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Transfer Pricing

The Indian Landscape & Recent Developments

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Transfer Pricing –
The Indian Landscape & Recent Developments

Includes:

- Recent developments
- Applicability, Approach, Compliance and Documentation requirements under TP regulations
- Transfer Pricing Compliance Calendar
- Landmark TP judgments
- Transfer pricing under different regulations in India
- List of countries with transfer pricing regulations

Preface

The Transfer Pricing regulations primarily deal with the "International transactions" between "Associated Enterprises". The Indian tax regulations require that these transactions are carried out at "Arm's Length Prices" and require maintenance of extensive documentation and reporting to the tax authorities. While the Transfer Pricing regulations have been introduced in India in 2001, there are several changes in the regulations as well as measures by the Indian Government to reduce litigation such as Advance Pricing Agreements / Safe Harbour Regulations / Scheme for settlement of litigation and disputes. There have been administrative circulars and judicial verdicts which provide important guidance regarding the application of law in practice. A deep understanding of all these aspects is absolutely crucial for any business having International transactions with Associated Enterprises to ensure proper contractual arrangements and minimize tax exposure. The Transfer Pricing regulations have particular relevance for the Information Technology and Back Office Services, Pharma / Metallurgical / Auto / Engineering industry / Gems & Jewellery industry and BFSI sector as these businesses inherently have global operations and international transactions.

The Organisation for Economic Co-operation and Development (OECD's) and the Group of 20 major economies (G20) adopted 15 Action Plans to address the issue of Base Erosion and Profit Shifting (BEPS), now called BEPS 1.0. In the year 2017, India adopted the BEPS 1.0. However, BEPS 1.0 was not able to address tax avoidance and bring in transparency to the tax regulations worldwide. OECD brought about BEPS 2.0 which has a two pillar approach to help address tax avoidance, ensure coherence of international tax rules, and thus create a more transparent tax environment. BEPS 2.0 also looks to address the challenges arising from the taxation of the digital economy. Although OECD has been trying to obtain consensus for the two pillar approach it has been successful to a limited extent in getting major countries to agree to Pillar Two: Global Minimum Taxation.

The Transfer Pricing regulations adopted Action Plan 13 in respect of Country by Country Report and Master file.

The Finance Ministry with a view to reduce cases under audit and to reduce litigation has introduced certain far reaching measures to move away from a quantitative basis for selection of cases for transfer pricing audit to a risk based system. This has reduced the

cases under audit and litigation to a significant extent.

The Indian Government has taken several measures to reduce the compliance and litigation burden for taxpayers. The Safe Harbour Rules (SHR) have been extended to FY 2022-23 (it is anticipated that the SHR would be extended to FY 2023-24, but this needs to be watched out for). In the Financial Year 2023-24, the Central Board of Direct Taxes (CBDT) set a new record by entering into 125 Advance Pricing Agreements (APAs) with Indian taxpayers, comprising 86 Unilateral APAs (UAPAs) and 39 Bilateral APAs (BAPAs). This achievement marks the highest number of APA signings in any financial year since the inception of the APA programme. Compared to the previous fiscal year, there has been a significant increase of 31% in the number of APAs signed. This brings the total number of APAs since the initiation of the programme to 641, consisting of 506 UAPAs and 135 BAPAs. In view of the same, it appears that APAs have become a serious option to reduce potential tax exposure and litigation.

There have been certain landmark judicial verdicts which provide valuable insights regarding application of the Transfer Pricing regulations which have been discussed in this publication. Finally, Transfer Pricing regulations are not only confined to the income-tax regulations but also extend to the GST laws, customs regulations, company law, FEMA and accounting standards which at times have divergent objectives and hence, a careful consideration of the applicable regulations and taking a considered position becomes crucial.

In this publication, we have endeavored to provide an overview of the transfer pricing regulations 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 minimized.

Happy Reading!

May 2024

Table of Contents

Contents	Particulars	Page
Part A: Transfer Pricing – Recent Developments		
Chapter 1	Recent Developments	2
Chapter 2	Certain Recent Judicial Verdicts under Transfer Pricing Regulations	4
Chapter 3	Countries having Comprehensive Transfer Pricing Regulations	13
Part B: Transfer pricing regulations		
Chapter 4	Background	16
Chapter 5	International Transactions – Provisions and Definitions	22
Chapter 6	Domestic Transfer Pricing Regulations	30
Chapter 7	Methods and Computation of Arm's Length Price	36
Chapter 8	Comparability Analysis	54
Chapter 9	Documentation Requirements	56
Chapter 10	Penalties	61
Chapter 11	Transfer Pricing Assessment Procedure	63
Chapter 12	Transfer Pricing Compliance Calendar	68
Part C: BEPS and Secondary Adjustment		
Chapter 13	Base Erosion and Profit Shifting (BEPS)	70
Chapter 14	Secondary Adjustment	79
Part D: Alternative Resolution Mechanism		
Chapter 15	Safe Harbour Rules	84
Chapter 16	Advanced Pricing Agreements & Mutual Agreement Procedure	92
Part E: Judicial Pronouncement and other developments		
Chapter 17	Landmark Judicial Pronouncements	97
Chapter 18	Transfer Pricing — Multiple Regulations – Income-tax Act, GST, Customs, Company Law & FEMA	123
	Abbreviations	134

