DRP') and AO within 30 days of the receipt of the draft order.

Note: The AO is required to pass the Final Assessment Order within 1 month from the end of the month in which,-

(i) the acceptance is received from the assessee; or

(ii) the period of filing of objections (i.e. 30 days from receipt of the draft order) expires.

Time-limit for completion of Assessment

11.1.12 The Finance Act, 2016 has substituted section 153 of the Act with effect from 1 June 2016 with regard to time limit for completion of assessment. The said time limit is changed from 3 years to 33 months from the end of the relevant assessment year i.e, the time limit for completion of assessment is reduced by three months. Resultantly, TP assessment is now required to be completed by end of October. TP assessment for AY 2013-14 will have to be completed by 31 October 2016.

11.1.13 The Finance Act, 2016 has also proposed to amend sub-section (3A) of section 92CA to extend time limit in cases where assessment proceedings are stayed by any court or where a reference for exchange of information has been made by the competent authority and time available to TPO for making an order after excluding the time for aforesaid is less than 60 days, then the remaining period for passing an order shall be extended to 60 days.

11.2 Dispute Resolution Panel (DRP)

11.2.1 Finance (No.2) Act, 2009 inserted section 144C which provided for an alternate dispute resolution mechanism vide setting up of a DRP with the intent to facilitate expeditious resolution of disputes on a fast track basis. The DRP operates as a collegium constituted by the CBDT- comprising of 3 PCITs/CITs.

11.2.2 As per the Indian TP Regulations, the DRP shall issue directions for the guidance of the AO to enable him to complete the assessment. Such directions need to be issued within 9 months from the end of the month in which the draft order is forwarded by the AO to the assessee.

11.2.3 DRP has the power to confirm, reduce or enhance the variations proposed in the draft order but cannot set aside any proposed variation or issue direction for further enquiry.

11.2.4 DRP cannot leave adjudication of issue with tax authority by directing them to pass order of assessment by conducting further inquiry.

The decision of DRP is to be based on opinion of the majority of members. The order passed by the AO, after considering the DRP directions, is appealable before the ITAT which is to be filed within 60 days of receipt of the AO order.

11.2.5 The Finance Act, 2012 inserted a new explanation to section 144C(8) with retrospective effect from 1 April 2008. The explanation provides that the power of the DRP to enhance the variation shall include and shall be deemed always to have included the power to consider any matter arising out of the assessment proceeding relating to the draft order, notwithstanding that such matter was raised or not by the eligible assessee.

11.2.6 Pursuant to the amendments made by Finance Act, 2012 by inserting sub-section (2A) and (3A) under section 253, with effect from 1 July 2012, the AO was empowered to file appeal before the Tribunal against an order passed in pursuance and directions of the DRP.

11.2.7 In order to minimize litigation, the Finance Act 2016 has omitted subsection (2A) and (3A) of section 253 retrospectively to do away with the filing of appeal by the AO against the order of DRP.

11.3 Whether order passed by the AO pursuant to GAAR provisions under section 144BA is appealable before DRP?

11.3.1 The Finance Act, 2013 as amended with effect from 1 April 2016 (FY 2015-16) has

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provided under section 144C(14A) that the assessment / reassessment order passed by AO with the prior approval of the PCIT/CIT pursuant to GAAR provisions (as per section 144BA) shall not be appealable before the DRP. The appeal in such case shall lie before the ITAT.

11.4 Whether DRP is required to pass a speaking order after considering the submissions of the assessee?

11.4.1 It has been observed that the directions issued by the DRP in many cases are not speaking one and are even without considering the submissions of the assessee. Hence, question arises as to whether DRP has to pass a speaking order after considering the submissions made by the assessee before DRP.

11.4.2 In this respect, it is to be noted that the Delhi High Court in the case of **Vodafone Essar Ltd. vs. DRP-II & Others** (2010-TII-HC-DEL-INTL), held that when a quasi-judicial authority deals with an issue, it is obligatory on its part to ascribe cogent and germane reasons as the same is the heart and soul of the matter and further, the same also facilitates appreciation when the order is called in question before the superior forum. The Delhi High Court remanded the matter to the DRP for fresh adjudication.

11.4.3 The Chennai Tribunal further in the case of **SCM Microsystems (India) (p.) ltd. Vs. ACIT** [(2012) 21 taxmann.com 264 held that DRP has to pass a speaking order stating that all the objections of the taxpayer and disposing them by giving cogent reasons for adjudication of the objections.

11.4.4 Further, the Delhi Tribunal in the case of **Gap International Sourcing India Pvt. Ltd. vs. DCIT** (2010-TII-59-ITAT-DEL-TP), held that the DRP needs to pass a speaking order after taking into account the objections raised by the assessee. The relevant extract of the observations of the Tribunal is given below:

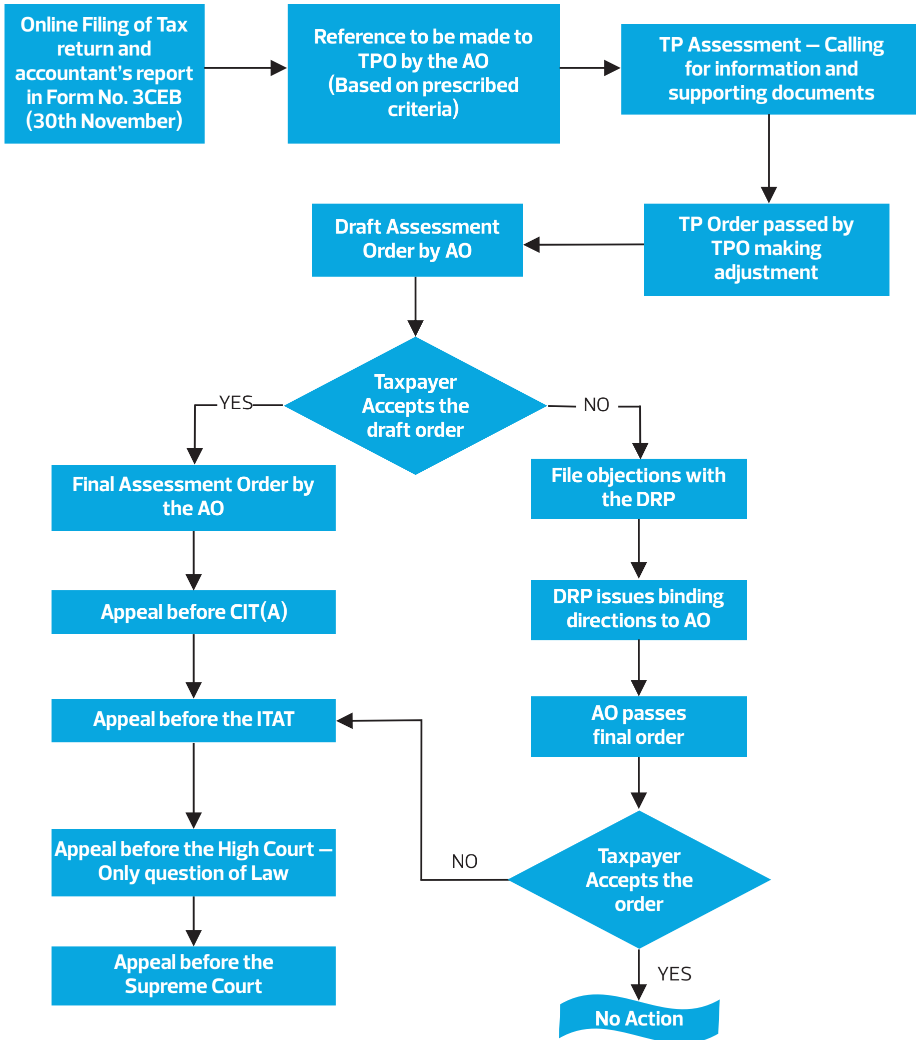
"As against the above provisions of the Act here the DRP has passed a very laconic order. Ld. counsel of the assessee contended that voluminous submissions have been made before the DRP against the draft assessment order. But the DRP has brushed aside everything without even a whisper of the assessee's

objections and the submissions of the assessee. Under the circumstances, in our opinion, the directions of the DRP are too laconic to be left uncommented. The directions given by the DRP almost tantamount to supervising the Assessing Officer's draft order and in that sense it can be equated that appellate jurisdiction being exercised."

