# An Overview of Transfer Pricing

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# Need for Transfer Pricing Regulation

# Need for Transfer Pricing Regulations?

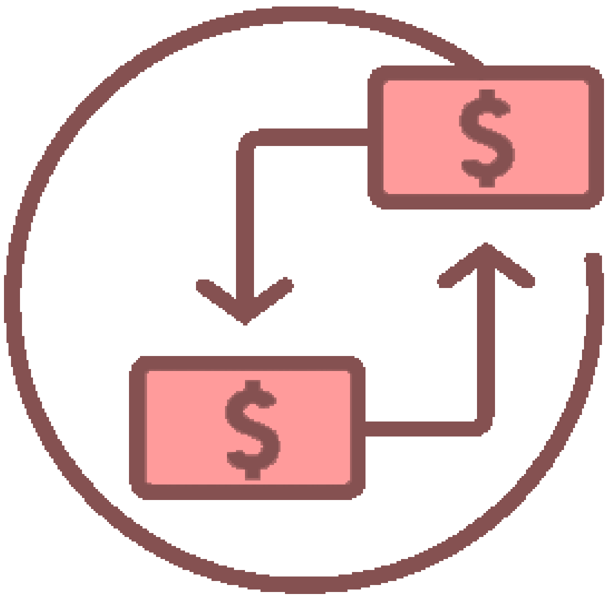
❖ **Situation before the enactment of Transfer Pricing Regulations**

| India | Dubai |
|---|---|
| TP Limited (AE 1) | Al habibi LLC (AE 2) |
| Selling Price = 10/- p.u. | Selling Price = 110/- p.u. |
| Less Cost = 10/- p.u. | Less Cost = 10/- p.u. |
| Profit = 0/- p.u. | Profit = 100/- p.u. |
| **Income Tax = NIL** | **Income Tax = NIL** |
| (Assuming Tax rate @ 25%) | (Assuming Dubai as tax haven) |

❖ **Situation after the enactment of Transfer Pricing Regulations**

| | |
|---|---|
| TP Limited (AE 1) | Al habibi LLC (AE 2) |
| Selling Price = 100/- p.u. (ALP) | Selling Price = 110/- p.u. |
| Less Cost = 10/- p.u. | Less Cost = 100/- p.u. |
| Profit = 90/- p.u. | Profit = 10/- p.u. |
| **Income Tax = 22.5/-** | **Income Tax = NIL/-** |
| (Assuming Tax rate @ 25%) | |

# Indian Transfer Pricing Framework



# Relevant Regulations

| Provision | Section | Rules |
|---|---|---|
| Computation of income having regard to ALP | 92 | --- |
| Meaning of Associated Enterprise | 92A | --- |
| Meaning of International transaction | 92B | --- |
| Meaning of Specified Domestic Transaction | 92BA | --- |
| Methods of computation of ALP<br>*Rule 10AB – Any other method for determination of ALP | 92C(1)/(2) | Rule 10B/10AB/10C/10CA |
| Reference to Transfer Pricing Officer (TPO) | 92CA | --- |
| Safe harbour rules | 92CB | Rule 10TA to 10TF |
| Advance Pricing agreement | 92CC | Rule 10F to 10T |
| Effect of advance pricing agreement | 92CD | |
| Secondary Adjustments | 92CE | Rule 10CB |
| Maintenance of information and documents by persons entering into an international transaction or specified domestic transaction (Amended to include requirement of CbCR &Master File) | 92D | Rule 10D,<br>Rule 10DA & 10DB |
| Accountant's Report entering into an international transaction or specified domestic transaction | 92E | Rule 10E<br>(Form 3CEB) |
| Definitions: Accountant, ALP, Enterprise, PE, Specified date, Transaction | 92F | Rule 10A |

# Section 92

- 92(1) →Any income, expense or interest arising from an international transaction or specified domestic transaction shall be computed having regard to arm's length price.
- Includes -
  - 92(2) →Any cost or expense allocated or apportioned or contributed under a mutual agreement to be determined having regard to the ALP of the benefit, service or facility provided under such agreement
  - 92(2A) →Interest or any allowance for expenditure or allocation of cost or expense or income in relation to SDTs
- 92(3) →This section does not apply where it results in reduction of income chargeable to tax or increase in the loss.

# Associate Enterprise (AE)

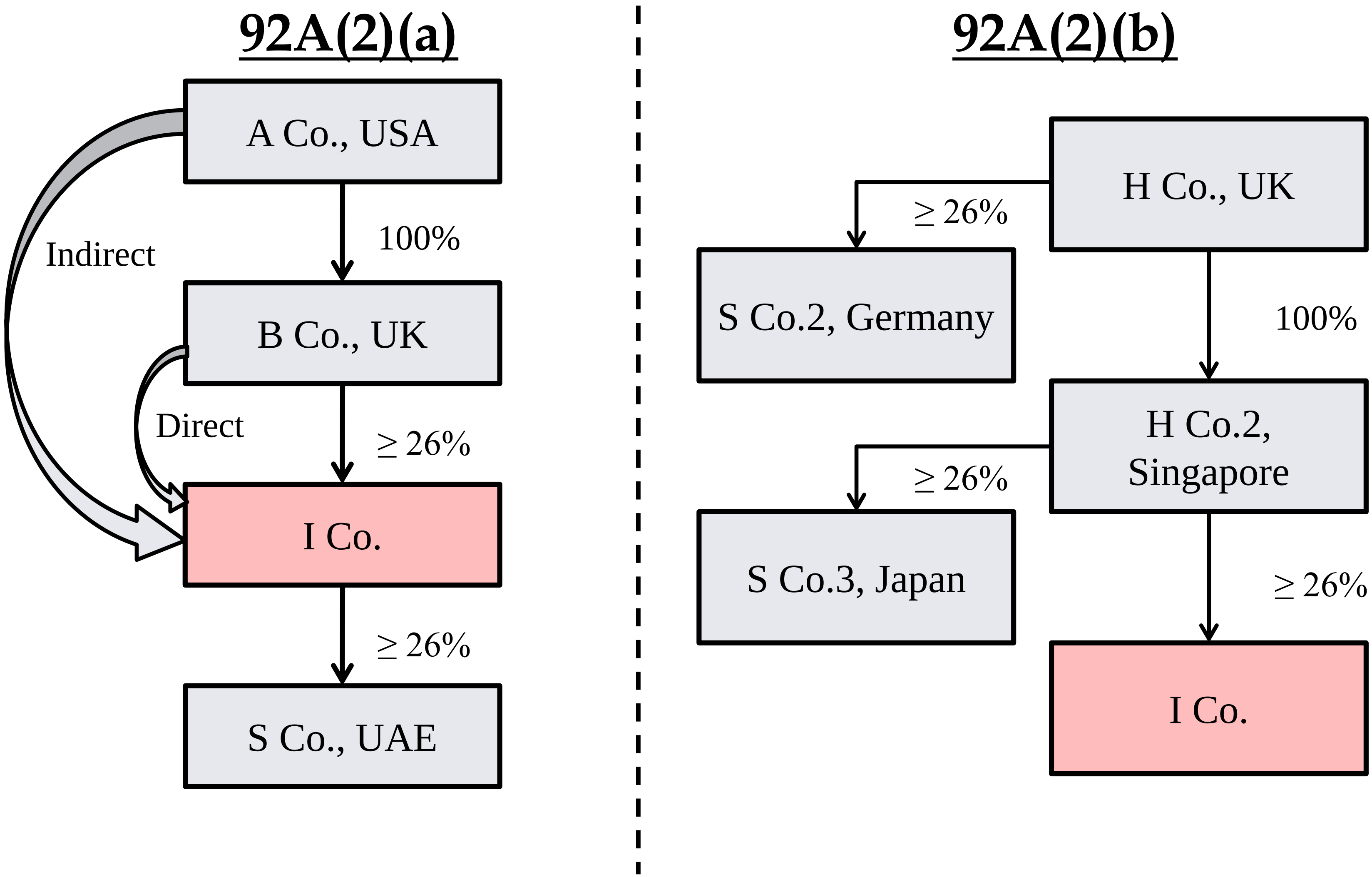
# Definition of Enterprise

- **Defined in Sec. 92F(iii) to mean -**
  - a person (including a permanent establishment of such person)
  - engaged in any specified activity, or in investment, or providing loan or in business of acquiring, holding, underwriting or dealing with securities
  - whether such activity or business is carried on, directly or through one or more of its units / divisions / subsidiaries, or
  - whether such unit / division / subsidiary is located at the same or at a different place or places
- Enterprise vis-à-vis person

# Definition of Associate Enterprise

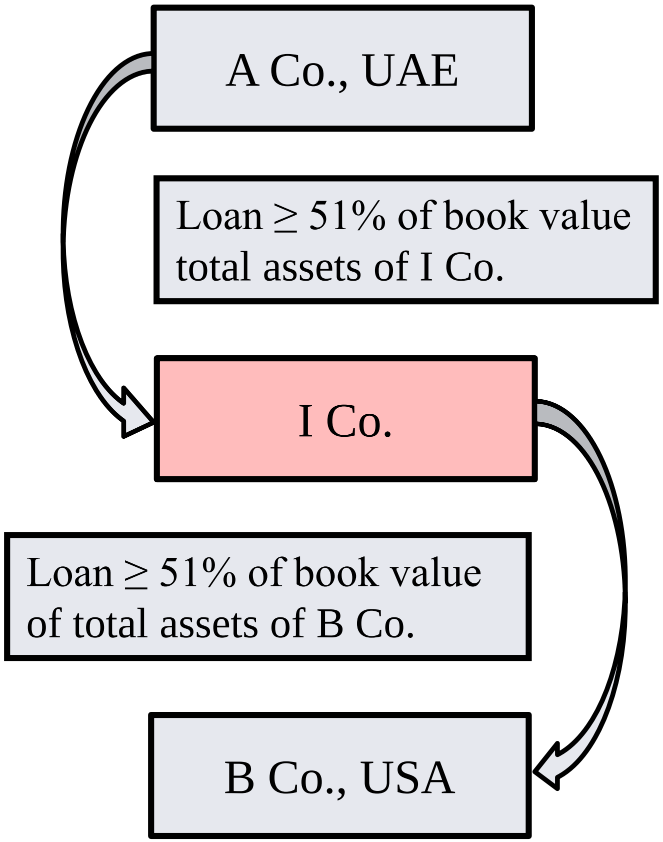
- **92A(1) – General conditions**
  - Direct or indirect participation by an enterprise in management, control or capital of another enterprise.
  - Direct or indirect participation by one or more persons in management, control or capital of two enterprises.
  - Extent of participation required is not laid down
- **92A(2) – Specific conditions**
  - Deemed AE relationship based on conditions linked to shareholding, board of directors, loans, guarantees, etc.
  - "At anytime during the year"