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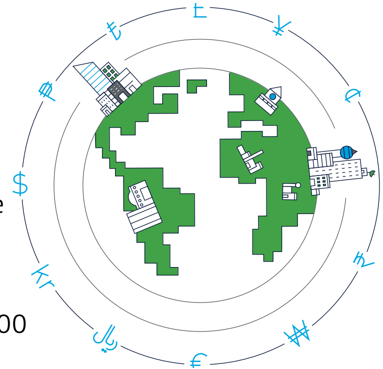
Part A : Transfer Pricing – Recent Developments

1.1 Increase in Threshold for Country-By-Country Reporting



The provisions relating to filing of Country-By-Country Reporting (CbCR) shall be applicable in case where the total consolidated group revenue of the international group is equal to or greater than INR 6,400 Crores (INR 64,000 million). The earlier threshold was INR 5,500 crores (INR 55,000 million).

The CbCR 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. 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 prescribed information.

1.2 Time limit for submission of CbCR extended

The Finance Act 2018 has extended the time limit for furnishing of CbCR to 12 months from the end of the reporting accounting year. Therefore, the due date may vary for each case depending on the reporting accounting year for each taxpayer to whom CbCR provisions are applicable.

1.3 Applicability of APA / SHR in respect of Attribution of Profits of a PE

In the Finance Act 2020, CBDT has clarified that it is possible for a taxpayer to file an APA in relation to profit attribution to a PE, provided the taxpayer formally conceded the existence of a PE.

To address uncertainty surrounding profit attribution for business connections or Permanent Establishments (PEs), the Income Tax Law (ITL) has been amended.

This amendment provides taxpayers with an option to either apply for Safe Harbour Rules, or for Advance Pricing Agreements (APAs) for profit attribution.

The Income Tax Act, 1961 (hereinafter referred to as 'the Act') further provides that in the case of an APA, income attributable to a PE may be determined based on the methods prescribed under TP rules or as per the methods provided by rules made under the Act, with such variations or adjustments as required.

1.4 Amendment of SHR in respect of advancing of loans to Associated Enterprises (AE) in foreign currency

The CBDT vide **Circular no 716 dated 19 December 2023** has amended SHR in respect of advancing of loans to AE's in foreign currency.

The amendment has tweaked the definition of intra-group loans and also removed the condition of sourcing the loan only in Indian rupees. The amendments will come into effect from April 1, 2024 i.e. for Financial Year 2023-24 relevant to the Assessment Year 2024-25.

Chapter 2 Certain Recent Judicial Verdicts Under Transfer Pricing Regulations

The important issues arising out of Transfer Pricing regulations have been discussed under the respective chapters and the discussion here is confined to certain latest judicial ruling having general and wider applicability. Chapter 17 contains detailed analysis of other Transfer Pricing issues that have been dealt in course of judicial rulings.

2.1 Comparability Analysis for Determining the ALP

2.1.1 Issue

The process of identifying a Comparable Uncontrolled transaction and determination of ALP involves various aspects – such as selection of the most appropriate method, comparability parameters and filters, comparable companies, comparability adjustments, etc. The ALP determination, because of its significance in TP analysis, has given rise to substantial number of TP disputes. These disputes originate at the Transfer Pricing Officer ('TPO')/ Assessing Officer ('AO') level and then make their way to Income-Tax Appellate Tribunal ('Tribunal') wherein the Tribunal is usually considered as the final 'fact finding' authority on such ALP disputes. The issue before consideration was that in every case where the Tribunal determines the ALP, the same shall attain finality and Hon'ble High Court ('HC') is precluded from considering the determination of the ALP determined by the Tribunal, in exercise of powers under Section 260A of the Act.

2.1.2 Judicial Pronouncements:

Recently in case of **SAP Labs India Pvt. Ltd. [TS-225-SC-2023-TP],** the Hon'ble Supreme Court ('SC') held that any determination of the ALP under Chapter X of the Act de hors the relevant TP provisions in the Act and the Income Tax Rules, 1962 (hereinafter referred to as 'the Rules'), can be considered as perverse and it

may be considered as a substantial question of law as perversity itself can be said to be a substantial question of law. It was held that there cannot be any absolute proposition of law that in all cases where the Hon'ble Tribunal has determined the ALP, the same shall be final and cannot be subject matter of scrutiny by the Hon'ble HC in an appeal under Section 260A of the Act. The Hon'ble HC should examine whether the TP guidelines laid down in the Act and the Rules are followed while determining the ALP and therefore, the determination of the ALP by the Tribunal would not be final and can be a subject matter of scrutiny.

2.1.3 Precautionary measure:

In view of the above Hon'ble SC judgement, taxpayers need to ensure that they are documenting and clearly distinguishing factual contentions and legal contentions before the Indian tax authorities. Taxpayers with a history of TP litigation should evaluate the feasibility of alternative options for dispute resolution/ prevention, such as Safe Harbour, APAs etc. to avoid the long-drawn litigation process.