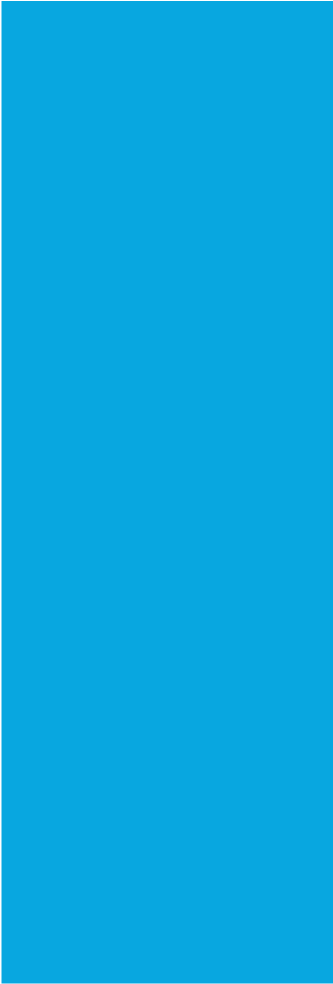
The matter was remitted to the file of DRP to consider the issue once again and pass a proper and speaking direction u/s 144C of the Act after giving assessee an adequate opportunity of being heard.

The above judicial pronouncements make it amply clear that the DRP is required to pass a speaking order after considering all the submissions made by the assessee before the DRP.

11.5 Litigation Process in India



SIGNIFICANT DEVELOPMENTS



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Chapter 12 BASE EROSION AND PROFIT SHIFTING (ACTION PLAN 13)

12.1 Overview

12.1.1 The integration of national economies and market has increased substantially in recent years putting a strain on the international taxes, which were devised many years ago. Weaknesses in the current roles create opportunities for Base Erosion and Profit Shifting ('BEPS') requiring bold moves by policy makers to restore confidence in the system and ensure that the profits are taxed where economic activities take place and value is created. Accordingly, OECD and G20 countries adopted a 15-point action plan to address BEPS. Recently, G20 along with OECD agreed to implement recommendations of BEPS project.

12.1.2 With a view to align the existing Indian Transfer Pricing regulations pertaining to maintenance of documentation, the Finance Act, 2016 has adopted Action 13 of the Action Plan on BEPS ('BEPS Action Plan 13') for transfer pricing documentation and CbC reporting by introducing an amendment to section 92D and inserting a new section 286. These provisions will be effective from the Assessment year 2017-18 (financial year commencing 1 April 2016) and subsequent assessment years.

12.2 Action Item 13 – Transfer pricing documentation and Country-by-Country Reporting

12.2.1 The G20 / OECD have agreed on very significant changes to the compliance and reporting of global information for risk assessment and transfer pricing purposes. The OECD Report on Action 13 of BEPS Action plan provides for revised standards for transfer pricing documentation and a template for CbC reporting of income, earnings, taxes paid and certain measure of economic activity.

A three-tier structure has been mandated consisting of:

- A master file containing standardised information relevant for all MNE group members;

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- A local file referring specifically to material transactions of the local taxpayer and

- A CbC report containing certain information relating to the global allocation of the MNE's income and taxes paid together with certain indicators of the location of economic activity within the MNE group.

- **Contents of master file**

  The report requires businesses to prepare a transfer pricing master file providing a high-level overview of the MNE's global operations along with an overview of the group's transfer pricing policies. The master file requirements include:

  - Legal ownership structure chart, including geographies;

  - Description of the business, including drivers of profit, supply chain for 5 large products/service offerings plus other products or services amounting to more than 5% of a MNC's sales, important service arrangements including locations, capabilities, cost allocations and pricing;

  - Description of overall strategy for development, ownership and exploitation of intangibles, including of principal R&D facilities and R&D management and details of intangibles related intra-group agreements (including related transfer pricing policies);

  - Financing arrangements with third parties, group financing companies and their location and transfer pricing policies; and

  - Financial and tax information including annual consolidated financial statements and details of unilateral APAs and other tax rulings relating to income allocation.

  The master file is to be filed locally with tax authorities and it is recommended that the master file be finalised by the filing date for the tax

return of the ultimate parent entity.

- **Contents of local file**

The local file is required to provide information and support of the intercompany transactions that the local company engages in with related parties. It needs to contain most of the information traditionally included in transfer pricing documentation, though specific additional requirements have been introduced, that include:

- Local Management structure and an organization chart, and disclosure of local management reporting lines;
- Details of intercompany transactions and financial information;
- Detailed functional and economical analysis for the intercompany transactions:
    - With preference for local comparables
    - With search for comparable companies once every three years for same functional profile and annual data
- Details of unilateral/ bilateral/ multilateral APAs, and other rulings 'related to' the transaction of the entity.

The local file is to be filed locally and it is recommended that it be finalised by the filing date for the local tax return.

- **Country-by-country report ['CbC']**

Requirements

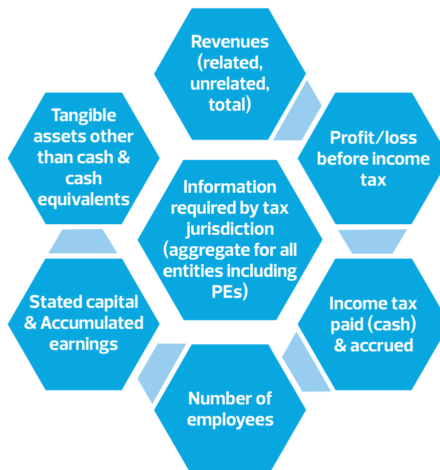
The CbC report requires each MNE to provide key financial information on an aggregate country basis with an activity code for each member of the MNE. CbC report is a new concept for the international tax world and represents the biggest change to the existing Guidelines. The provision of the CbC

report to the tax authorities is a 'minimum standard' requirement, and the report makes clear that countries participating in the BEPS project are expected to commit to and adopt this measure. It will provide tax authorities with global information for the purposes of risk assessment.

The elements relating to CbC reporting requirement shall apply in respect of an international group having consolidated revenue, based on consolidated financial statements, exceeds the threshold limit in the preceding accounting year. The current international consensus is for a threshold of €750 million equivalent in local currency.

The CbC report requires MNEs to report annually and for each tax jurisdiction in which they do business; the amount of revenue, profit before income tax and income tax paid and accrued. It also requires MNEs to report their total employment, capital, accumulated earnings and tangible assets in each tax jurisdiction. Finally, it requires MNEs to identify each entity within the group doing business in a particular tax jurisdiction and to provide an indication of the business activities of each entity.

The CbC report should set out the specified financial data (diagrammatically represented) as stated below of the Group by tax jurisdiction, in a prescribed template together with a list of constituent entities by country of residence and indication of their activities.



A model template for the CbC Report

Table 1. Overview of allocation of income, taxes and business activities by tax jurisdiction

Name of the MNE group:
Fiscal year concerned:

Tax Jurisdiction	Revenues			Profit (Loss) Before Income Tax	Income Tax Paid (on cash basis)	Income Tax Accrued – Current Year	Stated capital	Accumulated earnings	Number of Employees	Tangible Assets other than Cash and Cash Equivalents
	Unrelated Party	Related Party	Total							

Table 2. List of all the Constituent Entities of the MNE group included in each aggregation per tax jurisdiction

Name of the MNE group:
Fiscal year concerned:

Tax Jurisdiction	Constituent Entities resident in the Tax Jurisdiction	Tax Jurisdiction of organisation or incorporation if different from Tax Jurisdiction of Residence	Main business activity(ies)												
			Research and Development	Holding or Managing intellectual property	Purchasing or Procurement	Manufacturing or Production	Sales, Marketing or Distribution	Administrative, 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[2]
	1.														
	2.														
	3.														
	1.														
	2.														
	3.														

[2] Please specify the nature of the activity of the Constituent Entity in the "Additional Information" section.

Table 3. Additional Information

Name of the MNE group: **Fiscal year concerned:**
Please include any further brief information or explanation you consider necessary or that would facilitate the understanding of the compulsory information provided in the country-by-country report.

Submission, exchange and use

The CbC is to be filed in the tax jurisdiction of the ultimate parent entity (or nominated surrogate parent entity) and will be exchanged widely by governments, including with many developing countries, via various sharing mechanisms. If the CbC report is not filed with and shared by the tax jurisdiction of the ultimate parent company (or the nominated surrogate), then companies may be required to file the CbC report locally. The report includes three model competent authority agreements that can be used by tax authorities to facilitate implementation of the exchange of CbC reports. The agreements make it clear that information shared as a result of these agreements must be kept confidential and used appropriately. In particular, the agreements emphasize that the information should not be used as a substitute for detailed transfer pricing analysis of individual transactions based on full functional and comparability analysis, and that transfer pricing adjustments should not be made on the basis of the CbC reporting alone.

Timelines

The CbC report has to be submitted by parent entity of an international group to the prescribed authority in its country of residence. This report is to be based on consolidated financial statement of the group. As per the guidance:

- The first CbC reports will be required to be filed for MNE fiscal years beginning on or after January 1, 2016.
- MNCs will be allowed 1 year from the close of the fiscal year to which the CbC report relates to prepare and file the CbC report, the first CbC reports would be filed by 31 December 2017.
- It should be noted that the MNE fiscal year relates to consolidated reporting period for financial statement purposes, not to taxable years or the financial reporting periods of individual group entities.
- The G20/OECD has provided an XML Schema and a related User Guide to allow for electronic tagging of data in the CbC reports to facilitate their exchange electronically. Countries will be monitored on their implementation of the CbC reporting requirements and associated exchange of information.