# Associate Enterprise

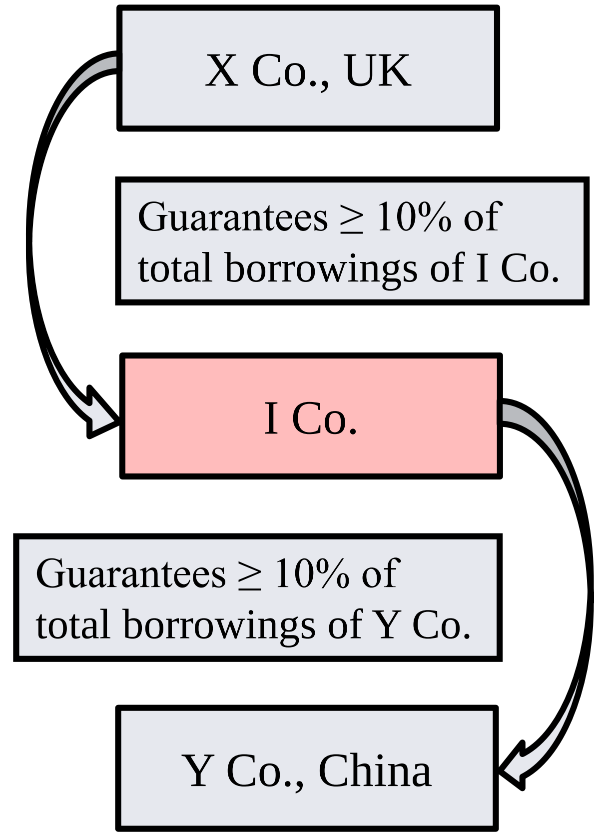


# Associate Enterprise

## 92A(2)(c)

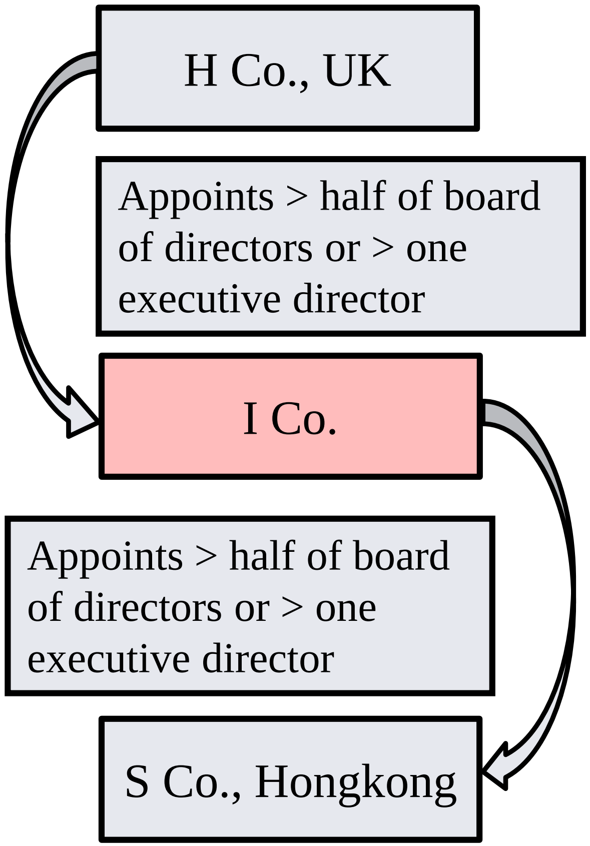



## 92A(2)(d)

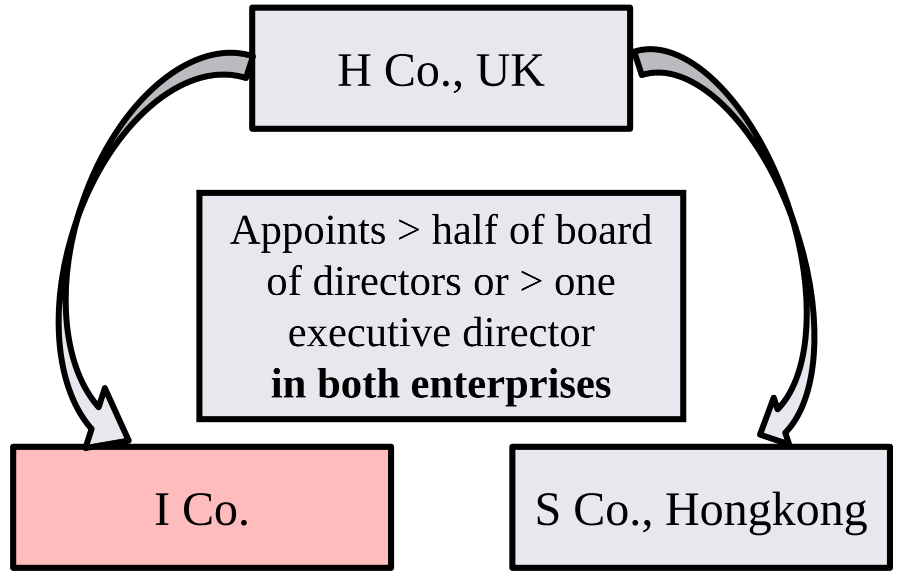


# Associate Enterprise

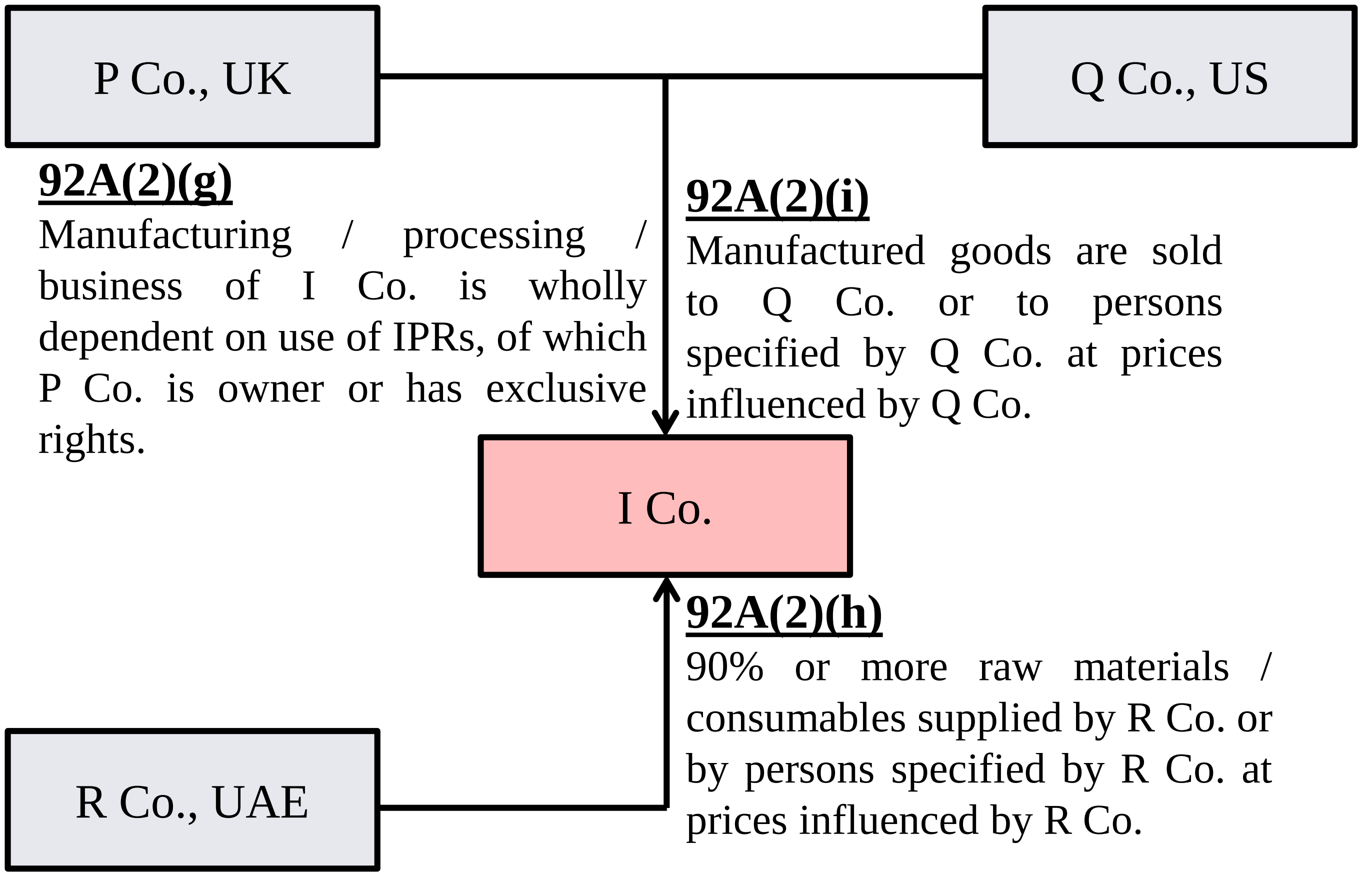
## 92A(2)(e)



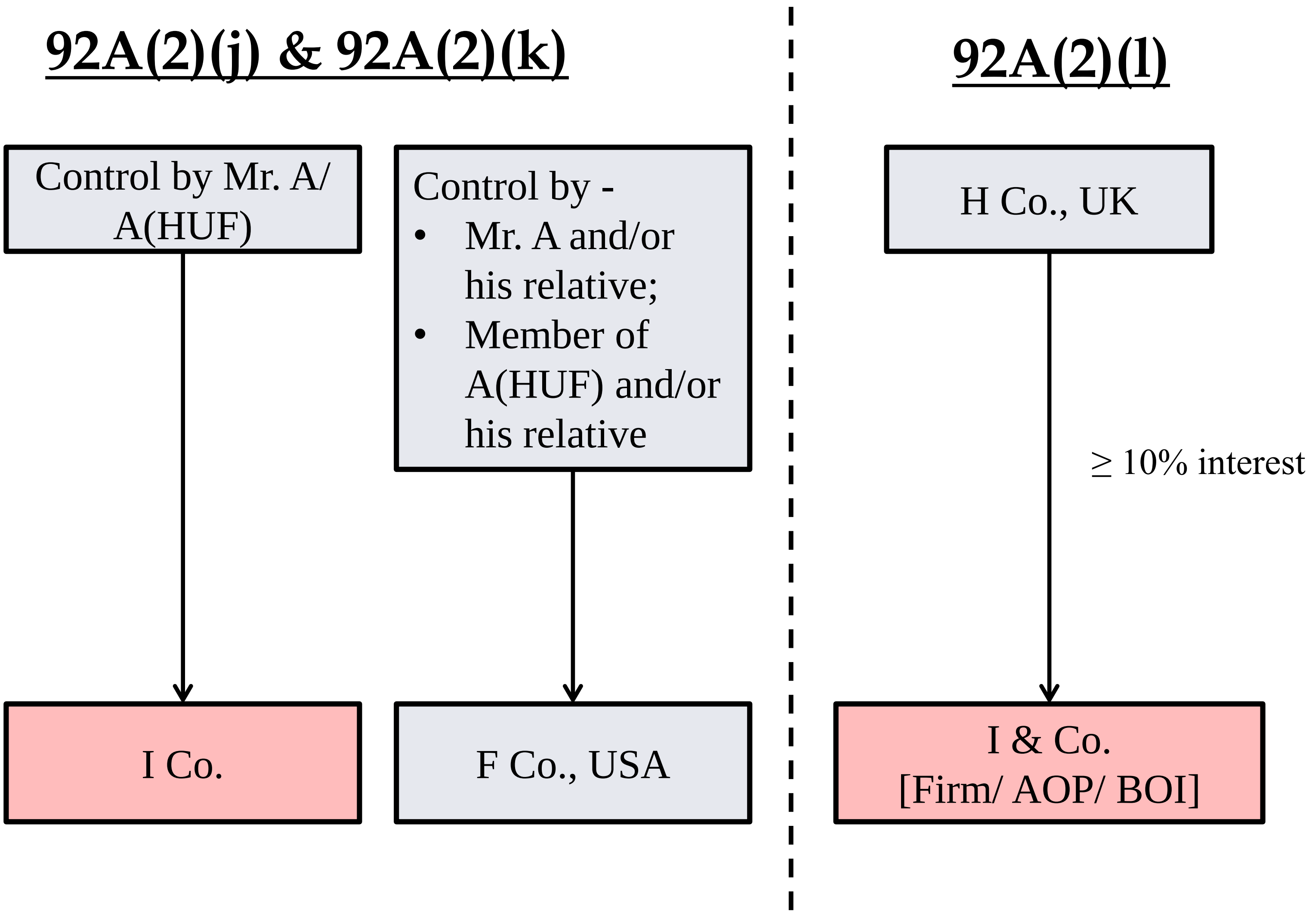

## 92A(2)(f)



# Associate Enterprise



# Associate Enterprise



# International Transaction (Section 92B)

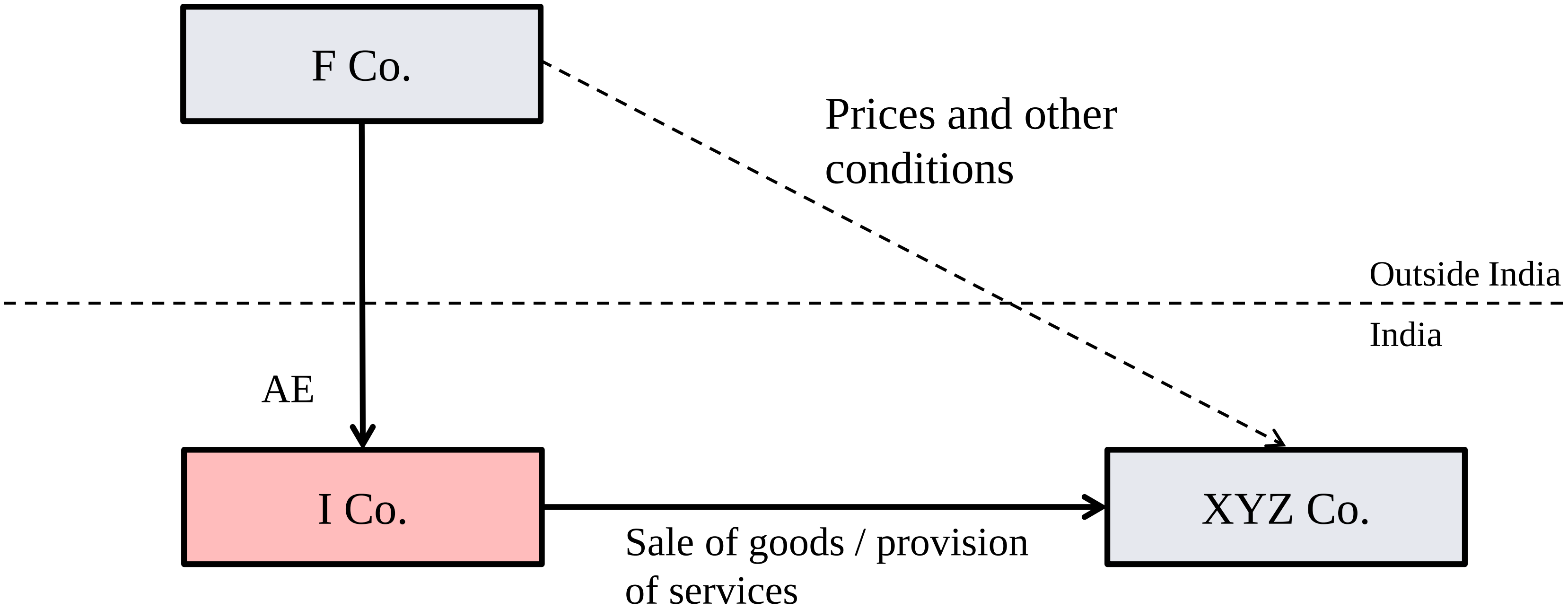
# International Transaction

- **92B(1) → International transaction means**
  - A transaction between two or more AEs, either or both of whom are non-residents,
  - In the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises
  - Includes a cost allocation / apportionment / contribution arrangement
- **“Transaction” defined in Sec. 92F(v) to include-**
  - an arrangement, understanding or action in concert,
  - whether or not it is in writing,
  - whether or not it is intended to be enforceable by legal proceeding

# Deemed International Transaction

- **92B(2) → Transaction with a non-AE deemed to be a transaction between two AEs, if**
  - there exists a prior agreement in relation to the relevant transaction between such other person and the AE, or
  - the terms of the relevant transaction are determined in substance between such other person and the AE
- S. 92B(2) deems international transaction without creating deemed AE relationship.
- **Transaction between two residents, where –**
  - third party is interposed between two resident AEs
  - third party is interposed between Indian assessee and non-resident AE
  - IJM (India) Infrastructure Ltd. v. ACIT 147 ITD 437 (Hyd. Trib.)