2.2 Marketing Intangibles

2.2.1 Issue

The contours of the controversy are that the taxpayer has incurred Advertising Marketing Promotion ('AMP') expenditure in the course of its business operations. The issue herein pertains to the following legal and economic considerations:

- The AMP expenditure incurred is an international transaction of provision of service by the taxpayer to its overseas AE, for which the taxpayer should have been compensated by the AE.
- The AMP expenditure has been incurred for and on behalf of AE who is the legal owner of the brand which the taxpayer is promoting in India.
- The taxpayer is creating a marketing intangible by enhancing the value of the brand owned by the AE.
- Any excess expenditure incurred (non-routine) in comparison to expenditure incurred by other comparable companies is regarded as a

separate international transaction of provision of service (based on the **Bright Line Test**).

2.2.2 Judicial Pronouncements:

The said issue was first legally examined in 2013 by the Special Bench of Hon'ble 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. On AMP expenses, the Tribunal held 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 for the foreign AE.

The Hon'ble Tribunal further concluded that the transaction of brand building by the taxpayer for AE is in the nature of the "provision of service" requiring a mark-up. Moreover, the Tribunal also endorsed the use of the Bright Line test to determine the transaction value of such AMP expenses. The Tribunal held that Section 92 of the Act is much wider in its ambit and TP provisions are special provisions and once there is an international transaction, these provisions shall prevail over the general provisions of section 37(1) of the Act. The Tribunal also provided broad guidance on various factors that needs 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.

In 2015, the Hon'ble Delhi HC in the case of **Sony Ericsson Mobile Communications India Pvt. Ltd. [(2015) 55 taxmann.com 240 (Delhi)]** adjudicating on the issue of marketing intangibles for taxpayers engaged in marketing and distribution functions held that AMP expenses incurred by a subsidiary of multinational enterprise can be categorised as an international transaction subject to TP provisions. It held that marketing and distribution activities 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 an aggregate basis. The Hon'ble HC overruled the application of the bright line test and concluded that it would be illogical and improper to treat AMP expenses as a separate transaction using the bright line test method.

Hon'ble Delhi HC also recognised the concept of economic ownership of trade name/ trademark is acceptable in international taxation as one of the components or aspects for determining TP. The Hon'ble HC has further stated that economic ownership would arise only in cases of long-term contracts and where there is no negative stipulation denying economic ownership.

However, later in 2015, a contrary view was held by the Hon'ble Delhi HC in case of **Maruti Suzuki Ltd. [ITA No. 110/2014],** on the issue of marketing intangibles for licensed manufacturers wherein it concluded that the AMP expenses incurred cannot be considered as an international transaction and therefore no TP adjustment can be made on account of AMP expenses. It also held that the Bright Line test is not permitted by the law relying on the Sony Ericsson judgment.

Hon'ble Mumbai Tribunal in the case of **L'Oreal India Pvt Ltd [TS-829-ITAT-2019(Mum)-TP],** deleted the AMP adjustment finding that the Indian tax authorities failed to prove that the assessee had agreed to incur AMP expenses for brand building of its AE, viz. L'Oreal S.A, France. The Hon'ble Tribunal held that the mere fact that the taxpayer was permitted to use the brand name of its AE, would not automatically lead to an inference that any expense incurred towards AMP was only to enhance the brand of its AE.

While the Hon'ble SC has admitted a special leave petition filed by the Indian tax authorities against the Hon'ble Delhi HC judgment in Maruti Suzuki India Ltd., the same is yet to be adjudicated upon.

Some of the other relevant judicial pronouncements in context of AMP expenses are as under:

- Kellogg India (P.) Ltd. v. Assistant Commissioner of Income-tax [(2022) 139 taxmann.com 205]

- Lenovo India (P.) Ltd. v. Deputy Commissioner of Income-tax [(2023) 148 taxmann.com 237]
- Perfetti Van Melle India (P.) Ltd. v. Deputy Commissioner of Income-tax [(2023) 149 taxmann.com 27]
- Whirlpool of India Ltd. [(2023) 146 taxmann.com 136]
- Xerox India Ltd. v. Deputy Commissioner of Income-tax [(2022) 145 taxmann.com 416]

2.2.3 Precautionary measure:

The emphasis of the rulings is on substance over legal form. Accordingly, it is advisable for taxpayers to analyse as part of their inter-company policies and actual business conduct that there is no arrangement/ agreement implied or otherwise with the AE and the AMP related decisions are independently taken for the benefit of the taxpayer's business. Taxpayers should also evaluate their TP policy in light of detailed analysis of roles / responsibilities undertaken, risks borne/ reward reaped and robust documentation including legal contracts etc. needs to be maintained by the taxpayer.

2.3 Issuance of Corporate Guarantee on behalf of the AE

2.3.1 Issue

The Indian tax authorities are of the view that by providing a corporate guarantee to its AE, the Indian taxpayer has rendered service or provided a benefit to its AE, for which the Indian taxpayer should charge a guarantee fee. The rate/ quantum of guarantee fee that the taxpayer should receive is also a litigative question in the absence of any directive in the Indian TP regulations.