12.3 Introduction of Action Plan 13

Three tier transfer pricing documentation approach under BEPS project adopted by India (BEPS Action Plan 13)

The Finance Act 2016 has inserted section 286 in the Act to provide specific reporting regime in respect of CbC reporting and also the master file. The elements relating to CbC reporting requirement and matters proposed to be included are:

- The reporting provision shall apply in respect of an international group having consolidated revenue, based on consolidated financial statements, exceeds the threshold limit in the preceding accounting year. The current international consensus is for a threshold of €750 million equivalent in local currency. This threshold in Indian currency would be equivalent to INR 5,395 Crores (at current rates).
- The parent entity of an international group, if it is resident in India shall be required to furnish the report in respect of the group to the prescribed

authority on or before the due date of furnishing of return of income for the Assessment Year relevant to the Financial Year (previous year) for which the report is being furnished;

- The parent entity shall be an entity which is required to prepare consolidated financial statement under the applicable laws or would have been required to prepare such a statement, had equity share of any entity of the group been listed on a recognized stock exchange in India;

- Every constituent entity in India, of an international group having parent entity that is not resident in India, shall provide information regarding the country or territory of residence of the parent of the international group to which it belongs. This information shall be furnished to the prescribed authority on or before the prescribed date;

- The report shall be furnished in prescribed manner and in the prescribed form and would contain aggregate information in respect of revenue, profit & loss before income-tax, amount of income-tax paid and accrued, details of capital, accumulated earnings, number of employees, tangible assets other than cash or cash equivalent in respect of each country or territory along with details of each constituent's residential status, nature and detail of main business activity and any other information as may be prescribed. This shall be based on the template provided in the OECD BEPS report on Action Plan 13, the prescribed date for filing the CbC report is proposed to be the due date of filing of return of income for the relevant assessment year for which the report is being furnished;

- An entity in India belonging to an international group shall be required to furnish CbC report to the prescribed authority if the parent entity of the group is resident:

  - in a country with which India does not have an arrangement for exchange of the CbC report; or

  - such country is not exchanging information with India even though

there is an agreement; and

- this fact has been intimated to the entity by the prescribed authority.

- If there are more than one entities of the same group in India, then the group can nominate (under intimation in writing to the prescribed authority) the entity that shall furnish the report on behalf of the group. This entity would then furnish the report;

- If an international group, having parent entity which is not resident in India, had designated an alternate entity for filing its report with the tax jurisdiction in which the alternate entity is resident, then the entities of such group operating in India would not be obliged to furnish report if the report can be obtained under the agreement of exchange of such reports by Indian tax authorities;

- The prescribed authority may call for such document and information from the entity furnishing the report for the purpose of verifying the accuracy as it may specify in notice. The entity shall be required to make submission within 30 days of receipt of notice or further period if extended by the prescribed authority, but extension shall not be beyond 30 days.

12.4 Penalty for failure to furnish report or for furnishing inaccurate report under section 286

Finance Act 2016 has introduced penalty for non-furnishing of the report or furnishing inaccurate report, under which a graded penalty structure namely by inserting section 271GB of the Act and amending section 271AA of the Act. The details have been provided in Chapter 7.

Section D

LITIGATION RESOLUTION MECHANISM

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Chapter 13 Safe Harbour Rules

13.1 Background

To reduce increasing number of transfer pricing audits and prolonged disputes, the CBDT issued the Safe Harbour Rules ('SHR') on 18 September 2013. SHR is covered under section 92CB of the Act and the Rules are comprehended in Rules 10TA to 10TG.

13.2 Who is Eligible to Apply for SHR?

The SHR mechanism is available only for the following assessees ('eligible assessee'):

- Engaged in providing Software Development Services & Information Technology Enabled Services or Knowledge Process Outsourcing services with insignificant risk to foreign principal;
- Has provided corporate guarantee;
- Engaged in providing contract research and development services wholly or partly relating to software development and generic pharmaceutical drugs with insignificant risk to foreign principal;
- Engaged in manufacture and export of core or non-core auto components and where 90% or more of total turnover during the year is in the nature of original equipment manufacturer sales;
- Has issued loan to its AE(s)
- Has entered into SDT and is engaged in business of –
    - Supply of electricity, transmission of electricity, wheeling of electricity
    - Purchase of milk or milk products by a co-operative society from its members.

13.3 Conditions for Safe Harbour

Where an eligible assessee has entered into an eligible international transaction

and the option exercised by the said assessee is not held to be invalid under rule 10TE, the transfer price declared by the assessee in respect of such transaction shall be accepted by the income-tax authorities, if it is in accordance with the circumstances as specified in the table below in respect of the eligible international transactions:

Sr. No.	Eligible International Transaction	Safe Harbour ratios
1.	Software development services (IT services) and Information Technology Enabled services (ITES), with insignificant risks – ▪ where aggregate value of such transactions £INR 500 crores (INR 5 billion) ▪ Where aggregate value of such transaction > INR 500 crores (INR 5 billion)	Operating profit margin to operating expenses ▪ ‡ 20% ▪ ‡22%
2.	Knowledge Process Outsourcing services (KPO Services), with insignificant risk	Operating profit margin to operating expense ‡25%
3.	Intra-group loan to Wholly Owned Subsidiary ('WOS') where the amount of loan: ▪ £INR 50 crores (INR 500 million) ▪ >INR 50 crores (INR 500 million)	Interest rate equal to or greater than the base rate of SBI as on 30th June of the relevant previous year: ▪ Plus 150 basis points ▪ Plus 300 basis points
4.	Explicit corporate guarantee to WOS where the amount of loan: ▪ £INR 100 crores (INR 1 billion) ▪ >INR 100 crores (INR 1 billion) and the credit rating of the borrower, by a Securities and Exchange Board of India ('SEBI') registered agency is of the adequate to highest safety *(explicit corporate guarantee does not include letter of comfort, implicit corporate guarantee, performance guarantee or any other guarantee of similar nature)*	▪ Commission or fee of 2% or more p.a. on the amount of guarantee ▪ Commission or fee of 1.75% ormore p.a. on the amount of guarantee

Sr. No.	Eligible International Transaction	Safe Harbour ratios
5.	Specified contract research and development services (Contract R&D services), with insignificant risks, wholly or partly relating to software development	Operating profit margin to operating expense ‡ 30%
7.	Contract R&D services, with insignificant risks, wholly or partly relating to generic pharmaceutical drugs	Operating profit margin to operating expense ‡ 29%
8.	Manufacture and export of: ▪ Core auto components ▪ Non-core auto components Where 90% or more of total turnover relates to original equipment manufacturer sales	Operating profit margin to operating expenses: ▪ ‡ 12% ▪ ‡ 8.5%

13.4 Safe Harbour Rules for Specified Domestic Transactions

13.4.1 The CBDT vide notification 11/2015 dated 4 February 2015 announced the applicability of Safe Harbour Rules for SDT's undertaken by *Government companies*[15] engaged in business of generation, supply, transmission and distribution of electricity.

SDT's, in relation to above, includes:

- Supply of electricity; or
- Transmission of electricity; or
- Wheeling of electricity.

13.4.2 Further, the CBDT vide notification 90/2015 dated 8th December, 2015 also announced the applicability of Safe Harbour Rules for SDT's undertaken by co-operative society engaged in the business of procuring and marketing milk.

15 Government Company shall have the same meaning as assigned to it in sub-section (45) of section 2 of the Companies Act, 2013 (18 of 2013)

13.4.3 Evaluation of Transactions

Sr. No.	Eligible Specified Domestic Transaction	Safe Harbour ratios
1.	Supply of electricity, transmission of electricity, wheeling of electricity referred to in clauses (i), (ii) or (iii) of rule 10 THB, as the case may be.	The tariff in respect of supply of electricity, transmission of electricity, wheeling of electricity, as the case may be, is determined or the methodology for determination of tariff is approved by the *Appropriate Commission*[16] in accordance with the provisions of the Electricity Act, 2003 (36 of 2003).
2.	Purchase of milk or milk products referred to in clause (iv) of rule 10THB.	The price of milk or milk products is determined at a rate which is fixed on the basis of the quality of milk, namely, fat content and Solid Not Fat (SNF) content of milk; and- (a) the said rate is irrespective of,- (i) the quantity of milk procured; (ii) the percentage of shares held by the members in the co-operative society; (iii) the voting power held by the members in the society; and (b) such prices are routinely declared by the cooperative society in a transparent manner and are available in public domain.