# Deemed International Transaction




**Transaction between I Co. and XYZ Co. is deemed international transaction**

# Explanation (i) to Section 92B

| Clarification to definition of International Transaction | | | | |
|---|---|---|---|---|
| Tangible Property | Intangible Property | Capital Financing | Services | Business restructuring |
| • Purchase, sale, transfer, lease or use of tangible property<br>• Includes building, vehicle, machinery, equipment, plant, furniture, etc. | • Purchase, sale, transfer, lease or use of intangible property<br>• Includes transfer of ownership or the provision of use of rights | • Long-term or short-term borrowing or lending<br>• Guarantee<br>• Purchase or sale of marketable securities<br>• Advance, payments or deferred payment or receivable or any other debt | • Includes market research / development, marketing management<br>• Administration<br>• Technical service<br>• Repairs, design, consultation<br>• Agency<br>• Scientific research<br>• Legal or accounting | • Entered into by an enterprise with an AE<br>• Irrespective of whether it has bearing on the profit, income, losses or assets at the time of the transaction or at any future date |

# Explanation (ii) to Section 92B

**"Intangible Property" to include:**

| Sr. No. | Intangible Assets | Examples |
|---|---|---|
| 1 | Marketing related | Brand names, Logos, Trade Names, Trade Marks. |
| 2 | Technology related | Patent Applications, Process patents, Technical documentation such as laboratory notebooks, Technical know-how. |
| 3 | Artistic related | Copyrights, Engravings, Literary works and copyrights, Maps, Musical Compositions. |
| 4 | Data Processing related | Automated databases, Integrated circuit masks and masters, Proprietary computer software, Software copyrights |
| 5 | Engineering related | Blue prints, Engineering drawing and schematics, Industrial design, Product patents, Proprietary documentation, Trade secrets |

# Explanation (ii) to Section 92B

| Sr. No. | Intangible Assets | Examples |
|---|---|---|
| 6 | Customer related | Customer lists, Customer contacts, Customer relationship, Open purchase orders. |
| 7 | Human capital related | Employment agreements, Trained and organised work force, Union contracts. |
| 8 | Location related | Air rights, Easements, Leasehold interest, Mineral exploitation rights, Water rights. |
| 9 | Goodwill related | Celebrity goodwill, General business going concern value, Institutional goodwill, Personal goodwill of professional, Professional practice goodwill. |
| 10 | Methods, systems, procedures, etc. | Campaigns, Customer lists, Estimates, Forecasts, Methods, Procedures, etc. |
| 11 | Other similar items | Any other similar items which derives its value from its intellectual content rather than its physical attributes |

# Prescribed Transfer Pricing Methods

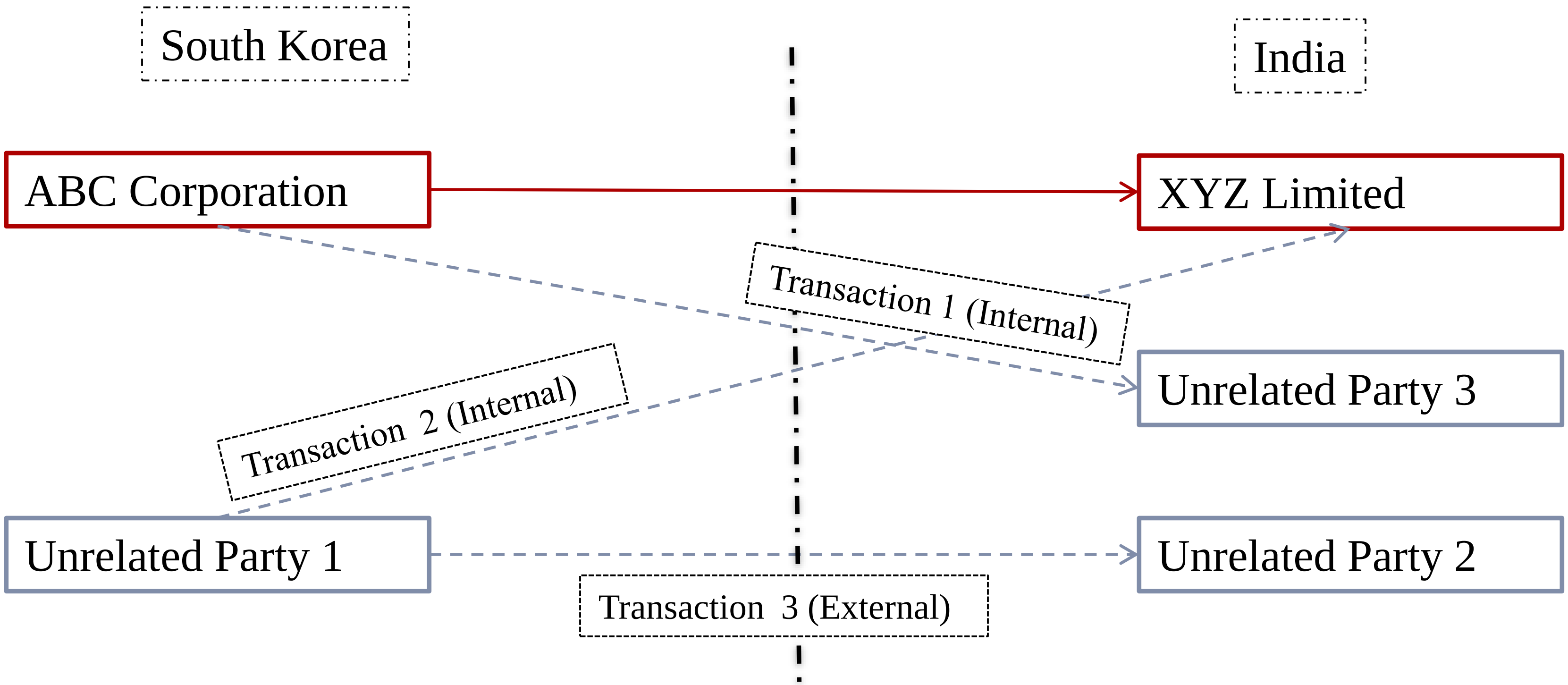
# Prescribed Transfer Pricing Methods

- 92C(1)→ALP to be determined applying any of the following methods, being the most appropriate method:
  - **Comparable uncontrolled price method;**
  - **Resale price method;**
  - **Cost plus method;**
  - **Profit split method;**
  - **Transactional net margin method;**
  - **Other method of determination (Rule 10AB)**
- 92C(2)→Most appropriate method to be adopted as per Rule 10C. Factors to be considered:
  - Nature and class of transaction
  - Taking into account FAR analysis
  - Availability + reliability of data & accurate adjustments
  - Degree of comparability

# Prescribed Transfer Pricing Methods

| | |
|---|---|
| Comparable Uncontrolled Price (‘CUP’) | The CUP method compares the price charged in a controlled transaction to the price charged in a comparable uncontrolled transaction in comparable circumstances. |
| Resale Price Method (‘RPM’) | The RPM evaluates whether the amount charged in a controlled transaction is arm’s length by reference to the gross profit margin realized in comparable uncontrolled transactions. |
| Cost Plus Method (‘CPM’) | The CPM method evaluates a controlled transaction by reference to the markup on cost earned in comparable uncontrolled transactions. |
| Profit Split Method (‘PSM’) | The PSM allocates operating profits or losses from controlled transactions in proportion to the relative contributions made by each party in creating the combined profits or losses or in proportion to allocation of profits in arm’s length transactions. |
| Transactional Net Margin Method (‘TNMM’) | The TNMM compares the net profit margin of the assessee arising from a non-arm’s length transaction with the net profit margins realized by arm’s length parties from similar transactions. |
| Other Method | Any method that takes in to account the price which has been charged or paid or would have been charged or paid for same or similar uncontrolled transaction with or between non – associated enterprises |

# Prescribed Transfer Pricing Methods
# Case Study – CUP Method




**Facts:** The controlled transaction in this case involves the transfer of television between ABC Corporation, a television manufacturer in South Korea, and XYZ Limited, a television importer in India. *ABC Corporation is the parent company of XYZ Limited.*

# Prescribed Transfer Pricing Methods
# Case Study – CUP Method

❑ **<u>Application of the CUP Method</u>**

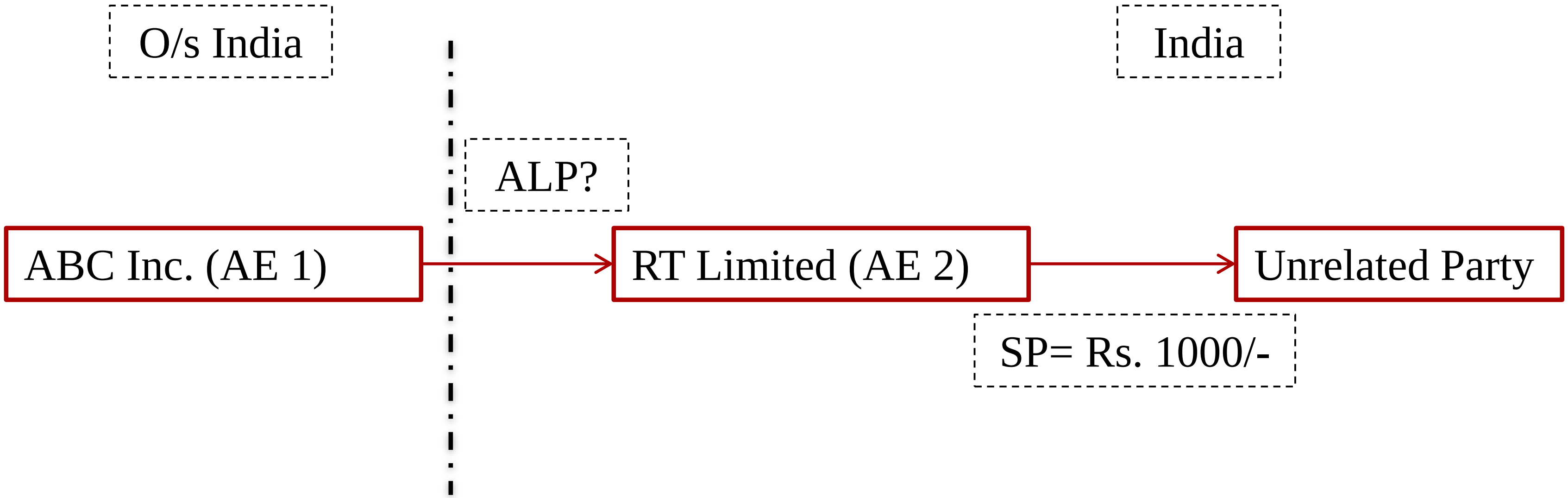
❖ In applying the CUP method to determine whether the price charged for television transferred in a controlled transaction is at arm's length or not, the following information is assumed to be available for consideration:

- The price charged for television transferred in a comparable uncontrolled transaction between XYZ Limited and Unrelated Party 1; and
- The price charged for television transferred in a comparable uncontrolled transaction between ABC Corporation and Unrelated Party 3; and
- The price paid for television transferred in a comparable uncontrolled transaction between Unrelated Party 1 and Unrelated Party 2.

❖ **<u>Analysis:</u>**

- Comparison of controlled transaction price with price charged under Transaction 1 / Transaction 2 / Transaction 3 [Mean price under Rule 10CA (7)]

# Prescribed Transfer Pricing Methods
# Case Study – Resale Price Method




**<u>Facts:</u>** ABC Inc. is the parent company of the RT Limited. ABC Inc. sells the goods to RT Limited. RT Limited in turn sells the same goods to the unrelated party at the given price of Rs. 1000/-. Assume that a third party distributor competitor earns gross margin of 30% on sales made to unrelated party. Compute the arm's length price for the transaction of the sell of goods between ABC Inc. and RT Limited.

# Prescribed Transfer Pricing Methods
# Case Study – Resale Price Method

- **<u>Application of the Resale Price Method</u>**

- Under RPM, the transfer price for the sale of goods between ABC Inc. and RT Limited can be described as per the following formula:

  ***Transfer Price = Resale Price * (1 – Gross Profit Margin)***

  *<u>Where,</u>*

  *Resale price means the price at which the goods are sold by* RT *Limited to unrelated party.*

  *Gross Profit Margin refers to margin earned by competitor when the goods are sold to the unrelated party.*

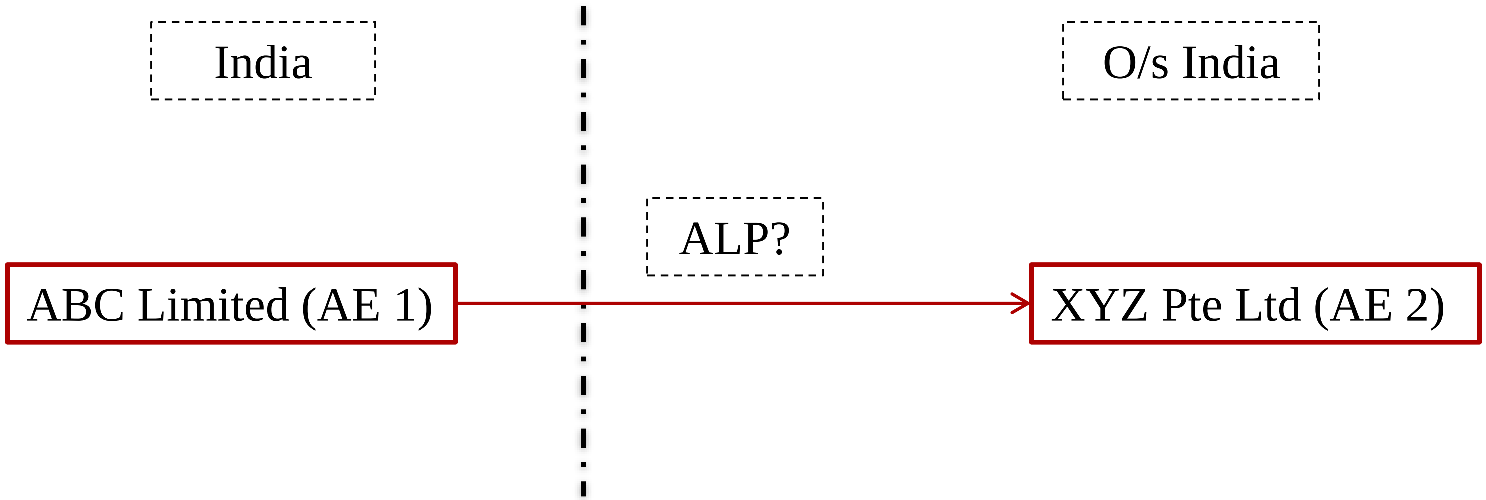
- Therefore, in this case transfer price (ALP) of transaction of sell of goods between ABC Inc. and RT Limited can be calculated as follows:

**TP = Resale Price * (1 – GPM)**

**∴ TP = 1000 * (1 – 30%)**

**∴ TP = 700/-**

# Prescribed Transfer Pricing Methods
# Case Study – Cost Plus Method




**Facts:** ABC Limited is the parent company of the XYZ Pte Ltd . ABC Limited sells the goods manufactured by them to XYZ Pte Ltd on a contract basis. Cost of goods sold by ABC Limited to XYZ Pte Ltd is Rs. 1,000/-. Assume that Arm's length gross profit mark-up that competitor earns is 35%. Compute the arm's length price for the transaction of the sell of goods between ABC Limited and XYZ Pte Ltd .