2.3.2 Judicial Pronouncements:

The Hon'ble Delhi Tribunal in the case of **Bharti Airtel Limited Vs. ACIT [TS-76-ITAT-2014(DEL)-TP]** observed that under 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 Hon'ble 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 Hon'ble Tribunal noted that the corporate 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. Accordingly, the Hon'ble Tribunal deleted the addition made on account of issuance of corporate guarantees stating that it does not constitute 'International transaction' within meaning of section 92B of the Act.

In the case of **Everest Kanto Cylinders Ltd [TS-714-ITAT-2012(Mum)-TP]** the Hon'ble Tribunal 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. It was 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.

Hon'ble Ahmedabad Tribunal in the case of **AIA Engineering Ltd [TS-9-ITAT-2021(Ahd)-TP]** held that the issue of corporate guarantee was in the nature of shareholder activity and the same could not be included in the provision for services under the definition of international transaction under section 92B of the Act. Placing reliance on **Micro Ink Limited [TS-568-ITAT-2015(Ahd)-TP],** the Hon'ble Tribunal held that these guarantees do not have any impact on profit, losses or assets of the assesse and therefore it is outside the ambit of international transaction under section 92B of the Act. It was further held that there can be a hypothetical situation in which a guarantee default takes place and therefore the enterprise may have to pay the guarantee amount but such a situation, even if that can be so, is only a hypothetical situation.

In the case of **Berger Paints India Ltd [TS-491-ITAT-2022(Kol)-TP],** Hon'ble Kolkata Tribunal upheld the adjustments made on guarantee commissions, stating that there was an inherent risk in providing guarantees and guarantee commissions payment is liable. The Hon'ble Tribunal rejected the contention that

the transaction cannot be considered an international transaction as it did not involve any cost and is a shareholder activity.

The Hon'ble Mumbai Tribunal in the case of **Macrotech Developers Ltd [TS-237-ITAT-2023 (Mum)-TP]** upheld the alternative benchmarking of taxpayer based on yield approach, derived after considering proper credit rating of AEs as TPO failed to account for tenor adjustment, currency swap and attribution of interest saved to contracting parties.

2.3.3 Precautionary measure:

Considering that the corporate guarantee provided by the taxpayer to its AE is a subject matter of litigation, it is advisable to document the terms of guarantee, rate charged, duration of guarantee etc. in the intercompany agreements.

2.4 Charging notional interest for delay in realization of sales proceeds from AEs

2.4.1 Issue

In case of excessive credit period allowed to AE's and delay in realization of sales proceeds from AE's as compared to Non-AE's, the Indian tax authorities are of the view that 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 AE's on excess amount outstanding or extended credit period.

2.4.2 Judicial Pronouncements

The Hon'ble Delhi Tribunal in the case of **Kusum Healthcare Pvt Ltd. [TS-129-ITAT-2015(DEL)-TP]** 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 Transactional Net Margin Method (TNMM), no further TP adjustment for interest on outstanding receivables is warranted.

The Hon'ble Delhi HC in the case of **Mckinsey Knowledge Centre India (P.) Ltd [TS-518-HC-2021(DEL)-TP],** held that under no TP norm, principle or evaluation of any "benefit" can there be a one-sided adjustment taking into account delayed invoices while at the same time ignoring invoices/payment received in advance.

Since amount received by assessee in advance from its AE far outweighed amount received late, thus there was no outstanding receivable from AE's to assessee, adjustment on account of notional interest was to be set aside.

The Hon'ble Ahmedabad Tribunal in the case of **Effective Teleservices Pvt Ltd [TS-223-ITAT-2023(Ahd)-TP]** held that where working capital adjustment takes into account the impact of outstanding receivables no further adjustment is required of interest on outstanding receivables of AE's beyond the agreed credit period if the margin of the assessee is comparable to that of external comparables. It was further held that there may be a delay in collection of money due to a variety of factors which will have to be investigated on case-to-case basis.

2.4.3 Precautionary measure

It is advisable to ensure realizations and payments within the normal credit period and maintain robust documentation to prove that the excess credit period, if allowed to AE, is due to specific business reasons.

2.5 Determination of Arm's Length Price (ALP) for a non-resident in India

2.5.1 Issue

Whether the TPO was correct in making an ALP adjustment to the income of the non-resident in India with respect to interest free loan granted to its wholly owned subsidiary in India that constitutes international transactional under the Indian TP laws.

2.5.2 Judicial Pronouncements

The Hon'ble Kolkata Tribunal Special Bench ruled in favor of the Indian tax authorities, in the case of **Instrumentarium Corporation Limited [TS-467-ITAT-2016(Kol)-TP]** by rejecting the argument of base erosion with respect to the interest free loan advanced by a non-resident assessee to its wholly owned subsidiary in India.

The assessee argued that the case was covered within the purview of section 92(3) of the Act, which states that the TP provisions shall not apply if the adjustment has the effect of reducing income or increasing losses of the assessee.

Further, assessee contended that since there is no erosion of tax base in India on account of receiving interest free loans from a non-resident entity, the provisions of TP could not be pressed into service in this case. Assessee also stated that the ALP adjustment could not be made in respect of income that has not been reported as International transactions.