13.5 Validity

SHRs are applicable for a maximum period of 5 years starting from AY 2013-14 for the prescribed sectors. The option of being governed by SHRs shall continue to remain in force for the period specified by the taxpayer in the prescribed form (Form No. 3CEFA) or a period of 5 years, whichever is less.

16 Appropriate Commission shall have the same meaning as assigned to it in sub-section (4) of section 2 of Electricity Act, 2013 (36 of 2013)

13.6 SHR Not Applicable in Respect of International Transactions with NJAs

SHR shall not be applicable in respect of an international transaction entered with an entity located in Notified Jurisdictional Area as per section 94A. Till date, Cyprus has been notified as NJA under section 94A.

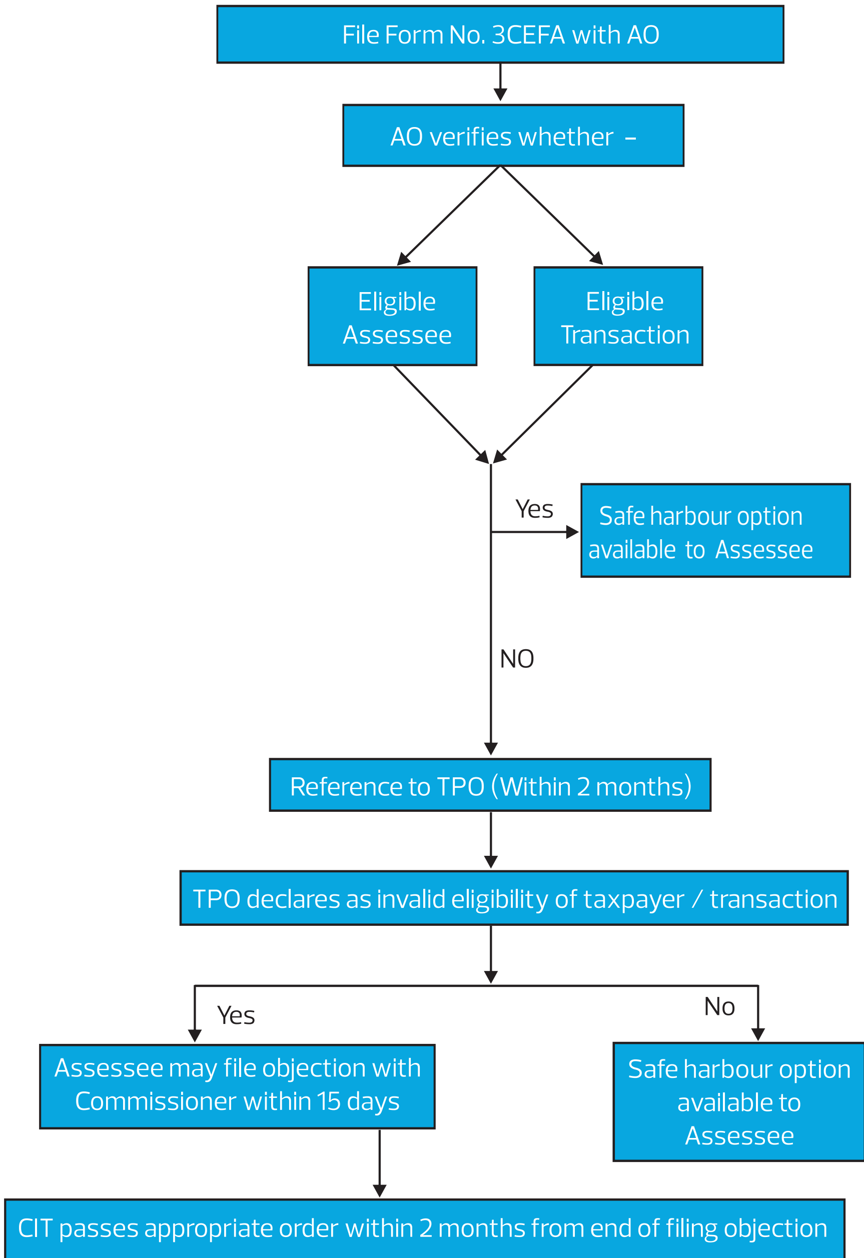
13.7 MAP Not to Apply When SHR Opted for

A taxpayer opting for SHR shall not be allowed to invoke Mutual Agreement Procedure ('MAP') provided under relevant DTAAs.

13.8 Safe Harbor Regulations As A Tool of Tax Exposure Management

Safe Harbor Regulations provide an enormous opportunity for reducing tax exposure on account of transfer pricing adjustments. This is particularly relevant for enterprises engaged in Information Technology (IT), ITeS and auto component sector.

13.9 Procedure to File SHR



Chapter 14 Advance Pricing Agreements And Mutual Agreement Procedure

14.1 Background

To bring down Transfer Pricing disputes and provide tax certainity, the Finance Act, 2012 had introduced the provisions of Advance Pricing Agreement ('APA') with effect from 1 July 2012. An APA is an agreement between the CBDT and a taxpayer, which determines in advance the ALP or specifies the manner of the determination of ALP, in relation to international transaction. Thus, once APA has been entered into with respect to an international transaction, the ALP with respect to that international transaction, for the period specified in the APA, shall be determined only as per the APA.

14.2 Definition and Applicability

An APA is an agreement between the taxpayer and the tax authority on the pricing of future intercompany transactions. The taxpayer and tax authority mutually agree on the transfer pricing methodology to be applied and its application for a period specified in the APA for covered transactions (subject to fulfillment of critical assumptions).

APA scheme is applicable to international transactions only and not to SDT.

The ALP of any international transaction, in respect of which APA has been entered into, shall be determined in accordance with the APA so entered.

APA provisions are provided in section 92CC and 92CD of the Act and are contained in Rules 10F to 10T and Rule 44GA of the Rules. The APA scheme became effective from 30 August 2012.

14.3 Current Status of APA Scheme

Since the notification of APA scheme, approximately 580 applications for APA have been filed and about half of these contain a request for roll-back provisions. As on 31 March 2016, CBDT had signed a total of 59 APAs of which 3 are bilateral and 56 are unilateral.

14.4 Who is Eligible to Apply for SHR?

- Any person who has undertaken an international transaction; or
- Any person who is contemplating to undertake an international transaction is eligible to enter into an APA.

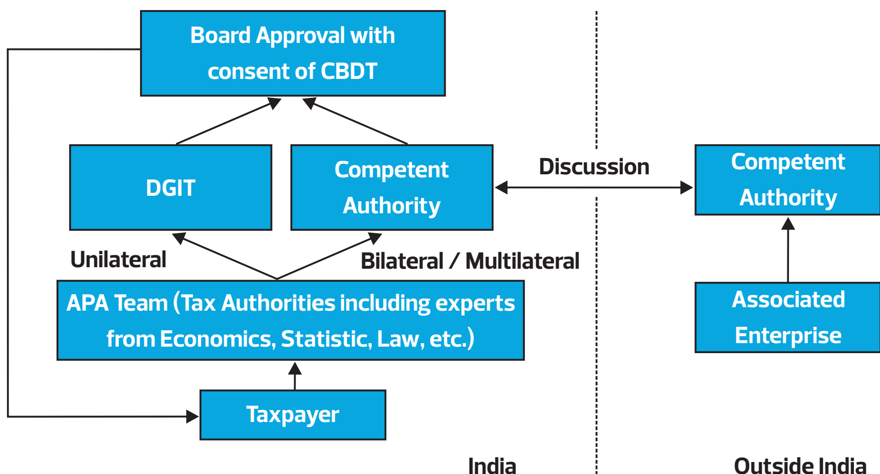
14.5 Time Involved

There is no binding or tentative timeframe prescribed within which the APA process needs to be completed.