# Prescribed Transfer Pricing Methods
# Case Study – Cost Plus Method

- **<u>Application of the Cost Plus Method</u>**

- Under CPM, the transfer price for the sale of goods between ABC Limited and XYZ Pte Ltd can be described as per the following formula:

  ***Transfer Price = COGS * (1 + GPM)***

  *Where,*

  *COGS refers to the cost of goods sold to the manufacturing company;*

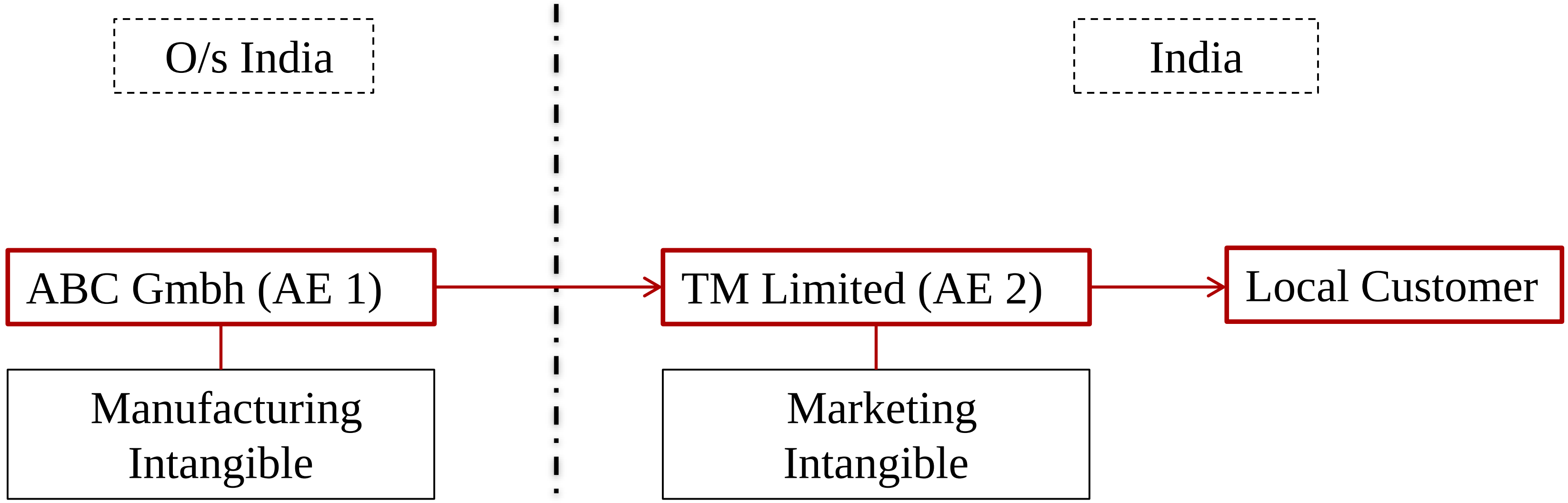
- Therefore, in this case transfer price (arm's length price) of transaction of sale of goods between ABC Limited and XYZ Pte Ltd can be calculated as follows:

$$\textbf{TP = COGS * (1 + GPM)}$$

$$\therefore \textbf{TP = 1000 * (1 + 35\%)}$$

$$\therefore \textbf{TP = 1350/-}$$

# Prescribed Transfer Pricing Methods
# Case Study – Profit Split Method




**Facts:** ABC Gmbh is the parent company of the TM Limited. ABC Gmbh sells high-end cars manufactured by them to their sole distributor TM Limited. ABC Gmbh possesses manufacturing intangibles in the form of secret process for manufacturing, R&D Centre for manufacturing high-end cars. TM Limited performs the distribution function and sells the cars to the local customer in India. TM Limited spends on brand building activities to increase the sale of cars in India. Given data below, compute arm's length profit to be earned by TM Limited.

# Prescribed Transfer Pricing Methods
# Case Study – Profit Split Method

- **<u>Exhibit of the financial performance of ABC Gmbh & TM Limited</u>**

| Particulars | ABC Gmbh | TM Limited | Total |
|---|---|---|---|
| Sales | 100 | 160 | 260 |
| Normal Operating Cost | 40 | 100 | 140 |
| *Expenditure incurred in relation to the unique and valuable intangible* | *30* | *20* | *50* |
| Operating Profit | 30 | 40 | 70 |

# Prescribed Transfer Pricing Methods
# Case Study – Profit Split Method

## Application of the Profit Split Method

- **Step 1 –** Determination of initial return for the non-unique manufacturing/marketing functions.
  Assume routine return on manufacturing – 25% on Cost
  Assume routine return on Distribution & Sales activity – 5% on sales

| Company Name | Particulars (Calculation) | Amount |
|---|---|---|
| ABC Gmbh | (Operating Cost * 25% ) = (40 * 25%) | 10 |
| TM Limited | (Sales amount * 5% ) = (160 * 5%) | 8 |
| | Total Profit allocated through initial return | **18** |

# Prescribed Transfer Pricing Methods
# Case Study – Profit Split Method

❑ **<u>Application of the Profit Split Method</u>**

- **Step 2 –** Determination of Residual Profit that needs to be split

| Particulars | Amount |
|---|---|
| Total Operating Profit | 70 |
| Profit already allocated in Step 1 (initial return) | 18 |
| Residual Profit that needs to be split (proportion of expenditure in relation to the creation of the unique and valuable intangible) | **52** |

# Prescribed Transfer Pricing Methods
# Case Study – Profit Split Method

## ❑ Application of the Profit Split Method

▪ **Step 3 –** Allocation of Residual Profit

| Company Name | Particulars (Calculation) | Amount |
|---|---|---|
| ABC Gmbh | (Residual Profit * Unique Exp. incurred by ABC Gmbh / Total Unique Exp.) = (52 * 30/50) | ~31 |
| TM Limited | Residual Profit * Unique Exp. incurred by TM Limited / Total Unique Exp.) = (52 * 20/50) | ~21 |

## ❑ Total Profits Allocated

| Company Name | Particulars (Calculation) | Amount |
|---|---|---|
| ABC Gmbh | (Step 1 Amount + Step 3 Amount) = (10+31) | 41 |
| TM Limited | (Step 1 Amount + Step 3 Amount) = (8+21) | 29 |

# Prescribed Transfer Pricing Methods
# Case Study – Transactional Net Margin Method


**Facts:** ABC Inc. is the parent company of XYZ Limited. XYZ Limited purchases raw material from ABC Inc. at a price of Rs. 60/- for manufacturing of goods. Given data below of XYZ Limited, compute the arm's length price for the transaction of the purchase of goods between ABC Inc. and XYZ Limited.

| Particulars | Amount |
|---|---|
| Sales (Local Customer) | 100 |
| RM Cost (Pur. From ABC Inc.) | 60 |
| Other Operating Cost | 30 |
| Operating Profit | 10 |
| OPM | 10% |

| Particulars | WAM |
|---|---|
| 35th Percentile | 12% |
| 65th Percentile | 22% |
| Median of the Dataset | 15% |

# Prescribed Transfer Pricing Methods
# Case Study – Transactional Net Margin Method

❑ **<u>Application of the Transactional Net Margin Method</u>**

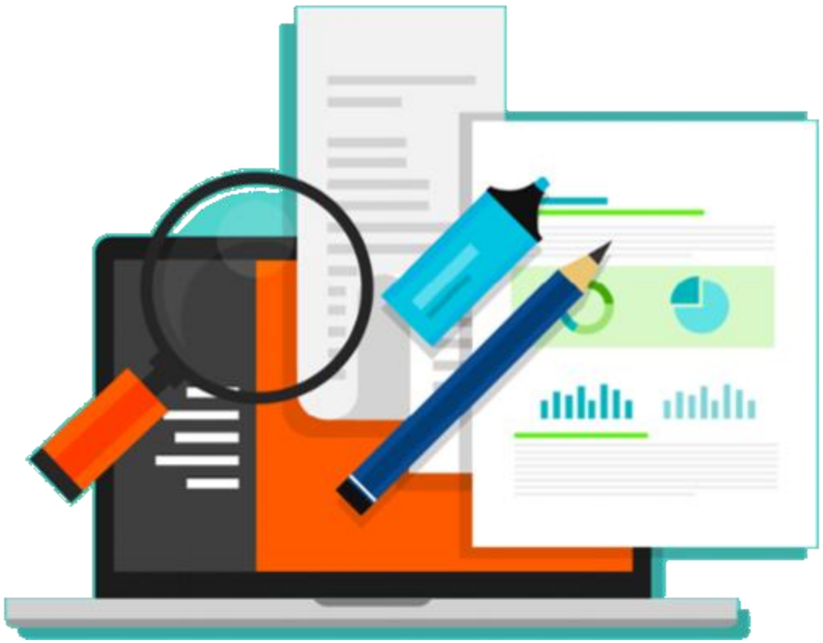
❖ If the OPM earned in the international transaction is outside the arm's length range then, the arm's length OPM is median of the dataset.

❖ Since, the OPM earned by XYZ Limited is 10% which is falling outside the range of OPM earned by comparables in India. Therefore, to compute OPM which XYZ Limited should earn on sales made to local customer, we need to take Median of the dataset viz.15%. Thus, OP that XYZ Limited should earn is Rs.15 (100 * 15%).

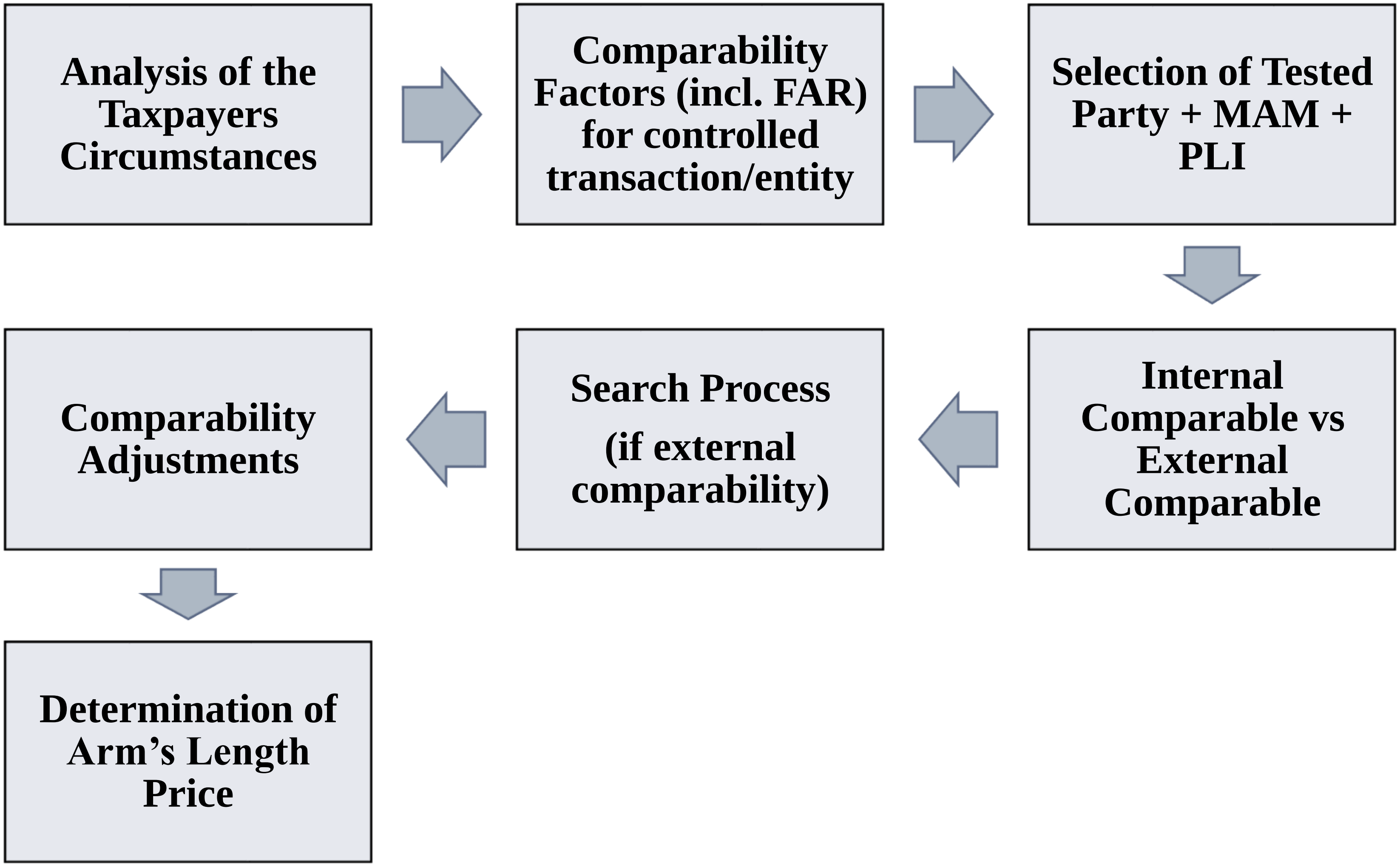
❖ <u>Computation of Arm's length Raw Material Cost:</u>

| Particulars | Amount |
|---|---|
| Sales | 100 |
| Other Operating Cost | 30 |
| Operating Profit | 15 |
| ***∴ Arm's Length RM Cost*** | ***55*** |
| ***vs. Actual RM Cost*** | ***60*** |

# Comparability Analysis



# Steps under Comparability Analysis



# Step 1 – Analysis of Taxpayers Circumstances

- ❖ Collection of information about the taxpayer: Business operations and activities, identification of AEs, information about relevant cross-border controlled transactions, etc.
- ❖ Analysis of industry, competition, economy, regulatory factors affecting taxpayer.
- ❖ Sources of information: Annual report, news articles, research report, management/ internal reports.
- ❖ A study of these documents will provide an idea of:
  - the industry to which the enterprise belongs;
  - the nature of its business activities (i.e. manufacturer, wholesaler, distributor, etc.);
  - its market segment;
  - market share;
  - market penetration strategies;
  - type of products/services dealt in, etc.
- ❖ Example: Hotel Industry – Various Business Models

# Step 2 – Comparability factors for Controlled Transaction

- Comparability factors as per Rule 10B(2) of Income Tax Rules, 1962:
  a. Specific **characteristics of the property or services transferred**;
  **b.** **FAR Analysis** of the respective parties to the transactions;
  c. the **contractual terms 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;
  d. 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, business cycle and level of competition and whether the markets are wholesale or retail (**Economic Circumstances**).

# Step 2 – Comparability factors for Controlled Transaction

- **Factor 1: Characteristics of the property transferred or services provided**

- Differing characteristics of property / service affects their values in open market. Indicative characteristics listed in UN TP Manual 2021:
  - *In case of tangible property:* physical features, quality, reliability, availability and the volume of supply;
  - *In case of intangible property:* form of the transaction (e.g. licensing or sale) and the type and form of property, duration and degree of protection and anticipated benefits from use of the property; and
  - *In case of services:* nature and extent of such services.

- Transactional Analysis - **Separate v/s Aggregation**
  - The transfer pricing analysis needs to be made on a transaction-by-transaction basis *(**separate**).*

# Step 2 – Comparability factors for Controlled Transaction

**Factor 1: Characteristics of the property transferred or services provided (Cont.)**

- Transactional Analysis - **Separate v/s Aggregation**
  - Where transactions are so closely interrelated or continuous that application of the arm's length principle on a transaction-by-transaction basis would become unreliable or cumbersome, transactions can be often ***aggregated***.

- Transactional Analysis – **Intentional Set-Offs**
  - Intentional set-off typically occurs in a composite transaction when an AE provides a benefit to another AE within the MNC group and is compensated in return by that other enterprise with some other benefit.
  - Again, transactions need to be examined separately even though taxpayer may have carried out intentionally set-off.