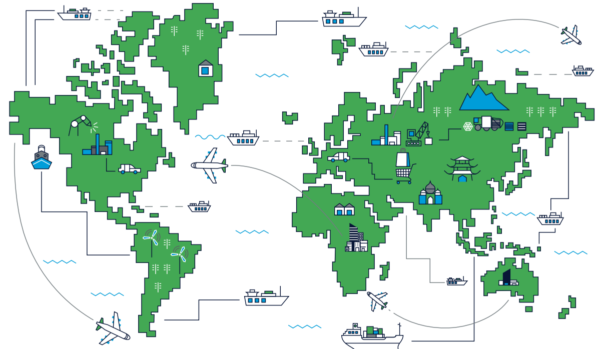
Special Bench rejected the arguments of the assessee stating that second proviso to section 92C(4) constitutes a bar against lowering income of the non-resident AE, as a result of lowering the deduction in the hands of the Indian AE, rather than enabling a higher deduction in the hands of the Indian AE as a result of increasing non-resident AE's income. The Special Bench further noted that the interest earned by the non-resident shall be taxable in India and accordingly, there is a loss to Indian tax authorities. The bench is of the view that it is quite uncertain for the Indian entity to earn sufficient profits in the coming eight assessment years that would subsume the losses within the purview of the Act. Special Bench opined that benefit of loss is not real and contingent on uncertain future event. Further, Special Bench taking plea of Vodafone India Services (P.) Ltd. V. Union of India [TS-621-HC-2015(BOM)-TP] rejected the view of the assessee and stated that even when no income is reported in respect of an item in the nature of income, such as interest, but the substitution of transaction price by arm's length price results in an income, it can very well be brought to tax under section 92 of the Act. Under the light of above arguments, Special Bench concluded the transactions under the purview of TP and accordingly, adjudicated the matter in favour of Indian tax authorities.

2.5.3 Precautionary measure

In view of the above, it is advisable to carefully frame the TP policy with respect to the international transactions between AE's. It is clear from the above verdict that the arm's length principle is to be separately applied on assessee as well as the non-resident AE. Going forward, taxpayers should resort to entering into bilateral APAs to avoid uncertainty.

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 1920's. 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 75 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.

Albania	Honduras	Panama
Angola	Hungary	Paraguay New
Argentina	Iceland	Papua New Guinea

Australia	India	Peru
Austria	Indonesia	Poland
Belgium	Ireland	Portugal
Bosnia and Herzegovina	Israel	Romania
Brazil	Italy	Russian Federation
Bulgaria	Jamaica	Saudi Arabia
Canada	Japan	Senegal
Chile	Kenya	Seychelles
China (People's Republic of)	Korea	Singapore
Colombia	Latvia	Slovak Republic
Costa Rica	Liberia	Slovenia
Croatia	Liechtenstein	South Africa
Czech Republic	Lithuania	Spain
Denmark	Luxembourg	Sri Lanka
Dominican Republic	Maldives	Sweden
Egypt	Malaysia	Switzerland
Estonia	Malta	Tunisia
Finland	Mexico	Turkey
France	Netherlands	Ukraine
Georgia	New Zealand	United Kingdom
Germany	Nigeria	United States
Greece	Norway	Uruguay

Part B :
Transfer Pricing
regulations

4.1 Background

4.1.1 The Finance Act, 2001 introduced the Transfer Pricing (TP) regime by introducing new sections 92A to 92F (w.e.f. 1 April 2002). The Transfer Pricing regulations primarily deals with the "International transactions" between "Associated Enterprises". The Indian tax regulations require that these transactions are carried out at "arm's length prices" and require maintenance of extensive documentation and reporting to the tax authorities. While the Transfer Pricing regulations have been introduced in India in 2001, there are several changes in the regulations as well as measures by the Indian Government to reduce litigation such as Advance Pricing Agreements, Safe Harbour Regulations and Scheme for settlement of litigation and disputes. There have been administrative circulars and judicial verdicts which provide important guidance regarding the application of law in practice. The Transfer Pricing regulations have particular relevance for the Information Technology and Back Office Services, Pharma / Metallurgical / Auto / Engineering industry / Gems & Jewellery industry and BFSI sector as these businesses inherently have global operations and international transactions.

4.1.2 The Organisation for Economic Co-operation and Development (OECD) and the Group of 20 major economies (G20) adopted 15 Action Plans to address the issue of Base Erosion and Profit Shifting (BEPS), now called BEPS 1.0. In the year 2017, India adopted the BEPS 1.0. However, BEPS 1.0 was not able to address the tax avoidance and bring in transparency to the tax regulations worldwide. OECD brought about BEPS 2.0 which has a two pillar approach to help address tax avoidance, ensure coherence of international tax rules, and thus create a more transparent tax environment. BEPS 2.0 also looks to address the challenges arising from the taxation of the digital economy. Although OECD has been trying to obtain consensus for the two pillar approach it has been successful to a limited extent in

getting major countries to agree to Pillar Two: Global Minimum Taxation.