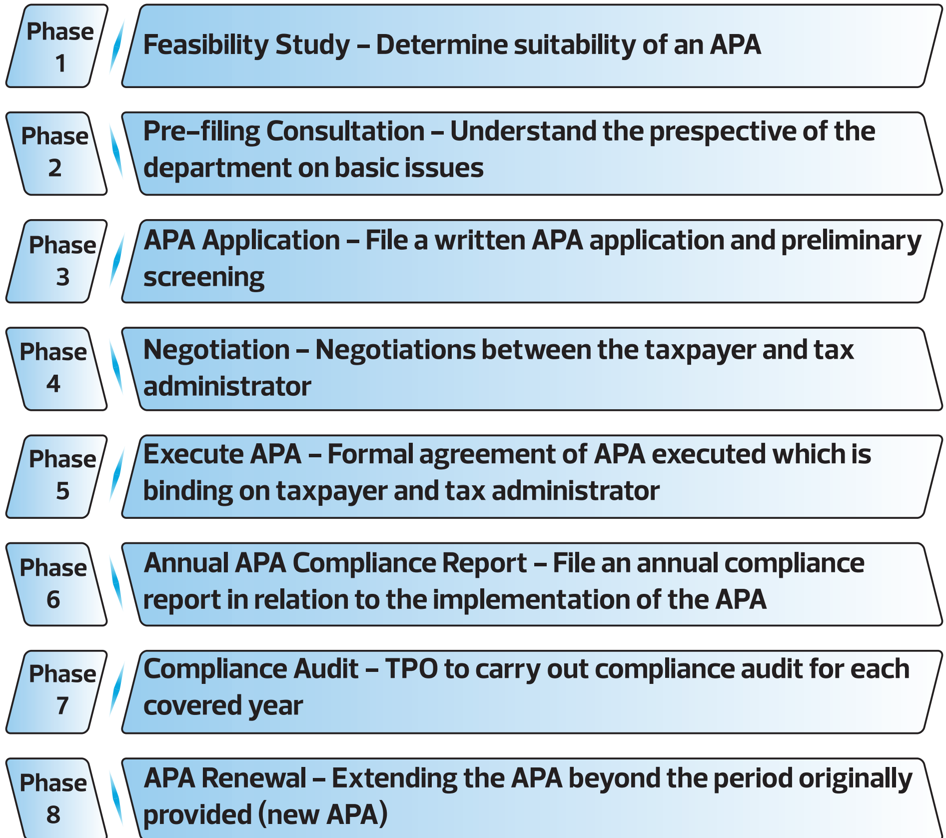
14.6 Types of APA

Type of APA	APA entered into between
Unilateral APA	a taxpayer and the tax administration of the country where it is subject to taxation
Bilateral APA	the taxpayers, the tax administration of the host country and the foreign tax administration
Multilateral APA	the taxpayers, the tax administration of the host country and more than one foreign tax administrations

14.7 Application for APA



14.8 APA Process



- **Phase 1: Feasibility Study**

  A feasibility study needs to be undertaken to analyze which transaction or group of transactions the taxpayer should cover while entering into an APA. In its simplest terms, the feasibility study should encapsulate the objective, type of transaction(s) to be covered, cost-benefit (economic) analysis and the risks assumed. This will enable a company to decide if an APA is feasible or not.

- **Phase 2: Pre-filing Consultation**

The process for APA would start with pre-filing consultation meeting. The taxpayer can request for a pre-filing consultation meeting which shall be held with the objective of determining the scope of the agreement, understanding the transfer pricing issues involved and examining the suitability of international transactions for an APA.

The taxpayer also has an option of applying for a pre-filing consultation on an anonymous basis. This process is non-binding on the taxpayers and the Revenue.

Going by the information required in Form (Form No. 3CEC) for a pre-filing consultation, it is clear that the Indian APA program puts lot of emphasis on pre-filing process. Pre-filing consultation will not only be vital to the APA process, but could possibly determine the course of APA.

Previously, pre-filing consultation was mandatory but the same has now been made optional and hence, an applicant can file the main APA application in Form No. 3CED without filing for pre-filing consultation.

After pre-filing consultation, the suitability of entering into an APA is determined. The applicant before filing formal APA application is required to pay fees which are as under:

Amount of international transaction entered into or proposed to be undertaken	Fees (in INR)
Amount not exceeding INR 100 crores	10 lacs
Amount not exceeding INR 200 crores	15 lacs
Amount exceeding INR 200 crores	20 lacs

Fees paid is not refundable except in case there is any defect in the proposed application, the DGIT or Competent Authority would require the taxpayer to remove such deficiency within stipulated time, barring which the application would be rejected and correspondingly the fee received

would also be refunded.

- **Phase 3: APA Application**

  After the pre-filing meeting, if the taxpayer is desirous of applying for an APA, an application would be required to be made in prescribed Form (Form No. 3CED) containing specified information.

- **Phase 4: Negotiation**

  Once the application is accepted, the APA team shall hold meetings with the applicant and undertake necessary inquiries relating to the case. Post the discussion and inquiries, the APA team shall prepare a draft report which shall be provided to the Competent Authority (in case of bilateral /multilateral APA), or DGIT (International Taxation and TP) (in case of unilateral APA).

- **Phase 5: Execute APA**

  This phase involves exchange of comments on draft APA, finalization of APA and giving effect to the initial years covered under the APA term that have already elapsed.

- **Phase 6: Annual compliances**

  Filing of Annual Compliance Report to DGIT (International Taxation) for each year covered in APA, in Form No. 3CEF, in quadruplicate, within 30 days of due date for filing Income-tax return for that year or within 90 days of entering into APA, whichever is later.

- **Phase 7: Compliance Audit**

  The TPO having jurisdiction over the taxpayer will carry out the compliance audit of the agreement for each of the year covered in the agreement. The TPO will have to furnish the compliance audit report within 6 months from the end of the month in which the annual compliance report is referred to him.

The TPO shall submit the compliance audit report, for each year covered in the agreement, to the DGIT (International Taxation) in case of unilateral agreement and to the Competent Authority in India, in case of bilateral or multilateral agreement.

- **Phase 8: APA Renewal**

  When an existing APA is drawing to a close of its term, the parties agree to enter into further discussions or negotiations with a view to extend the APA beyond the period originally provided. Any such extended arrangement is concluded as a new APA.

14.9 Roll Back Provision in APA Scheme

The Finance (No.2) Act, 2014 introduced the 'roll back' mechanism in the APA scheme with effect from 1 October 2014. The 'roll back' provisions refer to the applicability of the methodology of determination of ALP, or the ALP, to be applied to the international transactions which had already been entered into in a period prior to the period covered under an APA.

The APA is subject to such prescribed conditions, procedure and manner for determining the ALP or for specifying the manner in which ALP is to be determined, in relation to an international transaction entered into by a person, during any period not exceeding 4 previous years preceding the first of the previous year for which the APA applies.

14.10 APA Tenure

The tenure of APA can be up to 5 years for onward determination of ALP. In case of roll back mechanism, the APA can be made applicable for a period not exceeding 4 years. Hence, the total tenure applicable for APA can be 9 years.

14.11 Modified ROI

The person entering into an APA shall have to furnish a Modified Return of Income (ROI) in respect of the ROI already filed for a previous year to which APA applies,

within a period of 3 months from the end of the month in which the said APA was entered into. The modified ROI has to reflect only the changes in respect of the issues arising from APA which needs to be in accordance with the terms and conditions of APA.

14.12 Terms of the Agreement

An agreement may, amongst other things, include:

- International transactions covered by the agreement;
- Agreed transfer pricing methodology, if any;
- Determination of ALP, if any and
- Critical assumptions.

In case of any change in critical assumptions or failure to meet such conditions, the APA shall not be binding on the Board or the taxpayer.

14.13 Advantages of APA

- Certainty on the transfer pricing issues;
- Avoidance of possible audit along-with penalty and ligation costs;
- Efficient management of transfer pricing issues;
- Potential elimination of double taxation;
- Fewer compliance costs for MNE groups;
- Favourable environment for FDI and
- Ability to deal with contentious issues in open years

14.14 Disadvantages of APA

- Precision is required on the assumptions about future economic

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circumstances; any error can distort the whole process;

- Closure of APA requires substantial time;
- APA demands huge resources, both, in terms of costs and personnel;
- Unilateral APA does not eliminate the risk of double taxation;
- Cumbersome APA procedures can multiply the tax compliances;
- Potential misuse of the secret information shared by the taxpayer to the tax authorities, wastage of resources in case an APA cannot be finalized; and
- APA does not altogether eliminate the transfer pricing audit.

14.15 Global Comparison

Sr. No.	Countries	Pre–filing	Type of APA	Filing Fee	Time frame to conclude	Tenure of APA
1.	**India**	**Mandatory**	**Unilateral, Bilateral & Multilateral**	**INR 10-20 lacs**	**Not specified**	**5 years (in case of roll back additional 4 preceding years)**
2.	Australia	Mandatory	Unilateral, Bilateral & Multilateral	No Fees	Not specified	3-5 years
3.	Canada	Mandatory	Unilateral, Bilateral & Multilateral	▪ Flat fee of CAN$ 5,000 for limited transaction APA ▪ Out of pocket costs for other than limited	Not specified	3-5 years