# Step 2 – Comparability factors for Controlled Transaction

❑ **Factor 1: Characteristics of the property transferred or services provided (Cont.)**

**Effect of the differences in characteristics on selection of MAM:**

a. **Price based method (CUP Method):**

- Requirement for comparability of property transferred or services is the strictest for the CUP Method and thus, any material difference in the characteristics of property or services can have an effect on the price and would require an appropriate adjustment.

b. **Gross profit based methods (CPM/ RPM Method):**

- GPM of an entity represents the profits earned by performing core business functions and is not specifically related to the product in which a company deals in. Thus, differences in the characteristics of property or services are less likely to have a material effect.

# Step 2 – Comparability factors for Controlled Transaction

❑ **Factor 1: Characteristics of the property transferred or services provided (Cont.)**

**Effect of the differences in characteristics on selection of MAM (cont.):**

c. **Net profit based methods (TNMM):**

- Comparability based purely on characteristics of property transferred or services provided becomes even more liberal under TNMM as difference in characteristics are often reflected in variation in operating expenses.
- Thus, comparable uncontrolled transactions need to belong to same genus of products/services but they need not be identical.

# Step 2 – Comparability factors for Controlled Transaction

- **Factor 2 : FAR Analysis**

  Purpose of FAR Analysis:

  - As per economic theory, the more valuable the functions performed, assets employed and the greater the risks assumed by a party to a transaction the greater its expected return (or potential loss).
  - Comparison of only economically significant FAR
  - This analysis helps to select
    - the tested parties;
    - the most appropriate method (MAM);
    - the comparables; and
    - eventually to determine whether the profits/ losses earned by the entities are appropriate to the functions performed, assets employed and risks assumed.

# Step 2 – Comparability factors for Controlled Transaction

❑ **Factor 2 : FAR Analysis**

***Why to do FAR Analysis? – MAM***

**Section 92C -** The arm's length price in relation to an international transaction shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or **functions performed** by such persons or such other relevant factors"

**Rule 10C(2) -** "In selecting the most appropriate method, the following factors shall be taken into account, namely:

(b) the class or classes of AEs entering into the transaction and the **functions performed** by them taking into account **assets employed** or to be employed and **risks assumed** by such enterprises"

# Step 2 – Comparability factors for Controlled Transaction

❑ **Factor 2 : FAR Analysis**

***Why to do FAR Analysis? – Selection of Comparables & Documentation***

**Rule 10B(2) -** Comparability of an international transaction with an uncontrolled transaction shall be judged with reference to (among others):

- **Functions performed**, taking into account **assets employed** and **risks assumed**, by both the parties to the transactions

**Rule 10D(1) – Documentation**

"(e) a description of the **functions performed**, **risks assumed** and **assets employed** or to be employed by the assesse and by the associated enterprises involved in the international transaction"

# Step 2 – Comparability factors for Controlled Transaction

- **Factor 2 : FAR Analysis**

  Components of FAR Analysis:

  - **Functions performed:**
    - Functions performed are the activities that are carried out by each of the parties to the transaction.
    - Some of the important functions: R&D, warehousing and inventory, marketing and distribution, manufacturing etc.
  - **Assets employed**:
    - The type and nature of assets used (tangible/ intangible) in the course of controlled transaction needs to be identified.
    - It is essential to know which entity has developed the intangibles, who has the legal ownership of such intangibles & who enjoys the benefits of the intangibles.

# Step 2 – Comparability factors for Controlled Transaction

- **Factor 2 : FAR Analysis**

  Components of FAR Analysis:

  - **Risks assumed:**
    - Risk study includes identification of various risks that are assumed by each of the parties to the transaction.
    - Some of the significant risks: product liability risk, design and development of product risk, market risk, inventory risk, credit risk, obsolescence risk.
    - Ascertainment of parties who have control over risk and financial capacity to assume risk gains importance over contractual allocation of risks.

# Step 2 – Comparability factors for Controlled Transaction

- **Factor 2 : FAR Analysis**

**Effects of FAR Analysis on the selection of the MAM:**

a. **CUP Method:** Similarity in characteristics of the property transferred or service provided is of utmost importance rather than FAR Analysis.

b. **RPM/ CPM Method:** Similarity in functions, assets and risks becomes important as gross profit is driven more by functions performed and less by nature of products being transferred.

c. **TNMM**: Broad similarity in the FAR is desirable since net profit indicators are less adversely affected by differences in FAR.

d. **PSM:** Under PSM, combined profits are allocated on the basis of their relative contribution and this relative contribution is in turn measured in terms of FAR of each such entity. Hence, FAR analysis becomes critical.

# Step 2 – Comparability factors for Controlled Transaction

## Typical FAR of Manufacturers

| Particulars | Full Fledged Manufacturer | Contract Manufacturer | Toll Manufacturer |
|---|---|---|---|
| **Functions Performed** | | | |
| R&D | Significant | - | - |
| RM Procurement | Significant | Moderate | - |
| Manufacturing | Significant | Significant | Significant |
| Inventory Mgmt. | Significant | High | - |
| Marketing | Significant | - | - |
| **Assets Employed** | | | |
| Intellectual Property | Significant | - | - |
| Tangible Property | Significant | Significant | Significant |
| **Risks Assumed** | | | |
| Market risk | Significant | - | - |
| Inventory risk | Significant | High | - |

# Step 2 – Comparability factors for Controlled Transaction

## Typical FAR of Manufacturers

| Particulars | Full Fledged Manufacturer | Contract Manufacturer | Toll Manufacturer |
|---|---|---|---|
| Product Liability risk | Significant | - | - |
| Credit risk | Significant | Moderate | - |
| Warranty risk | Significant | Significant | Moderate |

❖ **<u>Indicators to evaluate FAR of comparables (Manufacturers)</u>**

- Manufacturing Sales / Sales
- R&D Expense / Sales
- Marketing Expense / Sales
- Plant & Machinery / Total Assets
- Inventory / Sales
- Royalty Expense / Sales
- Intangible Assets / Total Assets
- Raw Material / Total Cost

# Step 2 – Comparability factors for Controlled Transaction

## Typical FAR of Distributors

| Particulars | Distributor | Buy-sell Distributor |
|---|---|---|
| **Functions Performed** | | |
| Warehousing and Inventory Mgmt. | Significant | Low |
| Sale and Distribution support | Significant | Moderate |
| After sales services | Significant | Significant |
| Strategic marketing | Moderate | - |
| **Assets Employed** | | |
| Warehouse/Other Tangible Asset | Significant | Significant |
| Customer List (Asset) | Significant | Low |
| **Risks Assumed** | | |
| Market risk | Significant | Low |
| Inventory risk | Significant | Low |
| Obsolescence risk | Significant | - |

# Step 2 – Comparability factors for Controlled Transaction

## Typical FAR of Distributors

| Particulars | Distributor | Buy-sell Distributor |
|---|---|---|
| Freight risk | Significant | Moderate |
| Credit risk | Significant | Low |
| Foreign Exchange risk | Significant | Moderate |

❖ **Indicators to evaluate FAR of comparables (Distributors)**

- Plant & Machinery / Total Assets
- Advertising Expense / Sales
- Purchase Cost / Total Cost
- Inventory / Sales

# Step 2 – Comparability factors for Controlled Transaction

## Typical FAR of Service Provider

| Functions/ Assets/ Risks | Entrepreneur | Low risk/Captive service provider |
|---|---|---|
| **Functions Performed** | | |
| R&D | Significant | - |
| Quality Assurance | Significant | Moderate |
| Human resource | Significant | High |
| Marketing | Significant | - |
| **Assets Employed** | | |
| Intellectual property | Significant | - |
| Human resource intangible | Significant | - |
| **Risks Assumed** | | |
| Human resource attrition risk | Significant | Significant |
| Service liability risk | Significant | Moderate |

# Step 2 – Comparability factors for Controlled Transaction

## Typical FAR of Service Provider

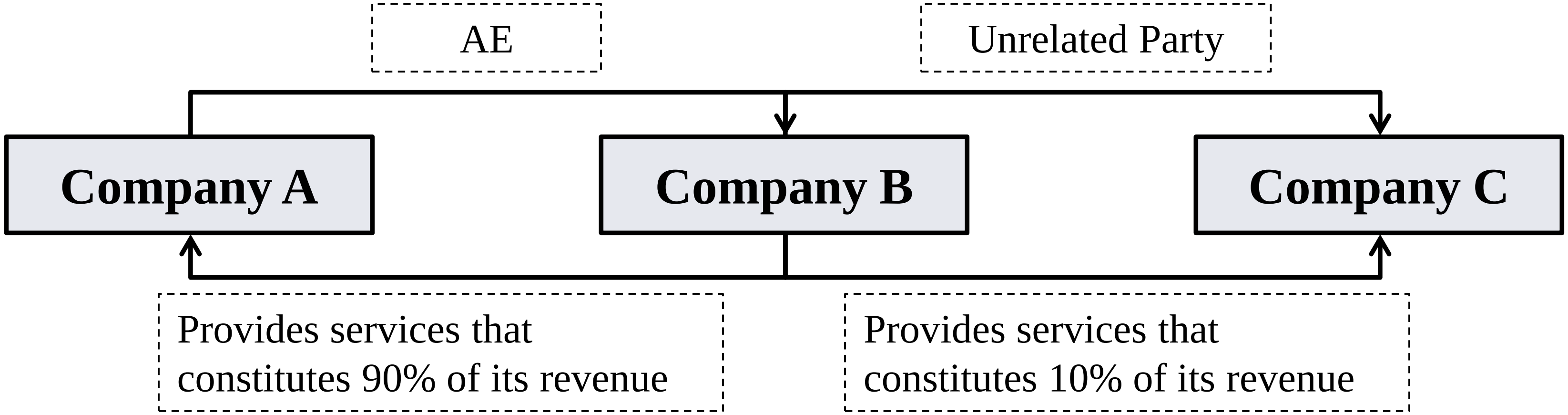
| Functions/ Assets/ Risks | Entrepreneur | Low risk/Captive service provider |
|---|---|---|
| Capacity utilization risk | Significant | - |
| Regulatory risk | Significant | Significant |
| Credit risk | Significant | - |

❖ **<u>Indicators to evaluate FAR of comparables (Service Providers)</u>**

- Employee Cost / Sales
- R&D Expense / Sales
- Intangible Assets / Total Assets
- RPT / Sales

# Step 2 – Comparability factors for Controlled Transaction

- **Factor 3 : Review of Contractual Arrangements**
  - Relevance of contractual arrangements:




In determining the degree of comparability between Company B's uncontrolled transaction with Company C and its controlled transaction with Company A, the difference in volumes involved in the two transactions, volume discount if any, and the regularity with which these services are provided must be taken into account where such factors would have a material effect on the price charged.

# Step 2 – Comparability factors for Controlled Transaction

- **Factor 3 : Review of Contractual Arrangements**

  **Effects of contractual arrangements on the selection of the MAM**:

  a. **Price based methods (CUP):** Differences in contractual terms of the transaction have a bigger impact as compared to profit based methods. For e.g. Similarity in the credit terms offered under controlled and the uncontrolled transaction need to be examined to determine comparability between controlled and uncontrolled transaction.

  b. **Profit based methods (CPM/ RPM/ TNMM):** Effect of differences in contractual terms may get evened out under profit based method and thus such differences may not affect selection of profit based methods.

# Step 2 – Comparability factors for Controlled Transaction

- **Factor 4 : Economic Circumstances**
  - Geographical Location
  - Size of the Market and Level of Competition
  - Nature of Market – Wholesale or Retail
  - Laws and Government orders in force
  - Cost of Labour and Capital
  - Overall Economic Development
  - Existence of Business Cycle

# Step 2 – Comparability factors for Controlled Transaction

- **Factor 4 : Economic Circumstances**

  **<u>Geographical Location</u>**

  Location Savings

  - Net ‘Cost savings’ realized by an MNC as a result of relocating manufacturing functions/ production/ operation sites from a ‘high cost’ to ‘low cost’ jurisdiction to obtain competitive advantage.
  - Typical cost savings include savings pertaining to:
    - Labour costs;
    - Raw material costs;
    - Rent and property taxes;
    - Training costs;
    - Infrastructure costs and
    - Incentives including tax exemptions
  - Most low cost locations are in the ‘Developing World’ (example- India, China, Indonesia, Vietnam etc.)

# Step 2 – Comparability factors for Controlled Transaction

- **Factor 4 : Economic Circumstances**

**Geographical Location**

Location Savings (cont.)

**Location savings = Input cost in a high cost region – Input cost in a low cost region**

**Net Location savings = Cost Savings – Dissavings**

**Location Specific Advantage (LSA) = Net Location savings +/– Other location specific benefits**

**LSA >= Location Rent**

- Issue → ALP attribution of Location Rent
- Country Practice - India (Para D.3.8)

# Step 2 – Comparability factors for Controlled Transaction

- **Factor 4 : Economic Circumstances**

**Size of the Market and Level of Competition**

- Size of market and level of competition have an effect on transaction prices.
- Pricing strategies of an enterprise may depend upon size of market and its market share therein.
- Similarly, pricing strategy also depends upon level of competition in the market.

**Nature of market – whether wholesale or retail**

- Nature of market plays a big role in profit earning capacity of an enterprise.

**Laws and Government orders in force**

- The government policies and regulations also have a considerable impact on the prices and margins of the enterprise. For e.g. Price control in pharma industry.

# Step 2 – Comparability factors for Controlled Transaction

- **Factor 4 : Economic Circumstances**

**Cost of Labour and Capital**

- The price in any particular transaction is a function of its cost and since the cost of labour and capital vary from market to market, so does the consequential price earned by the enterprise.

**Overall Economic Development**

- The overall state of the economy in terms of its level of development also needs to be considered in the comparability analysis.

**Existence of Business cycle**

- Whether the economy is in boom or recession would impact the selection of comparables.

# Step 3 – Selection of Tested Party

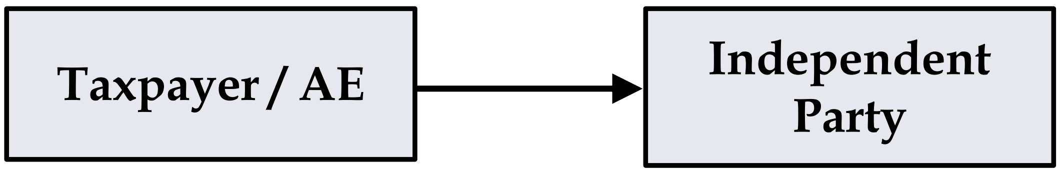
- For CPM, RPM and TNMM, it is necessary to chose the party to the transaction for which a financial indicator (GPM, NPM) is tested.
- FAR analysis would typically guide in choosing the tested party
- <u>Characteristics of Tested Party</u>
  - The tested party should be *least complex* among the parties to the transaction.
  - The tested party should be the one for which *reliable and accurate data* is available.
  - The tested party should be the one which requires *least adjustments* in order to make it comparable.
- Tested Party – Indian or Foreign ?