4.1.3 The Transfer Pricing regulations adopted Action Plan 13 in respect of Country by Country Report and Master file. The Finance Ministry with a view to reduce cases under audit and to reduce litigation has introduced certain far-reaching measures to move away from a quantitative basis for selection of cases for transfer pricing audit to a risk based system. This has reduced the cases under audit and litigation to a significant extent.

4.1.4 The Indian Government has taken several measures to reduce the compliance and litigation burden for taxpayers. The Safe Harbour Rules (SHR) have been extended to FY 2023-24. In the financial year 2023-24, the Central Board of Direct Taxes (CBDT) set a new record by entering into 125 Advance Pricing Agreements (APAs) with Indian taxpayers, comprising 86 Unilateral APAs (UAPAs) and 39 Bilateral APAs (BAPAs). This achievement marks the highest number of APA signings in any financial year since the inception of the APA programme. Compared to the previous fiscal year, there has been a significant increase of 31% in the number of APAs signed. This brings the total number of APAs since the initiation of the programme to 641, consisting of 506 UAPAs and 135 BAPAs.

4.1.5 The relevant provisions are contained in Chapter X of the Act — Sections 92 to 92F and 94A of the Act and Rules 10A to 10THD of the Rules. In addition to this, a major change was introduced in the Finance Act, 2017, accordingly TP documentation and certification compliance requirements with respect to domestic expenditures covered under section 40A(2)(b) of the Act have been removed with effect from the Fiscal Year 2016-17. However, the Government correctly retained Transfer Pricing compliance requirements for computing profit linked incentives or tax holiday schemes, with a view to prevent the propensity to shift profits from non-tax holiday undertakings to undertakings enjoying tax holiday.[1]

4.1.6 India had introduced secondary adjustment provisions in TP, in line with similar provisions prevalent in some of the major countries.

4.1.7 In continuation to India's commitment to the BEPS Project, the Honourable Finance

[1] Source: tp.taxsutra.com

Minister introduced provisions for thin capitalisation in the Finance Act 2017 by insertion of Section 94B under the Act. Under thin capitalization, a company finances its operations through a high level of debt compared to equity and accordingly leads to significant adjustment in the profit reported for tax purpose.

The tax legislations of different countries including India, generally allow a deduction for interest paid or payable in arriving at the profit for tax purposes, whereas, no deduction is allowable for the dividend paid on equity contribution. Hence, in order to achieve maximum benefit, the non-resident investors and multinational groups tend to re-structure their financing arrangements.

For example, when a non-resident holding company finances an Indian subsidiary with INR 100 crore comprising of an equal mix of equity and debt, wherein the Indian subsidiary makes a profit of INR 25 crore along with an interest expense of INR 5 crore on debt, its taxable profit would be INR 20 crore after deducting the said interest of INR 5 crore of profit, if the entire financing was done through equity.

In order to curb such loss of revenue and streamline the investment flow, section 94B was introduced in the Act to restrict deduction towards payment of interest on a debt sourced from outside the country.

Section 94B, which was applicable from AY 2018—19 onwards, restricts the deduction of payment of excess interest by Indian companies or Permanent Establishment (PE) of foreign companies on its borrowing from overseas AEs. This provision is not only applicable in case of direct lending from an AE but is also applicable on payment of interest to unrelated lenders if the AE has provided an implicit or explicit guarantee or paid the equivalent deposit for the debt.

The section shall be applicable only when interest or similar consideration paid to the AE exceeds an amount of INR 1 crore.

The interest amount that will be disallowed as deduction while computing the income of the tax payer is defined as lower of:

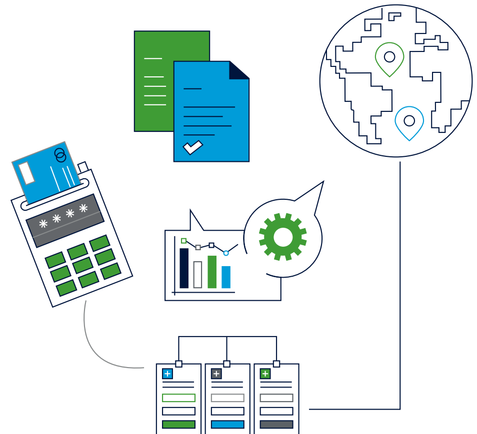
- The total interest amount in excess of 30% of earnings before interest, taxes, depreciation and amortization;

- Interest paid or payable to Associated Enterprise.

Finance Act, 2023 further amended Section 94B by carving out certain class of NBFC`s which are notified by the Central Government from the purview of organization's thin capitalization provision.

The Central Board of Direct Taxes (CBDT), vide **Notification 46/2017 dated 7 June 2017,** had come up with the revised Safe Harbour Rules ("new SHR"), which were made applicable from Financial Year ("FY") 2016-17 to FY 2018-19. The SHR were introduced about five years ago, and these rules were applicable from FY 2012-13 to FY 2016-17. While FY 2016-17 is an overlapping year, the new rules clarify that for FY 2016-17, the taxpayer can choose the best from the old and new rules. The SHR have been extended with certain changes to FY 2023-24 as discussed elsewhere in this publication.