Sr. No.	Countries	Pre–filing	Type of APA	Filing Fee	Time frame to conclude	Tenure of APA
				transaction APA		
4.	China	Mandatory	Unilateral, Bilateral & Multilateral	No Fees	Not specified	3–5 years
5.	France	Optional	Unilateral, Bilateral (multilateral may be possible)	No Fees	Not specified	3–5 years
6.	Germany	Optional	Bilateral & (multilateral may be possible)	No Fees	Not specified	3–5 years
7.	Israel	Optional	Unilateral, Bilateral & Multilateral	Not specified	Within 120 days of filing of application	Not specified
8.	Italy	Optional	Unilateral	Not specified	180 days	3 years
9.	Japan	Optional	Unilateral & Bilateral	No Fees	Not specified	3–5 years
10.	Korea	Optional	Unilateral, Bilateral & Multilateral	No Fees	Not specified	Not specified
11.	Lithuania	Optional	Unilateral	Not specified	60 – 120 days	Not specified
12.	Malaysia	Mandatory	Unilateral & Bilateral	Not specified	Not specified	3–5 years
13.	Mexico	Optional	Unilateral & Bilateral	Not specified	Not specified	Up to 3 years forward, 1 year back and issuing year
14.	Netherlands	Mandatory	Unilateral, Bilateral & Multilateral	Not specified	Not specified	3–5 years

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Sr. No.	Countries	Pre–filing	Type of APA	Filing Fee	Time frame to conclude	Tenure of APA
15.	Russia	Mandatory	Unilateral & Bilateral	Not specified	Not specified	3-5 years
16.	Singapore	Mandatory	Unilateral, Bilateral & Multilateral	No Fees	Not specified	3-5 years
17.	USA	Mandatory	Unilateral, Bilateral & Multilateral	▪ Indicatively between US$20,000 -50,000	Not specified	3-5 years
18.	UK	Optional	Unilateral & Bilateral (no distinction between Bilateral & Multilateral)	No Fees	Not specified	18 – 21 months

14.16 Mutual Agreement Procedure ('MAP')

Under various DTAAs, the MAP option provides for the competent authorities of the respective jurisdictions to interact with the intention of resolving international tax disputes. This option is in addition to options available under domestic laws.

A Framework Agreement was recently signed with United States under the MAP provision of the India-US DTAC. This is a major positive development. About 200 past transfer pricing disputes between the two countries in ITS and ITeS segments have been resolved under this Agreement during the year 2015.

Section E

JUDICIAL PRONOUNCEMENTS AND OTHER DEVELOPMENTS

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Chapter 15 Important Issues Under Litigation

15.1 Marketing Intangibles

Kindly refer Chapter 2.

15.2 Issue of Shares to Foreign AE

15.2.1 Issues

One of the recent high-ticket adjustments under the Transfer Pricing assessment regime was on account of chargeability to tax of notional income on purported undervaluation of shares issued by Indian subsidiary to its Foreign AE. There have been several cases, wherein the TPOs have made high value adjustments in cases where shares were issued to Foreign AE.

In the case of **Vodafone India Services Pvt. Ltd.** ('the Petitioner-assessee') issued 289,224 equity shares having face value of INR 10 each to its non-resident holding company at premium of INR 8509 per share. However, the revenue sought to tax the short-fall between the so-called Fair Market Value ('FMV') of equity shares (INR 53,775 per share) and the issue price of equity shares (INR 8519 per share) as income of the petitioner by applying the Transfer Pricing provisions. Further, treating such amount as deemed loan given by the Petitioner to its holding company, the revenue went on to compute deemed interest on deemed loan on the basis that, if the Arm's Length Price ('ALP') were received by the Petitioner, the Petitioner would be able to invest the same and earn income.

15.2.2 Judicial pronouncements

On these facts, the Bombay High Court ('the High Court') rendered the decision in favour of the Petitioner by holding that issue of shares at a premium by the Petitioner to its non- resident holding company did not give rise to any income and resultantly, the Chapter X of the Income-tax Act (which deals with Transfer Pricing Provisions), did not apply. The High Court observed that amount received on issue of share capital including the premium is on capital account and in the absence of any charging provision; such amount cannot be brought to tax. Further, it was held that Chapter X of the Income-tax Act is merely a machinery provision to compute the ALP.

15.2.3 Precautionary measure

Considering the current litigations and even though there is a positive judicial precedent, it is advisable that in case of issue of shares to Foreign AEs, as a matter of abundant precaution to report the transaction of issue of shares and value such shares as per the internationally accepted valuation methodologies. The decision of Bombay High Court in the case of Vodafone has provided much needed clarity on this aspect. Nevertheless, it is advisable to report the transaction as an International Transaction and also ensure that the valuation is commensurate with the internationally accepted valuation methodology.

15.3 Issuance of Guarantee on Behalf of the AE

Kindly refer Chapter 2.

15.4 Re-characterisation of the Share Application Transaction

15.4.1 Issue

If the share application money is paid to the AEs for acquiring shares and no shares have been allotted within the period as prescribed in the rules of the country of the AE, the tax authorities are of the view that it is nothing but interest free loan given to AE and hence, notional interest shall be determined having regard to ALP for taxability in the hands of Indian entity.

15.4.2 Judicial pronouncement

The Delhi Tribunal in the case of **Bharti Airtel Limited** [2014] 43 taxmann.com 150 observed that character of transaction of capital subscription as such is not in dispute and yet it has been treated as partly of the nature of interest free loan on the ground that there has been a delay in allotment of shares. The Tribunal viewed that there is no finding about what is the reasonable and permissible time period for allotment of shares, and even if one was to assume that there was an unreasonable delay in allotment of shares, the capital contribution could have, at best, been treated as an interest free loan for such a period of 'inordinate delay' and not the entire period between the date of making the payment and date of

allotment of shares. Further, the Tribunal opined that even if ALP determination was to be done in respect of such deemed interest free loan on allotment of shares under the CUP method, it was to be done on the basis as to what would have been interest payable to an unrelated share applicant if, despite having made the payment of share application money, the applicant is not allotted the shares. Also, the Tribunal observed that it was unreasonable and inappropriate on the part of the TPO to treat the transaction as partly in the nature of interest free loan to the AE. The Tribunal concluded that since the TPO has not brought on record anything to show that an unrelated share applicant was to be paid any interest for the period between making the share application payment and allotment of shares, the very foundation of impugned ALP adjustment is devoid of legally sustainable merits.

The Mumbai Tribunal in the case of **Allcargo Global Logistics Ltd Vs. ACIT** [2014] 47 taxmann.com 188 held that the share application money, though not allotted for a long time, cannot be treated as a loan for taxing notional interest.

15.4.3 Precautionary measure

In view of the above judgement and the view taken by the tax authorities, it is advisable that the allotment against the share application money paid to the foreign AE is made within a reasonable time, if there is no specific time period provided for such allotment under the local regulations. It is further advisable to maintain complete documentation to substantiate the reasons in case where the shares are not allotted within reasonable time, to prove that the transaction is not a sham.

15.5 Tax authorities Cannot question the commercial rationale of legitimate business expenses incurred

15.5.1 Issue

In certain cases, the taxpayer makes payment to its AE for the use of brand name, inspite of perpetual loss incurred by the taxpayer in its business. The Tax Authorities generally disallow such payments considering perpetual losses suffered by the Indian entity.

15.5.2 Judicial pronouncement

The Delhi High Court in the case of **EKL Appliance Ltd. Vs. CIT** [2012] 24 taxmann.com 199 held that any legitimate expenditure for business purpose cannot be disallowed while computing ALP merely because assessee was continuously incurring losses. As long as the expenditure or payment is demonstrated to be incurred or laid out for business purpose, it is no concern of the TPO to disallow the same on any superfluous reasoning. The taxpayer need not show that any expenditure incurred by him for the purpose of business has actually resulted in profit. The High Court relying on OECD guidelines opined that TPO is expected to examine the international transaction as he actually finds the same and then make suitable adjustment but a wholesale disallowance of the expenditure, particularly on the grounds which have been given by the TPO is not contemplated or authorized. The relevant extract of the observations of the High Court is given below:

"Even rule 10B(1)(a) does not authorize disallowance of any expenditure on the ground that it was not necessary or prudent for the assessee to have incurred the same or that in the view of the revenue the expenditure was unremunerative or that in view of the continued losses suffered by the assessee in his business, he could have been far better, had he not incurred such expenditure. These are irrelevant considerations for the purpose of rule 10B. Whether or not to enter into the transaction is for the taxpayer to decide. The quantum of expenditure can no doubt be examined by the TPO as per law but in judging the allowability thereof as business expenditure, tax administration has no authority to disallow the entire expenditure or a part thereof on the ground that the taxpayer has suffered continuous losses. The financial health of assessee can never be a criterion to judge allowability of an expense; there is certainly no authority for that. What the TPO has done in the present case is to hold that the assessee ought not to have entered into the agreement to pay royalty/brand fee, because it has been suffering losses continuously. So long as the expenditure or payment has been demonstrated to have been incurred or laid out for the purposes of business, it is no concern of the TPO to disallow the same on any extraneous reasoning. As provided in the OECD guidelines, he is expected to examine the international

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transaction as he actually finds the same and then make suitable adjustment but a wholesale disallowance of the expenditure, particularly on the grounds which have been given by the TPO is not contemplated or authorised"

15.5.3 Precautionary measure

The decision highlights the fact that the tax authorities per se cannot question the commercial rationale of legitimate business expenses incurred by the taxpayer. However, it also becomes imperative for taxpayer to demonstrate that the transaction is at arm's length by application of the prescribed methods with proper evidences/ documentation.