# Step 3 – Selection of MAM/ PLI

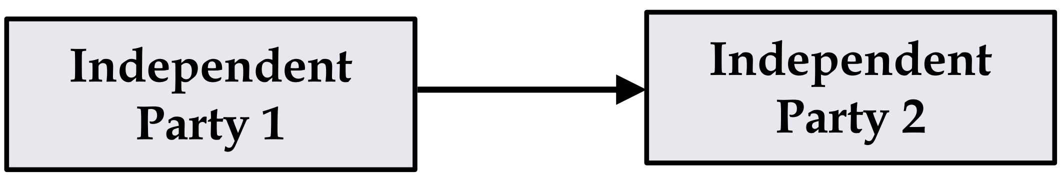
- There is no priority in selection of transfer pricing method. Instead, the method which is best suited to facts and circumstances of each transaction should be chosen as MAM.
- Rule 10C mentions following factors for selection of MAM:
  - Nature and class of transaction
  - Class of AE entering into transaction and FAR of such enterprise
  - Availability, coverage and reliability of data
  - Degree of comparability
  - Extent to which reliable and accurate adjustment can be made
  - Nature, extent and reliability of assumption required to be made

# Step 4 – Internal vs. External Comparable

- **Comparable uncontrolled transactions (“Comparables”) can be of 2 types:**
  - **Internal Comparables** i.e. transactions between one of the parties to the controlled transaction (taxpayer or foreign associated enterprise) and an independent party.




  - **Third party or External Comparables** i.e. comparable uncontrolled transactions between two independent parties, neither of which is a party to the controlled transaction.




- **Preference of Internal Comparable over External Comparable**

# Step 4 – Internal vs. External Comparable

- **<u>Internal Comparables</u>**
- Same level of scrutiny for internal comparables as is for external comparables.
- <u>Advantages of Internal Comparables:</u>
  - More direct and closer relationship to the transaction under review
  - Transaction specific info is more likely to be available
  - Less expensive as no public data search is required
- <u>Disadvantages of Internal Comparables:</u>
  - May not necessarily be the best evidence *if there are differences*, e.g. in transaction volumes, contractual terms, geographical markets and business strategy, which are material and cannot be eliminated through reliable comparability adjustments.
- **<u>External Comparables</u>**
- Depending upon MAM, external comparable could be transaction related data such as price or company related data such as gross/net margins

# Step 5 – Search Process

- **<u>Approaches to identifying potential comparables</u>**
- <u>Additive Approach vs. Deductive Approach</u>
  - Under additive approach, list of companies believed to be potentially comparable are drawn up.
  - Whereas under deductive approach, wide set of companies operating in same line of business are taken typically through a search on databases and thereafter refined by performing a quantitative or qualitative analysis.
- **Selection of Databases under Deductive approach:**
  - Indian – Capitaline, Prowess, AceTP, Prowess Pro,
  - Foreign – Amadeus, Royalty Stat, Bloomberg

# Step 5 – Search Process

- **Application of Quantitative & Qualitative Filters**
  - Financial Data
  - Industry of Tested Party
  - Turnover Filter
  - Net worth Filter
  - Related Party Transactions Filter
  - Consistently Loss Making Company Filter
  - Product Filter
  - Functional Filter
  - Ownership Filter

# Step 5 – Search Process
## Multi Year data – Rule 10B(5)

- From FY 2014-15,
- If method applied:
  - Resale price method;
  - Cost plus method;
  - Transactional net margin method;
- Data for analysis to be used:
  - Data for current year; or
  - Data of FY immediately preceding CY, if the data relating to CY is not available at the time of furnishing ROI
- Proviso: where the data relating to CY is subsequently available at the time of determination of ALP during the course of assessment proceeding, such data shall be used for such determination irrespective of the fact that the data was not available at the time of furnishing the return of income of the relevant assessment year

# Step 6 – Comparability Adjustments

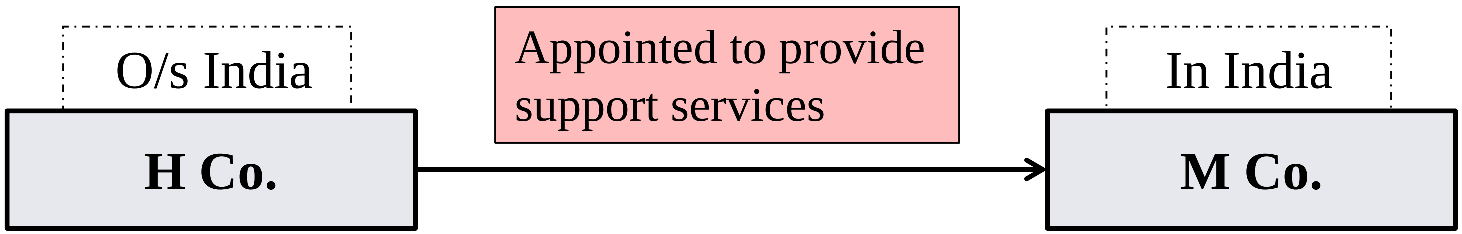
- To increase reliability of search process only
- Types of Comparability Adjustments:
  - Working Capital Adjustment
  - Fixed Asset Intensity Adjustment
  - Adjustments for accounting differences
  - Risk Adjustment
  - Adjustments for geographical factors, etc.

# Step 7 – Determination of ALP
# Range Concept & Multiple Year Data – Rule 10CA

- From FY 2014-15. ALP to be computed based on three PYs.
- If method applied:
  - Comparable Uncontrolled Price Method
  - Resale price method;
  - Cost plus method;
  - Transactional net margin method;
- More than or equal to 6 Comparables (data points)
- Margins between 35$^{th}$ & 65$^{th}$ Percentile – ALP satisfied;
- Arithmetic Mean to continue to apply:
  - PSM, OM
  - CUP, CPM, RPM, TNMM and < 6 comparables
  - Tolerance band: 3% or 1% available

# Case Study on Comparability Analysis

# Case Study




- H Co. provides full range of immigration services to Indian companies for cross border relocation.
- M Co. has been appointed to render the business support services to the H Co.
- M Co. provides all support service ancillary and supplementary to the business of H Co.
- H Co. remunerates M Co. for such support services.

# Case Study - FAR

## Functions Performed

| Particulars | H Co. | M Co. |
|---|---|---|
| **Planning Function** | √ | X |
| **Execution Function** | √ | √ |
| **Marketing and Advertising** | √ | √ |
| **Servicing Function** | √ | X* |
| **Billing and Collection** | √ | X |
| **Pricing Policy** | √ | X |
| **Admin Function** | √ | √ |

* M Co. provides business support service to H Co. and not directly to any third party

## Assets Employed

| Particulars | H Co. | M Co. |
|---|---|---|
| **Tangible Assets** | √ | √ |
| **Intangible Assets** | √ | X |

# Case Study - FAR

## Risks Assumed

| Particulars | H Co. | M Co. |
|---|---|---|
| **Planning and Execution** | √ | X |
| **Idle capacity risk** | √ | X |
| **Credit Risk** | √ | X |
| **Foreign Exchange Risk** | √ | √* |
| **Service Risk** | √ | √* |

* To the extent of support services provided to H Co.

# Case Study – Selection of Tested Party

| Particulars | H Co. | M Co. |
| --- | --- | --- |
| **Least Complex Entity** | X | √ |
| **Availability of Reliable and Accurate Data** | X | √ |
| **Requiring Least Adjustments** | X | √ |

❖ Since M Co. is:

- least complex entity;
- its financial data is available; and
- would require least adjustments while computing ALP,

**M Co. can be chosen as tested party.**

# Case Study – Selection of MAM/ PLI

| Particulars | M Co. |
|---|---|
| **Comparable Uncontrolled Price Method** | X |
| **Cost Plus Method** | X |
| **Resale Price Method** | X |
| **Profit Split Method** | X |
| **Transaction Net Margin Method** | √ |
| **Other Method** | X |

**Profit Level Indicator = Operating Profit/ Operating Cost**

# Case Study – Search Process

| Particulars | 2021/03 | 2020/03 | 2019/03 |
|---|---|---|---|
| **Total Universe of companies in the database** | XX | YY | ---- |
| **Industry Classification** | XX | YY | ---- |
| **NIC + Segment** | XX | YY | ---- |
| **Financial Data for the period under consideration** | XX | YY | ---- |
| **Sales Turnover** | XX | YY | ---- |
| **Sales/ Total Income %** | XX | YY | ---- |
| **Net Worth** | XX | YY | ---- |
| **Related Party Transaction** | XX | YY | ---- |
| **Comparability Factors Analysis of comparables** | 7 | 7+2 | 7+2 |

# Case Study - Comparability factors for Uncontrolled Entity

| SR. | Name of Potential Comparable | Analysis | Result 2021/03 | Result 2020/03 | Result 2019/03 |
|---|---|---|---|---|---|
| **1** | A | Software Development | NA | | |
| **2** | B | Computer Programming & Consultancy | NA | | |
| **3** | C | Call Centre, Back office Support Service | √ | √ | √ |
| **4** | D | Call Centre | √ | √ | X |
| **5** | E | IT & ITES | X | √ | √ |

# Case Study – Determination of ALP

| SR. | Name of Comparables | Weighted Average Margin |
|---|---|---|
| **1** | Comparable A | -17.68% |
| **2** | Comparable B | 3.01% |
| **3** | Comparable C | 3.95% |
| **4** | Comparable D | 4.62% |
| **5** | Comparable E | 5.55% |
| **6** | Comparable F | 12.29% |
| **7** | Comparable G | 19.36% |

| Range | Calculation | WAM |
|---|---|---|
| **$35^{th}$ Percentile** | (7*0.35) = 2.45 ~ $3^{rd}$ Position | 3.95% |
| **$65^{th}$ Percentile** | (7*0.65) = 4.55 ~ $5^{th}$ Position | 5.55% |
| **Median** | (7*0.50) = 3.50 ~ $4^{th}$ Position | 4.62% |

# Transfer Pricing Audit

# Transfer Pricing Audit – Guidance Note

- **<u>Section 92E:</u>** Every person who has entered into an international transaction/ specified domestic transaction during a PY shall obtain a report from an accountant and furnish such report on or before the specified date in the prescribed form duly signed and verified in the prescribed manner.
- **"accountant"** means a chartered accountant as defined in section 2 of the Chartered Accountants Act, 1949 who holds a valid certificate of practice under section 6 of that Act, but does not include certain person as prescribed.
- Section 92E does not stipulate that only the statutory auditor should perform the examination. The examination can, therefore, be conducted either by the statutory auditor or by any other CA in practice.
- Accountant should communicate with the accountant who had done the examination in earlier years.
- Accountant should obtain a letter of appointment for conducting examination.
- Appointment need not be made at AGM in case of company. If BOD authorised, they can appoint.
- Joint Auditor – Principle of SA 299 to be followed.

# Transfer Pricing Audit – Guidance Note

- CA who is in employment of a concern or in any other concern under the same management cannot examine the accounts under Section 92E.
- CA responsible for writing or the maintenance of the books of account of the assessee should not examine the accounts under Section 92E. Similarly internal auditor cannot do examination.
- No separate guidelines have been prescribed for fees under section 92E.
- CA is required to give his opinion as to whether the particulars are "true and correct". True and correct means factual accuracy.
- The accountant should obtain all the books of accounts/ info/ docs/ explanation etc. to enable him to discharge his responsibility in a satisfactory manner.
- In order that the accountant may be in a position to explain any question which may arise later on, it is necessary that he should keep detailed notes about the evidence on which he has relied upon while conducting the examination and also maintain all his working papers.
- The accountant must ensure that he receives MRL in respect of all oral representations explicitly or implicitly given to him.

# Transfer Pricing Audit – Guidance Note

- ‘Accounts and records’ to be examined solely in relation to ‘International Transactions’ &/or ‘Specified Domestic Transactions’ entered into by assessee during relevant PY
- Reconcile figures to be reported in 3CEB and those appearing under AS-18 disclosure
- Guidance note states TP auditor is not responsible for content of transactions and documentation maintained by the assessee.
- If proper documentation not maintained as per Rule 10D, auditor may need to qualify the report.
- Even where aggregate value of International transactions < 1 crore, assessee has to substantiate on basis of material in his possession. In these cases, auditor has to verify whether any material is available with the assesee in this regard and thereafter examine the same.

# Sub - Annexure to Form 3CEB

**Following are the relevant clauses for furnishing particulars regarding International Transactions:**

| **Clause No** | **Nature of Transaction** |
|---|---|
| Clause 10 | List of AE |
| Clause 11 | Tangible Property – RM / FG / FA |
| Clause 12 | Intangible property |
| Clause 13 | Services |
| Clause 14 | Lending or borrowing money |
| Clause 15 | Provision/ Receipt of Guarantee |
| Clause 16 | Capital financing |
| Clause 17 | Mutual Agreement/ arrangement |
| Clause 18 | Business restructuring / reorganizations |
| Clause 19 | Other transactions |
| Clause 20 | Deemed international transactions |

# Sub - Annexure to Form 3CEB

**Following are the relevant clauses for furnishing particulars regarding Specified Domestic Transactions:**

| Clause No | Nature of Transaction |
|---|---|
| Clause 21 | List of AE |
| Clause 22 | Transfer of goods/services by unit/undertaking u/s 80A(6), 80IA(8). 10AA |
| Clause 23 | Any transaction resulting into more than ordinary profits by unit/undertaking u/s 80IA(10)/10AA |
| Clause 24 | SDT in the nature of any business transacted between person referred to in 115BAB(6) which has resulted into more than ordinary profits |
| Clause 25 | Any other transactions |

# Safe Harbour Rules

# Safe Harbour – Section 92CB

- A "Safe Harbour" is defined as circumstances in which the tax authority shall accept the transfer price declared by the taxpayer.
- CBDT issued the Safe Harbour rules on 18th September 2013, applicable for five years beginning from financial year (FY) 2012-13 to FY 2016-17.
- CBDT vide notification 46/2017 dated 7 June 2017 amended the Safe Harbour rules by extending the applicability to an additional category of international transaction as well as revising the applicable price/margins for almost all eligible international transactions that would be accepted as arm's length.
- Safe Harbour provisions was applicable from FY 2016-17 to FY 2018-19. Accordingly, for FY 2016-17 (i.e. the overlapping year), option to opt for more beneficial Safe Harbour.
- **Further, CBDT had extended the applicability of Safe Harbour provisions for FY 2019-20 & FY 2020-21 from time to time.**
- **For FY 2021-22, CBDT Notification dated 17th June 2022 provided that rates applicable from FY 2016-17 to FY 2018-19 will continue to apply for FY 2021-22 as well.**