4.2 Transfer Pricing – Meaning and Purpose



Transfer Pricing refers to the price charged by one member of Multinational organization to another member of the same organization 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 arm's 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 Hon'ble 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, b**y manipulating the prices charged and paid** in such intra-group transactions, thereby, **leading to erosion of tax revenues.**

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 Specified Domestic Transactions (SDTs), 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 specified domestic transactions, is therefore needed.

4.3 Applicability of Transfer Pricing regulations

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

a. It has entered into an international transaction with its Associated Enterprise

b. 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 6 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 beginningg 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) and 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 6.

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, 10C, 10CA
Documentation (including Master File)	Section 92D	Rule 10D and Rule 10DA
Accountant's Report	Section 92E	Rule 10E
Penalties	Sections 270A, 271AA, 271BA, 271G, Section 271GB and Explanation 7 to Section 271(1)	–
Administrative	Sections 92C(3), 92C(4), 92CA and 144C	Income-tax (DRP) Rules, 2009
Secondary Adjustment	Section 92CE	Rule 10CB
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 Action Plan 13 – CbCR	Section 286	Rule 10DB

5.2 Provisions of Section 92

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

It also provides that allowance for expenses or interest arising from international transaction should be determined having regard to the ALP (e.g.: Imports from AE's).

5.2.2 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).

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 aim to protect erosion of India's tax base. **(CBDT's Circular No. 8/2002)**

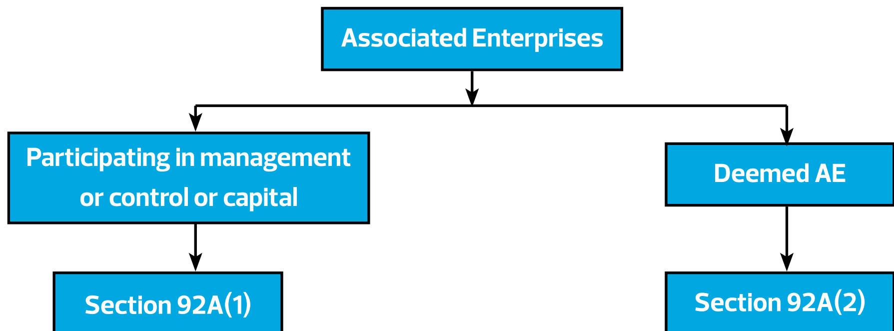
5.2.3 In case where the income is not subject to tax in India pursuant to the provisions of the tax treaty, the TP provisions may still be applicable. In case of **Castleton Investment Limited** [AAR No. 999 of 2010, dated 14 August 2012], the AAR held that the transfer of shares in an Indian company 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.**

5.2.4 The Hon'ble 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 share 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) where the same person, directly or indirectly or through intermediaries, participates in the management or control or capital of two or more enterprises

- 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 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).

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, transfer, use 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.

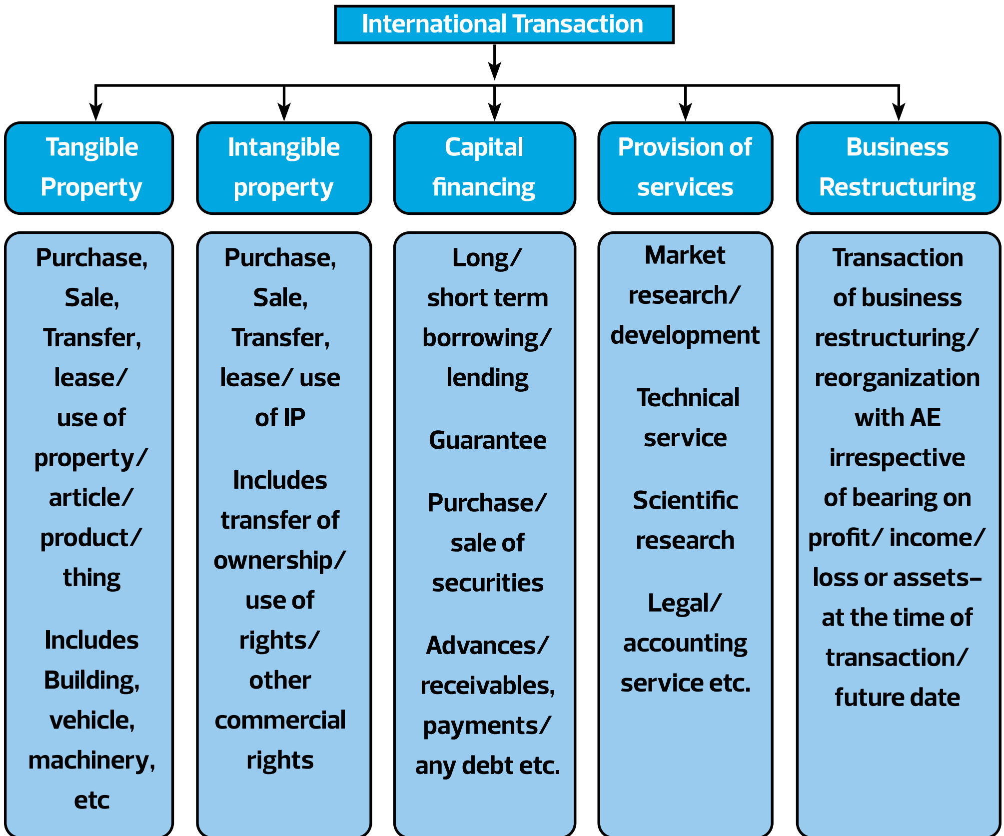
➢ **Deemed International Transaction:**

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 conditions 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.