15.6 Charging Notional Interest for Delay in Realisation of Sales Proceeds from AEs:

Kindly refer Chapter 2.

15.7 No Addition on Account of Location Saving (Movement of Business Activities from High Cost Jurisdiction to Low Cost Jurisdiction)

15.7.1 Issue

In case of movement of business operations / activities from high cost jurisdictions to low cost jurisdictions has led to debate between the taxpayers and tax authorities as to which jurisdiction enjoys the additional profits from such movement. The quantification and allocation of such profits has become an important issue in transfer pricing audit resulting in litigation.

15.7.2 Judicial pronouncements

The Delhi Tribunal ruling in the case of **GAP International Sourcing India Private Limited** [2012] 25 taxmann.com 414 , viewed that the intent of sourcing from low cost countries for a manufacturer / retailer is to survive in stiff competition by providing a lower cost to its end-customers. Generally, the advantage of location savings is passed onto the end-customer via a competitive sales strategy. The arm's length principle requires benchmarking to be done with comparables in the jurisdiction of tested party and the location savings, if any, would be reflected in

the profitability earned by comparables which are used for benchmarking the international transactions. Accordingly, it was held that no separate / additional allocation is called for on account of location savings.

15.7.3 Precautionary measure

It is important for taxpayer to ensure robust documentation is maintained which includes a comprehensive FAR analysis to commercially substantiate that the transactions are at ALP.

15.8 Compensation for Intra Group Services

15.8.1 Issues

Indian tax authorities take an aggressive approach while examining the TP policies in respect of intra-group services, especially when an Indian entity is the recipient of services and management fee has been charged to Indian entity.

The Indian tax authorities mainly seek and examine the following details in this respect:

- Need of such services to Indian entity i.e. whether an independent enterprise in comparable circumstances would have been willing to pay for the activity if performed for it by an independent enterprise or would have performed the activity in-house for itself.
- Whether the amount charged by AE for services commensurate with the benefit derived by the Indian entity by availing such services, whether the allocation key used by AE makes sense under the circumstances, etc.
- Whether such services have given any special advantage / commercial or economic benefit to the Indian entity or the services are just in the nature of shareholder's services i.e. services rendered to protect the interest of the AE, being the shareholder and thus, not recoverable.
- A copy of agreement between AEs and invoices/debit notes raised by AE to

examine exact nature of services rendered by AE and the basis on which the payment is made to AE.

15.8.2 Judicial pronouncements

The Bangalore Tribunal in the case of **Gemplus India Pvt. Ltd. vs. ACIT** (2010-TII-55-ITAT-BANG-TP) held that the onus was on the taxpayer to establish that the payments made to AE for service charges were commensurate to the volume and quality of services provided by the AE and that the costs were comparable to an uncontrolled transaction. Since, the assessee could not prove any commensurate benefits against the payment of service charges to AE; adjustment made by the TPO was justified.

15.8.3 Precautionary measure

It is advisable to design a proper Group TP policy, considering various factors such as the nature of the activity services rendered, significance of the activity to the group, functional profiling and the characterization of the intra-group transactions involved, relative efficiency of the service supplier, any advantage that the activity creates for the group, etc. Further, it is advisable to maintain robust documentation to demonstrate the actual receipt of intra-group services and fulfillment of the benefit test i.e., to demonstrate that the consideration received by the AE for services rendered to Indian entity is proper as compared to the benefit which Indian entity received from such intra group services.

15.9 Management Charges

15.9.1 Issues

The taxpayer receives certain services from its AE's for which it makes payment in nature of management charges. The tax authorities determine the management service charges as NIL using CUP Method. This has become a major issue of litigation.

15.9.2 Judicial pronouncements

The Delhi Tribunal in the case of **AWB India P Ltd** (ITA No. 6480 of 2012) 2014 50 taxmann.com 323 observed that it is a call taken by the assessee whether the management services are commercially expedient or not and all that the TPO can see is at what price similar services are actually rendered in the uncontrolled conditions. So long as agreement was not found to be a sham agreement, the value of the services cannot be taken as 'nil' on the ground that these services were not actually required by the assessee.

Further, the Delhi Bench in case of **McCann Erikson India (P) Ltd** (ITA No. 5871/Del/2011), held that entity level TNMM for benchmarking would be the most appropriate method for computing ALP, due to assessee's distinct nature of business and services received from AE. There are no segments or activities which can be said to be as independent of each other in the assessee's business. The ITAT ruled that in the field in which the assessee's company was functioning, it would be difficult to envision a business entity that can successfully carry out its operations the global environment without receipt of services, which carry a huge intrinsic and creative value. No one except a business expert can evaluate the true value of such services.

Also, the Mumbai Tribunal in case of **Dresser Rand India Pvt Ltd.** (ITA No. 3509/Mum/2008), concluded it is entirely the assessee's prerogative to determine the manner in which it conducts its business, and it is not for the tax department to make the decision on its behalf. The Tribunal also observed that an assessee may have any number of qualified accountants and management experts on his rolls, but that goes not prevent the assesse from engaging the services of outside experts for auditing and management consultancy.

Further, it is not for the tax authorities to question the assessee's wisdom in doing so. Whether a particular expense on services received is beneficial for an assessee in monetary terms should not be a consideration for the tax authorities. The benefit of the service or the lack thereof to the organisation cannot influence the ALP of that service. The real question that is to be determined in such cases is

whether the price of this service is equivalent to the price that an independent enterprise would have paid for the same.

15.9.3 Precautionary measure

In view of the above it is advisable to enter into a detailed agreement with the AE specifying the service to be received and fees for the same. In addition the taxpayer needs to maintain evidences in respect of services like email communications etc. to justify receipt of services from its AE's.

15.10 Re-imbursement of Expenses

15.10.1 Issues

The transactions involving pure cost reimbursements also require a TP analysis (including benchmarking) for determination of ALP.

15.10.2 Judicial Pronouncements

The Delhi High Court in the case of **Cushman and Wakefield India Pvt Ltd** (Delhi HC (2014) 89 CCH 0076) struck down the taxpayer's argument that mere cost recharge without mark-up requires no benchmarking analysis. Since uncontrolled transactions would involve a mark-up and lead to higher price. Cost incurred in an uncontrolled transaction cannot be speculated to be higher on account of mark-up. Whether the cost charged by the AE is inflated or not is required to be tested explicitly by undertaking a benchmarking analysis. The High Court emphasized maintenance of documentary evidence to demonstrate receipt of service, basis of cost incurred, activities for which they were incurred, benefits directly related to such act etc. for providing validity of claim and determination of ALP. The decision as to whether the services claimed to be provided to the taxpayer existed and the expenditure was wholly and exclusively for the purposes of business is a fact to be determined by the AO. This right of the AO is not prejudiced due to reference made to the TPO, whose role is limited to determination of ALP of the transactions. The High Court remanded the case back to the files of AO and TPO.

15.10.3 Precautionary measure

In view of the above, it is advisable to carefully frame the policy for reimbursement of expenses incurred on behalf of AEs. If the expenses are administrative/routine in nature, it is advisable to maintain documentation in support of expenses incurred, the benefit, if any, derived by the AE, rationale for incurring the expenses by Indian entity, arrangement/agreement with the AE in respect of the same, etc.

Further, in cases where such activities are done on regular and frequent basis and continue over a period of time, it is important to look into the substance of the transaction to find whether the activities carried on by the Indian entity amounts to service rendered by the Indian entity for which it should charge appropriate amount of service fee to the AEs.

15.11 Economic Adjustments

Kindly refer Chapter 2.

Chapter 16 Nexus With Other Statutory Laws

A business enterprise in India is required to comply with various statutory regulations resulting in the submission of data with such authorities (E.g. In case of imports the business enterprise would need to submit documents to custom authority etc.) Considering the fact that data is readily available with various such authorities and the synchronized working approach recently adopted by them including data exchange, it is pertinent that abundant caution and diligence is observed by such enterprise to ensure uniformity in compliances to minimize litigations. Some instances are as under:

(i) A business enterprise is required to disclose the details of transactions with specified related parties under the Act and also needs to ensure that such disclosure is in consonance with the related party disclosures under the Companies Act 2013, Customs Act etc.

(ii) Under the Transfer Pricing Regulations, the price adopted by the customs authorities (who follow a defined valuation methodology) may not necessarily be adopted. This leads to different valuation methodology adopted by different authorities for valuation of a single transaction.

As discussed above, due to readily available data, robustness of the IT systems, increased inter-connectivity and close working of various departments, it is pertinent that the business enterprise maintain uniformity , ensure consistency and have a reasoned approach which dealing with such authorities and compliances under the various regulations, as any contravention would lead to unavoidable legal hassles.