# Safe Harbour Rules

<table>
<tr><th>Sr. No.</th><th>Eligible International Transactions</th><th>Safe Harbour Regime</th></tr>
<tr><td>1.</td><td>Provision of Software Development Services (SDS)</td><td>
<table>
<tr><th>International Transaction Value</th><th>Operating Profit/ Operating Expense %</th></tr>
<tr><td>≤ 100 Cr</td><td>≥ 17%</td></tr>
<tr><td>> 100 Cr but ≤ 200 Cr</td><td>≥ 18%</td></tr>
</table>
</td></tr>
<tr><td>2.</td><td>Provision of Information Technology Enabled Services (ITES)</td><td>
<table>
<tr><th>International Transaction Value</th><th>Operating Profit/ Operating Expense %</th></tr>
<tr><td>≤ 100 Cr</td><td>≥ 17%</td></tr>
<tr><td>> 100 Cr but ≤ 200 Cr</td><td>≥ 18%</td></tr>
</table>
</td></tr>
<tr><td>3.</td><td>Provision of Knowledge Process Outsourcing Services (KPOs)</td><td>
International Transaction Value should be ≤ 200 Cr
<table>
<tr><th>Employee Cost/ Operating Expense %</th><th>Operating Profit/ Operating Expense %</th></tr>
<tr><td>≥ 60%</td><td>≥ 24%</td></tr>
<tr><td>≥ 40% but < 60%</td><td>≥ 21%</td></tr>
<tr><td>< 40%</td><td>≥ 18%</td></tr>
</table>
</td></tr>
</table>

# Safe Harbour Rules

<table>
<tr><th>Sr. No.</th><th>Eligible International Transactions</th><th>Safe Harbour Regime</th></tr>
<tr><td>4.</td><td>Advancing of Intra-group loans in INR</td><td>Benchmark rate should not be less than 1 year SBI MCLR as on 1st April of the relevant previous year plus:
<table>
<tr><th>CRISIL rating</th><th>Credit spread over Benchmark rate</th></tr>
<tr><td>AAA to A or equivalent</td><td>1.75%</td></tr>
<tr><td>BBB-, BBB or BBB+ or its equivalent</td><td>3.25%</td></tr>
<tr><td>BB to B or its equivalent</td><td>4.75%</td></tr>
<tr><td>C to D or its equivalent</td><td>6.25%</td></tr>
<tr><td>Rating not available and amount of loan to all AEs ≤ 100 Cr</td><td>4.25%</td></tr>
</table>
</td></tr>
</table>

# Safe Harbour Rules

<table>
<tr><th>Sr. No.</th><th>Eligible International Transactions</th><th>Safe Harbour Regime</th></tr>
<tr><td>5.</td><td>Advancing of Intra-group loans in Forex</td><td>Benchmark rate should be 6-month LIBOR of relevant foreign currency as on 30<sup>th</sup> September of the relevant previous year plus:
<table>
<tr><th>CRISIL rating</th><th>Credit spread over Benchmark rate</th></tr>
<tr><td>AAA to A or equivalent</td><td>1.5%</td></tr>
<tr><td>BBB-, BBB or BBB+ or its equivalent</td><td>3%</td></tr>
<tr><td>BB to B or its equivalent</td><td>4.5%</td></tr>
<tr><td>C to D or its equivalent</td><td>6%</td></tr>
<tr><td>Rating not available and amount of loan to all AEs ≤ INR 100 Cr</td><td>4%</td></tr>
</table>
</td></tr>
</table>

# Safe Harbour Rules

<table>
<tr><th>Sr. No.</th><th>Eligible International Transactions</th><th>Safe Harbour Regime</th></tr>
<tr><td>6.</td><td>Providing Corporate Guarantee</td><td>Guarantee Commission/ Fee ≥ 1% p.a. of the amount guaranteed</td></tr>
<tr><td>7.</td><td>Provision of contract R&D services wholly or partly relating to software development</td><td><table><tr><th>International Transaction Value</th><th>Operating Profit/ Operating Expense %</th></tr><tr><td>≤ 200 Cr</td><td>≥ 24%</td></tr></table></td></tr>
<tr><td>8.</td><td>Provision of contract R&D services wholly or partly relating to generic pharmaceutical drugs</td><td><table><tr><th>International Transaction Value</th><th>Operating Profit/ Operating Expense %</th></tr><tr><td>≤ 200 Cr</td><td>≥ 24%</td></tr></table></td></tr>
<tr><td>9.</td><td>Manufacture and export of core auto components</td><td>Operating profit margin ≥ 12%</td></tr>
<tr><td>10.</td><td>Manufacture and export of non-core auto components</td><td>Operating profit margin ≥ 8.5%</td></tr>
<tr><td>11.</td><td>Receipt of low value-adding intra-group services</td><td>Value of International Transaction (including mark-up of ≤ 5%) ≤ 10 Crores<br>(Provided methods & calculations are certified by an accountant)</td></tr>
</table>

# Secondary Adjustment

# Secondary Adjustments

| | |
|---|---|
| **What** | Section 92CE(1) read with 92CE(3)(v) requires secondary adjustment in the books of the taxpayer, in whose hands the primary adjustment is made, to reflect actual allocation consistent with transfer price which led to primary adjustment |
| **When** | Secondary adjustment is to be done if the primary adjustment results in **increase in total income or reduction in loss of the Assessee** either on account of :<br>➢ Suo moto adjustment in ROI<br>➢ Addition by AO accepted by taxpayer<br>➢ Determination by APA<br>➢ Determination pursuant to safe harbour rules<br>➢ Resolution under MAP methodology` |
| **How** | ➢ **“Excess money”** available with AE to be actually repatriated to India<br>➢ If not repatriated within prescribed time limit, such “excess money” shall be deemed to be an advance by the Assessee to its AE<br>➢ Interest on such advance shall be computed in the manner as may be prescribed |
| **Applicability** | Section 92CE shall apply if:<br>Amount of primary adjustment in any previous year exceeds INR 1 crore;<br>**and**<br>Primary adjustment pertains to AY 17-18 and onwards |

# Secondary Adjustments

| | |
|---|---|
| **Excess money** | ALP in primary adjustment − Actual value of international transaction = Excess Money |
| **Primary Adjustment** | ➢ Transfer price<br>➢ Determined in accordance with Arms Length Principle<br>➢ Resulting in an increase in the total income of Assessee or<br>➢ Resulting in a reduction in the losses of Assessee |
| **Secondary Adjustment** | ➢ Adjustment in books of accounts of Assessee and its AEs to reflect that the actual allocation of profits between the assessee and its AE are consistent with the transfer price determined as a result of primary adjustment, thereby removing the imbalance between cash account and actual profit of Assessee |

# Secondary Adjustments

- Notification No. 52/2017 dated 15 June 2017: rules for implementing secondary TP adjustment prescribing time limit for repatriation and manner of computing interest on deemed advance amount.

| **Type of primary adjustment** | **Time limit for repatriation** | **Applicable interest rate for delayed receipts** | |
|---|---|---|---|
| | | Transaction in Indian Rupee | Transaction in Foreign Currency |
| **Adjustment made by Indian Tax Authority and accepted by the taxpayer** | On or before 90 days from the date of relevant order | 1-Year Marginal Cost of fund Lending Rate (MCLR) of SBI as on 1st April of relevant Financial Year (FY) (+) 325 basis points | 6-Month London Interbank Offered Rate (LIBOR) as on 30th September of relevant FY (+) 300 basis points |
| **Suo-moto adjustment by the taxpayer** | On or before 90 days from due date of filing return of income | | |
| **Adjustment pursuant to APA, Safe Harbour or MAP** | | | |

# Secondary Adjustments

- Section 92CE further provides that in case assessee has not repatriated excess money within the prescribed time period then assessee may pay additional income tax @ 18% on such excess money.
- The tax on the excess money so paid by the assessee shall be treated as the final payment of tax in respect of the excess money not repatriated.
- Further no credit shall be claimed by the assessee or by any other person in respect of the amount of tax so paid.
- No deduction under any other provision of this Act shall be allowed to the assessee in respect of the amount on which tax has been paid on excess money.
- In such a case assessee shall not be required to make secondary adjustment or compute interest from the date of payment of such tax.
- **Accordingly taxpayers have three broad options:**
  1. Bring in excess money within 90 days
  2. Delay in receipt of excess money + Pay interest for delay
  3. Pay tax @ 18% upon expiry of 90 days

# Documentation requirements under Income Tax Act

# Section 92D read with Rule 10D

- Mandatory documentation requirements in case where aggregate of international transactions, as recorded in the books, exceeds Rs. 1 crore.
- Even in cases where aggregate value of international transactions is below Rs. 1 crore, assessee is required to maintain adequate material to substantiate the arm's length nature of the transactions.
- Fresh documentation need not to be maintained separately in each previous year unless there is a significant change in nature and terms of international transaction.
- Documents to be maintained for 8 years from the end of the assessment year.
- New 3 tiered approach suggested by OECD's BEPS Action Plan 13 – Master File + Local File + Country-by-Country Report

# Documents and Information to be maintained

| Rule 10D | Provision | Reference to TP Documentation |
|---|---|---|
| (a) | Description of ownership structure | Group Overview |
| (b) | Profile of multinational group | |
| (c) | Broad description of business and industry of the assessee and AE | Group Overview and Industry Overview |
| (d) | Nature and terms (incl. prices) of international transactions | Economic Analysis + respective documents |
| (e) | FAR analysis | FAR Analysis |
| (f) | Record of economic and market analyses, forecasts, budgets etc. | Respective documents in separate files |

# Documents and Information to be maintained

| Rule 10D | Provision | Reference to TP Documentation |
|---|---|---|
| (g) | Record of uncontrolled transactions | Economic Analysis + relevant appendices |
| (h) | Evaluating comparability of uncontrolled transaction with relevant international or domestic transaction | |
| (i) | Description of methods considered and selection of most appropriate method | |
| (j) | Relevant working for determining arm's length price | |
| (k) | Factors affecting determination of arm's length price | Respective documents in separate files (if any) |
| (l) | Details of adjustments | |
| (m) | Any other relevant information for determination of arm's length price | |

# CbCR – Sec. 286

- Finance Act 2016 inserted Section 286 relating to filing of CbCR
- **Parent entity** means a constituent entity, of an international group holding, directly or indirectly, an interest in one or more of the other constituent entities of the international group such that –
  - It is required to prepare a **consolidated financial statement** under any law for the time being in force or the accounting standards of the country or territory in which the entity is resident; or
  - It would have been required to prepare a consolidated financial statement had the equity shares of any of the enterprises were listed on a stock exchange
- **Constituent entity** means –
  - Any separate entity of an international group that is included in the consolidated financial statement of the said group.
  - Any such entity that is excluded from the consolidated financial statement solely on the basis of size or materiality.
  - Any permanent establishment of any separate business entity.

# Master File- Rule 10DA

- ❑ Constituent Entity to file if:
- ➢ Consolidated Revenue of the International Group in Preceding accounting year > INR 500 crores

AND

- ➢ Aggregate value of International Transaction in Reporting Year As per Books of Accounts > INR 50 crores OR Aggregate value of International Transaction in Reporting Year in relation to Intangible property > INR 10 crores

## ❖ MasterFile Forms and Timelines

| **Particulars** | **Form** | **Timelines** |
|---|---|---|
| Every constituent entity of an international group | Form 3CEAA (Part A) | On or before filing due date of return of income |
| Constituent entity of the international group satisfying the above threshold | Form 3CEAA (Part A & B) | On or before filing due date of return of income |
| Multiple constituent group entities in India (Intimation) | Form 3CEAB | 30 days prior to filing return of income |

# Master File- Rule 10DA

**Constituent entity should keep and maintain the following information:**

- List of all the entities of the group
- Organisation structure – legal & ownership along with location
- General description of business including
  - Important drivers of business profit
  - Description of supply chain for + 5 pdts / >5% of consolidated group revenue
  - Important intra group services
  - Description of main service provider within the group
  - TP policy for allocation of cost and determination of price to paid
  - Main geographies of product/services offered
  - FAR of all the CEs that contribute > 10% revenue/assets/profit of the group
  - Important business restructuring transactions
- Groups overall strategy for the development of intangible
- List of all the entities of the group engaged in development/management of intangible property along with their address
- List of important intangibles & name of entity within group who owns it
- Important agreement related to intangibles such as CCA, R&D service / license agmt
- TP policy related to R&D and intangibles
- Important transfers of intangibles
- Description of financing arrangements including name & address of top 10 unrelated lender
- List of group entities that provide central financing functions & their POEM
- TP policy related to financing functions
- Consolidated financial statements
- Existing unilateral APAs and other rulings relating to allocation of income

# Country by Country Reporting (CbCR) - Rule 10DB

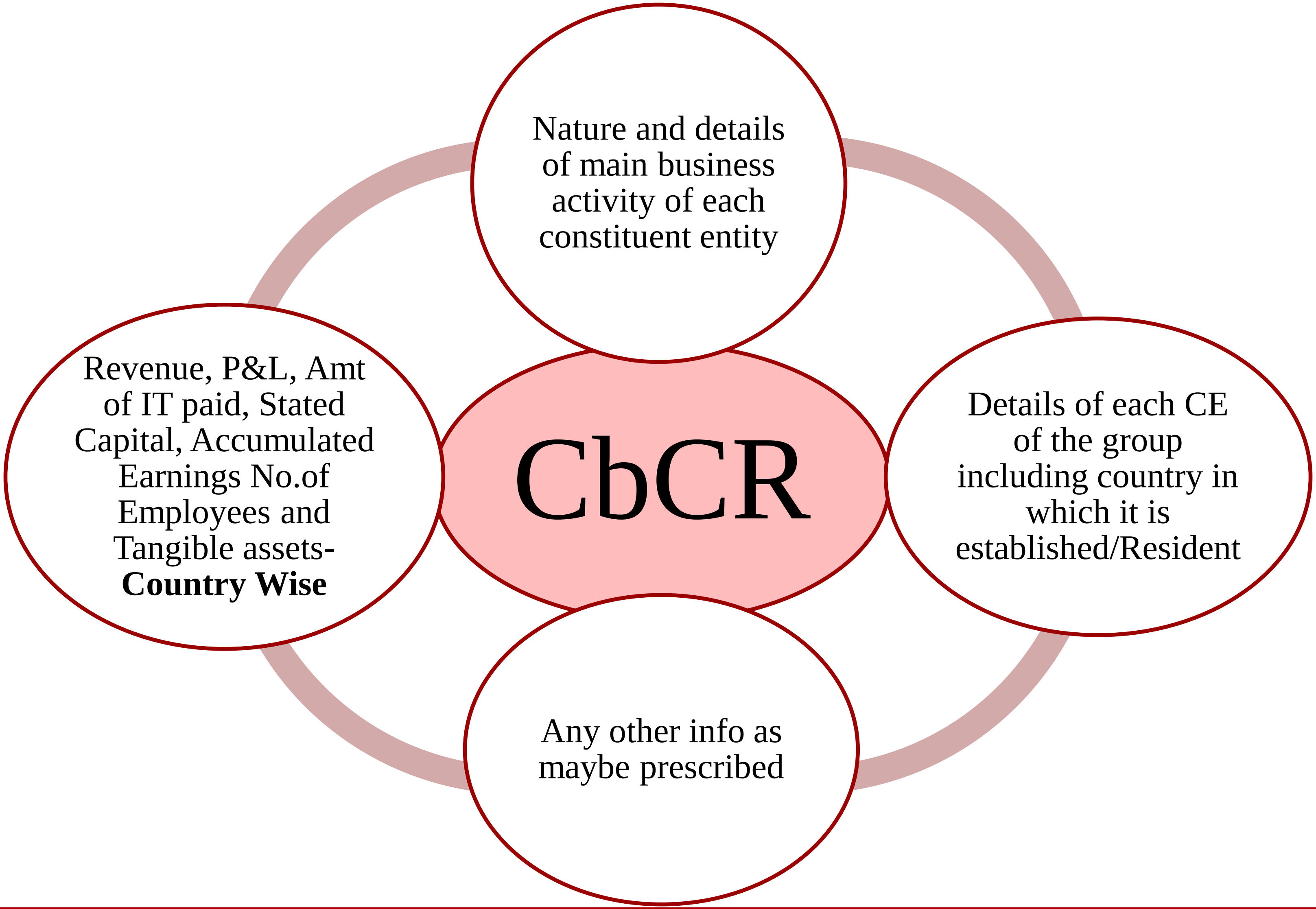
## ❖ CbCR Applicability

| Particulars | Threshold | Data to be considered |
|---|---|---|
| Consolidated Revenue of International Group | INR 6400 Crore | Preceding Accounting Year |