16.1 Nexus between Customs Act and Indian TP Regulations

16.1.1 The customs regulation in India has a prescribed valuation methodology in case of import of goods and also has defined parties which shall be treated as related under the said regulations.

16.1.2 The overview of the difference between Customs Valuation Rule and TP Regulation is as under:

Basis	TP Regulation	Customs valuation Rule
Applicability	International transaction	Import of physical goods
Related party	TP Regulation widely defined associated enterprise and deeming provision for the same in section 92A(2) of the Act.	Under customs legislation the expression related person and deemed related person is not defined widely.
Transaction value	In TP Regulation the ALP of international transaction / SDT shall be determined by applying any of the methods prescribed under the Act.	Under Customs Act the transaction value of goods can be accepted if the importer can demonstrate that the relationship between parties did not influence the price.
Guidelines	OECD & UN Model	World Trade Organisation Guidelines
Sources of Data	Financial data of comparable companies obtained from public databases like Prowess, Capitaline or ACETP. At time data from customs database like TIPS also considered	Data of similar imports, which is available in the Electronic Data Interchange (EDI) system maintained by the Customs authorities.

16.1.3 When the pricing of a particular transaction is accepted by the Customs department, whether the same would automatically be at ALP from transfer pricing perspective?

As per Rule 10B (2)(d), comparability of an international transaction / SDT with an uncontrolled transaction shall be judged with reference to the laws and government orders in force. However, based on the various judicial precedents it is observed that the valuation adopted by the customs authority may not be necessarily adopted by the TP authorities. Some of the rulings on this aspect are as under:

The Delhi Tribunal in the case of **Panasonic India Pvt. Ltd. vs. ITO** (2010-TII-47-

ITAT-DEL-TP), held that since the TP Regulation is a self-contained code, answers to all questions must be found in the written law contained in the Act and Rules. The relevant extract of the observations of the Delhi Tribunal is given below:

"We do not find any force in this ground and are of the view that where specific rules of law exist in the Statute on a particular subject, then they would hold the field. Chapter X and Rules made there under are a self-contained code and answers to all questions must be found in the written law contained in the Act and Statute. Here we are inclined to agree with learned CIT (DR) that that the Customs valuation is used for different purposes and Chapter X of the Act is for different purposes and different criteria are being used."

Similar view has been taken by the Mumbai Tribunal in the case of **Serdia Pharmaceuticals (I) Pvt Ltd vs. ACIT** (2011-TII-02-ITAT-MUM-TP).

Further, the Delhi Tribunal in case of **Tianjin Tianshi Biological Development Company Ltd vs. DCIT** (ITA no 1110/Del/2014) held that

"Turning to the issue of alleged suppressed sale by the assessee, after careful consideration of written submissions and arguments placed by both the sides, at the outset, we observe that the DRP held that the determination of ALP is of no relevance in deciding the issue of suppressed sale by the assessee and went on to estimate the value of suppressed sale on account of difference between the value of MRP declared to the custom authorities and MRP altered on the products sold to the Tianjin India. At the cost of repetition we reiterate our above noted observation that the legal fiction created by the Central Excise Act and the Customs Act provides a measure for levy of excise/custom duty which cannot be followed or imported to the Income Tax Act".

Thus from the above it can be derived that the ITAT has held that the Excise and Customs can be used for levy of excise/ customs duty which cannot be followed for the purpose of transfer pricing.

However, the Chennai Tribunal in the case of **Coastal Energy Pvt Ltd Vs. ACIT** [2011] 12 taxmann.com 355 held that use of comparable prices obtained from customs

authorities appropriate for computing ALP of coal imports; custom valuation not arbitrary, but based on large volumes of data classified as per internationally accepted protocol.

16.1.4 Other aspects on valuation – investigation by the Special Valuation Branch

The transactions with the AE, are investigated by the Special Valuation Branch ('SVB'). The Central Broad of Excise & Customs has issued Circular No 11/2001—Cus dated 23 February, 2001 on the procedure for registration/ finalization of cases referred to SVB. As such, the business entities need to ensure that the transactions entered into by it with its AEs are at ALP under the custom's regulation and TP Regulations.

16.2 Central Excise Act and TP Regulations

16.2.1 The central excise regulation in India has a prescribed valuation methodology and defined parties which shall be treated as related under the said regulation.

16.2.2 Under Central Excise Act, a buyer and seller are considered to be related if they are so associated that they have interest, directly or indirectly, in the business of each other. The term 'relative' assumes significance under Central Excise as it has a direct bearing on valuation and determination of excise duty.

16.2.3 As such, there is a difference in approach of direct and indirect tax authorities in terms of valuation and the coverage of related parties under the said regulations.

16.3 Nexus between Indian TP Regulations and The Companies Act 2013

16.3.1 Companies Act 2013 has introduced the arm's length concept for Related Party Transactions (RPT). With the introduction of this concept, the Companies need to assess whether their related party transactions comply with the arm's length concept and evaluate their compliance and reporting obligations under the Companies Act. The Arm's Length concept was hitherto used only under Indian Transfer Pricing Regulations. As a consequence, related party transactions covered under the provisions of the Companies Act may now call for benchmarking and convergence with the India Transfer Pricing regulations.

16.3.2 Meaning of a 'related party' under Companies Act, 2013

Related party with reference to Company means

(i)	(ii)	(iii)	(iv)	(v)	(vi)	(vii)	(viii)	(ix)
Director or his relative	KMP or his relative	Firm in which a director, manager or his relative is a partner	private company in which a director or manager is a member or director	Public company in which a director or manager is a director and holds along with his relatives, more than two per cent. of its paid-up share capital	Any body corporate whose Board, managing director or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager	Any person on whose advice, direction or instructions a director or manager is accustomed to act.	Any company which is holding, subsidiary or an associate company, fellow subsidiary of such company	KMP of holding company or his relative

Nothing in clause (vi) or (vii) shall apply to advice given in professional capacity.

16.3.3 The definition of the term 'relative' has been limited and now only includes members of a Hindu Undivided Family, husband and wife and father including step father, mother including step mother, son including step son, son's wife, daughter, daughter's husband, brother including step brother, and sister including step sister.

Abbreviations

Terms	Definition
AAR	Authority for Advance Ruling
ACIT	Assistant Commissioner of Income- tax
AE	Associated Enterprise
ALP	Arm's Length Price
AMP	Advertising Marketing & Promotion
AO	Assessing Officer
AOP	Association of Persons
APA	Advance Pricing Agreement
AY	Assessment Year
BEPS	Base Erosion And Profit Shifting
BOD	Board of Directors
BOI	Body of Individuals
CBDT	Central Board of Direct Taxes
CCA	Cost Contribution Arrangement
CIT	Commissioner of Income-tax
CPM	Cost Plus Method
CUP	Comparable Uncontrolled Price
DCIT	Deputy Commissioner of Income- tax
DGIT	Director General of Income- tax
DIT	Director of Income-tax
Draft Order	Draft Assessment Order
DRP	Dispute Resolution Panel
DTAA	Double Taxation Avoidance Agreement
FAR Analysis	Functions, Assets and Risk Analysis
FDI	Foreign Direct Investment
FM	Finance Minister
FMV	Fair market Value
FY	Financial Year
GAAR	General Anti Avoidance Rule
GP	Gross Profit
HUF	Hindu Undivided Family
ICAI	The Institute of Chartered Accountants of India
INR	Indian Rupee
IT	Information Technology
ITES	Information Technology Enabled Services

Abbreviations

Terms	Definition
KMP	Key Management Personnel
KPO	Knowledge Process Outsourcing
MAM	Most Appropriate Method
MAP	Mutual Agreement Procedure
MNC	Multi National Company
NJA	Notified Jurisdictional Area
NPBT	Net Profit Before Tax
ODI	Outward Direct Investment
OECD	Organization for Economic Co-operation and Development
PCCIT	Principal Chief Commissionerof Income-tax
PCIT	Principal Commissioner of Income-tax
PE	Permanent Establishment
PLI	Profit Level Indicator
PSM	Profit Split Method
R&D	Research and Development
RBI	Reserve Bank of India
ROI	Return of Income
RPM	Resale Price Method
RPT	Related Party Transactions
SDT	Specified Domestic Transactions
SEBI	Security and Exchange Board of india
SEZ	Special Economic Zone
SHR	Safe Harbour Rules
SLP	Special Leave Petition
SVB	Special Valuation Branch
the Act	Income tax Act, 1961
the Rules	Income tax Rules, 1962
TNMM	Transactional Net Margin Method
TP	Transfer Pricing
TPO	Transfer Pricing Officer
UK	United Kingdom
UN TP	United Nations practical Manual on Transfer Pricing
US	United States of America
WOS	Wholly Owned Subsidiary

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