## ❖ CbCR Forms and Timelines

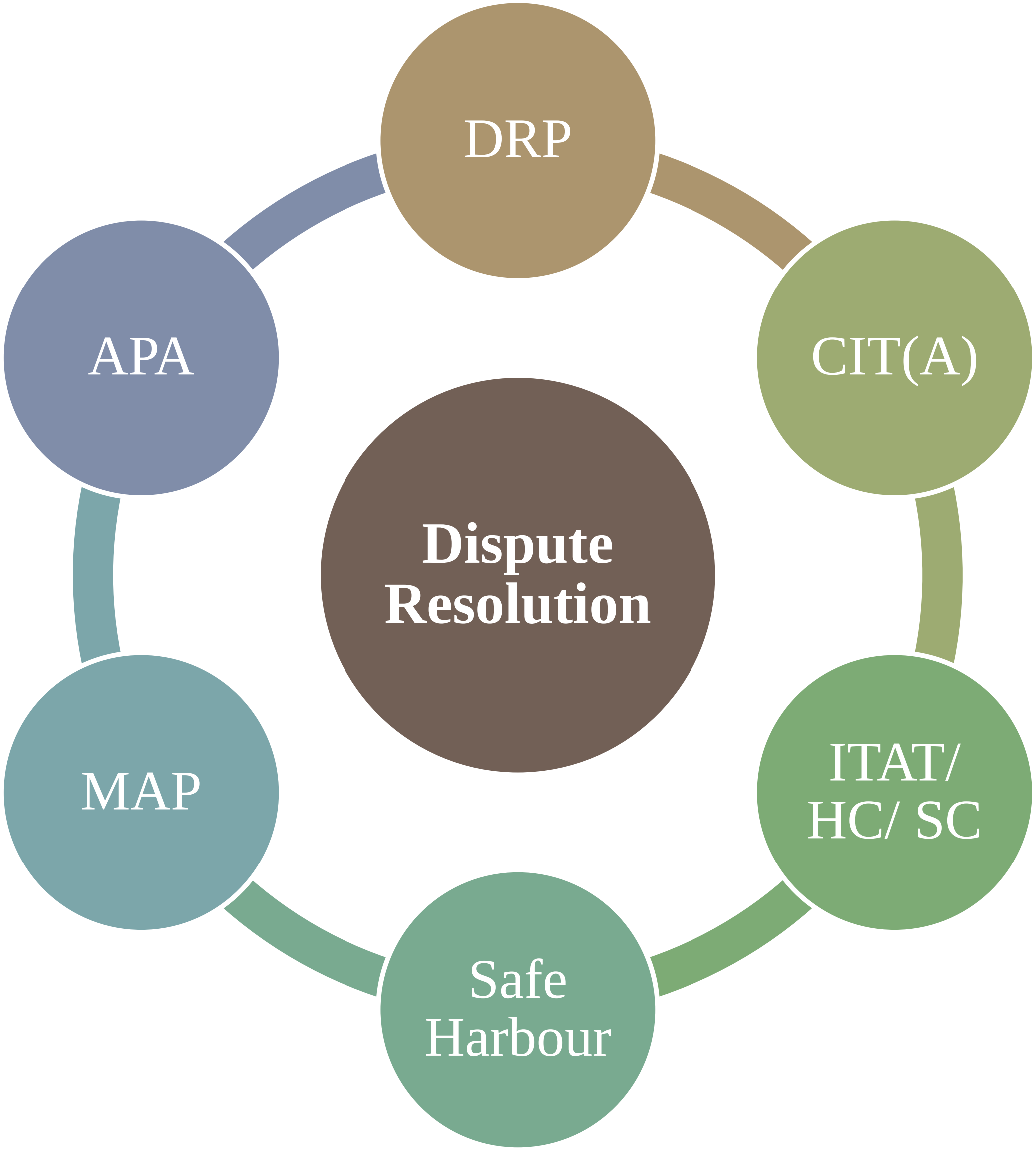
| Particulars | Form | Timelines |
|---|---|---|
| Intimation by Indian resident constituent entity : details of parent entity / alternate reporting entity which will file CbCR | Form 3CEAC | 2 Months prior to filing CbCR |
| Filling CbCR - Every parent entity or the alternate reporting entity resident in India (where parent is resident of country having no EOI for CbCR with India) | Form 3CEAD | Within 12 months from the end of reporting accounting year |
| Intimation of Multiple constituent group entities in India | Form 3CEAE | 2 Months prior to filing CbCR |

# Country by Country Reporting (CbCR) - Rule 10DB



# Advance Pricing Agreement (APA)

# Dispute Resolution Mechanism



# What is Advance Pricing Agreement?

- Advance Pricing Agreement ('APA') provisions were introduced in the Income-tax Act w.e.f. 1 July 2012. The rules in respect of the APA scheme have been notified by way of insertion of Rule 10F to Rule 10T and Rule 44GA in the Income-tax Rules, 1962.
- APA is an agreement between a tax payer and tax authority determining the transfer pricing methodology for setting up transfer price for the tax payer's international transactions for future years.
- The methodology is to be applied for a certain period of time based on the fulfillment of certain terms and conditions called critical assumptions.
- Critical assumptions means the factors and assumptions that are so critical and significant that neither party entering into an agreement will continue to be bound by the agreement, if any of the factors or assumptions is changed.
- Any person who has undertaken an international transaction or is contemplating to undertake an international transaction can apply for APA filing. [w.e.f. 01/04/20, APA also applicable for determination of profit attribution of NR in India]
- APA valid for period specified – Max 5 consecutive years.
- Rollback provision for prior 4 years.

# Types of Advance Pricing Agreement

**Unilateral APA**

- APA that involves tax payer & tax authority of country of taxpayer

Bilateral APA

- APA that involves taxpayer, AE of taxpayer, tax authority of country of taxpayer as well as of AE

Multilateral APA

- APA that involves taxpayer, 2 or more AEs of taxpayer, tax authority of country of taxpayer as well as of AEs

# Benefits & Scope of APA

- **Benefits of APA:**
  - Certainty with respect to international transaction of taxpayer
  - Avoids TP Litigation
  - TP Documents relief for APA period
  - Solution to complex transfer pricing issues
  - Reduction of TP compliance cost
  - For tax authority, reduced cost of administration
  - Reduce potential risk of double taxation
- **Scope of APA:** An APA among other thing includes:
  - International transaction covered by the agreement
  - Agreed TP methodology
  - Determination of ALP
  - Definition of relevant term
  - Rollback provision
  - Critical assumption & other conditions

# Rollback of the Agreement

- The Finance (No.2) Act, 2014 introduced the rollback provision under the APA programme.
- Option for taxpayer to rollback terms of APA for previous 4 years preceding the first year covered in the APA.
- Condition to be fulfilled:
  - International transaction same as covered in APA
  - Return of income for rollback years furnished before due date
  - Report in respect of international transaction has been furnished u/s 92E
  - Request for rollback for all years
  - Application in 3CEDA
- Rollback shall not be provided if:
  - Determination of ALP for such year has been subject matter of appeal and AT has passed the order on the same
  - It has effect of reducing total income or increasing the loss

# Typical APA Process

**Pre-filing**

Optional Pre-filing consultation to determine scope, TP issues, terms etc

**Filing of APA App.**

Application for APA in Form 3CED accompanied by fees as specified

**Accept/ Reject**

In case of any defect or relevant docs not attached, application may be rejected.

**Action by AO/ TPO**

Assessment proceedings by AO/ TPO continue w/o taking cognizance

**Amendment of AP**

Applicant may request in writing for amendment to its application

**Assignment of APA**

If an application is allowed, APA application will be assigned to APA Team

**Examination**

APA Team or competent authority will examine and analyze APA app

**Conversion**

Conversion of Unilateral APA to Bilateral APA possible

**Enter into APA**

Enter into Unilateral APA with the approval of CG

**Bilateral APA**

Negotiation by the competent authority and enter into APA

# Revision/ Cancellation/ Renewal of APA

**<u>Revision of APA</u>**

- Rule 10Q
- May be revised if there is change:
  - Critical assumption
  - Law
  - Request from competent authority of foreign country in case of bilateral/ unilateral APA

**<u>Cancellation of APA</u>**

- Rule 10R
- Shall be cancelled if:
  - Failed to file annual compliance
  - Annual compliance filed contains material error
  - Taxpayer failed to comply with terms of APA

**<u>Renewal of APA</u>**

- Rule 10S
- Request for renewal as new application
- Pre-filing not required

# Transfer Pricing Assessment

# Building Blocks for TP Assessment

### Assessment Units – Section 144B(3)(iii)

- Functions of assessment including identification of material issues/ seeking info or clarification/ analysis of the material furnished

### Verification Units – Section 144B(3)(iv)

- Function of verification including enquiry/ cross verification/ examination of books of account & witness/ recording of statements etc.

### Technical Units – Section 144B(3)(v)

- Function of technical assistance such as advice on legal, accounting, forensic, information technology, valuation, transfer pricing, data analytics, management or any other technical matter

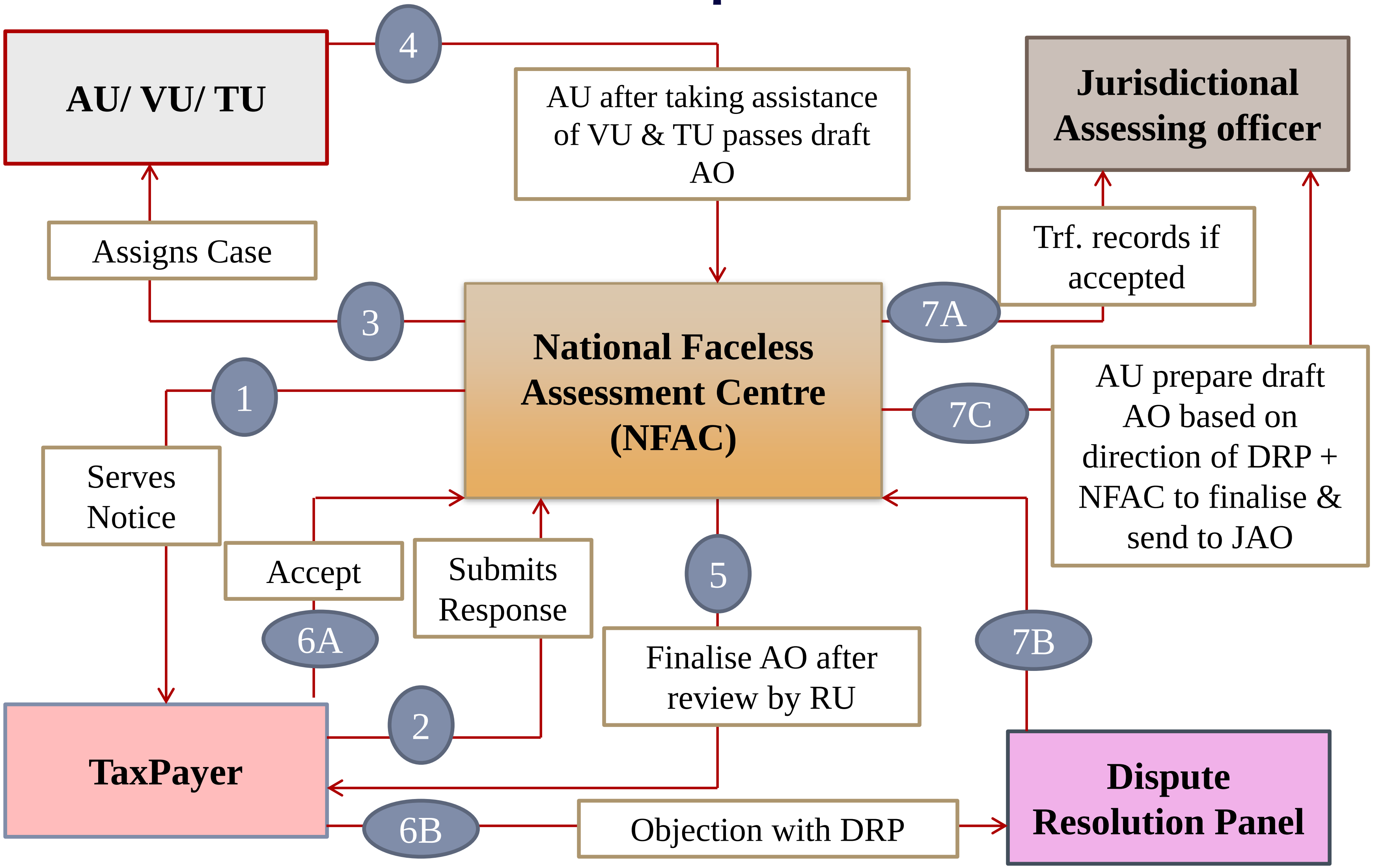
### Review Units – Section 144B(3)(vi)

- Function of reviewing draft assessment order/ check docs on record/ relevant point of law incorporated/ issue addition or disallowance

### Dispute Resolution Panel – Section 144C

- To facilitate expeditious resolution of disputes, DRP has been constituted

# Faceless Assessment Procedure w.e.f. AY 21-22– Simplistic Overview



Sincere Acknowledgement:

Naisar Shah

# Thank you