Explanation to section 92B



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

  Finance Act 2014 had amended Section 92B(2) on deemed international transaction to provide that the transaction between a taxpayer and the other person, even if such person is a non-resident or not, 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.

  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 K**odak 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 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.

6.1 Evolution of Domestic TP Regulations

The scope of TP was widened from FY 2012-13 by extending the same to Specified Domestic Transactions (SDT). The genesis of the above lies in the judgment of the Hon'ble 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.

TP documentation and certification compliance requirements with respect to domestic expenditures covered under Section 40A(2)(b) of the Act have been removed with effect from the Fiscal Year 2016-17. However, the Government retained the transfer pricing compliance requirements for computing profit linked incentives or tax holiday schemes, with a view to prevent the propensity to shift profits from non-tax holiday undertakings to undertakings enjoying tax holiday.[2]

6.2 Meaning of Specified Domestic Transaction – Section 92BA[3]

The definition of section 92BA which defines Specified Domestic Transaction is amended vide Finance Act 2017 and has removed transactions in the nature of

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[2] Source: tp.taxsutra.com

[3] Source: ICAI Guidance Note on Report under section 92E of the Income Tax Act, 1961 (Transfer Pricing). [Based on the law as amended by the Finance Act, 2017] (Revised 2017)

expenditure for which payment has been made or would be made to persons specified in Section 40A(2)(b). The said amendment is applicable for assessment year 2017-18 i.e. previous year 2016-17. Section 92BA defines SDT which is covered by TP regulations as under:

"For the purposes of this Section and Sections 92, 92C, 92D and 92E, "Specified Domestic Transaction" in case of an assessee means any of the following transactions, not being an International transaction, namely:-

(i) [...][4]

(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 sub-section (10) of section 80-IA;

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

(va) any business transacted between the persons referred to in sub-section (6) of section 115BAB.

(vb) any business transacted between the assessee and other person as referred to in sub-section 4 of section 115BAE.

(vi) any other transaction as may be prescribed.

6.3 Threshold limit and coverage

All the transactions covered under the above 5 limbs of section 92BA will be

[4] Omitted vide Finance Act 2017. Prior to its omission Clause(i) read as under:
"(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)"

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). If the threshold limit is crossed, TP compliances are required for all the SDTs covered under section 92BA.

6.4 Coverage of Domestic Transfer Pricing

Sections	Nature	Transaction with	Earlier methodology
80A, 80-IA(8)	Income or expenditure	Between different business units of same taxpayer	Fair Market Value
80-IA(10) (Including SEZ)	Profits	Close connection	More than ordinary profits
10AA	Income	SEZ Unit	100% for the first 5 years; 50% for the next 5 years; 50% of the profits or amount credited to SEZ re-investment reserve, whichever is less for next 5 years
115BAB(6)	Income or expenditure	Close connection	NA
115BAE(4)	Income or expenditure	Close connection	NA

6.5 Examples of Transactions with the Tax Holiday Units

The provisions currently in force which grant profit linked tax holiday deductions and which are regulated by section 80A(6) and, consequently, subject to Domestic Transfer Pricing are as follows:-

- 80-IA – Infrastructure development, etc
- 80-IAB – SEZ development
- 80-IAC – Startup business

- 80-IB – Industrial undertakings
- 80-IBA – Development and building house projects
- 80-IC – Industrial undertakings or enterprises in special category states
- 80-ID – Hotels and convention centres in specified area
- 80-IE – Undertakings in North-Eastern states
- 80JJA – Collection and processing of bio-degradable waste
- 80JJAA – Employment of new workmen
- 80LA – Offshore Banking units and International Financial Services Centre
- 80P – Co-operative societies

6.6 Inter-unit transfer of Goods / services as covered under section 80IA(8)

6.6.1 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.

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 92BAon.

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. This section covers income as well as expenditure.

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

6.7.1 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.

6.7.2 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'.

6.7.3 This section covers income as well as expenditure.

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

6.8 Business transaction with any other person generating more than ordinary profits – Section 115BAB(6)

6.8.1 Section 115BAB(6) applies to transactions entered between new manufacturing domestic companies which satisfies all the conditions under sub-section (1) 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 The amount of profits arising from such transaction shall be determined by arriving at the arm`s length price as defined in clause (ii) section 92F.

6.8.3 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'.

6.8.4 This section covers income as well as expenditure.

6.9 Business transaction with any other person generating more than ordinary profits – Section 115BAE(4)

6.9.1 Section 115BAE(4) applies to transactions entered between new manufacturing co-operative societies which satisfies all the conditions as mentioned under sub-section (1) 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.

6.9.2 The amount of profits arising from such transaction shall be determined by arriving at the arm`s length price as defined in clause (ii) section 92F.

6.9.3 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'.

6.9.4 This section covers income as well as expenditure.

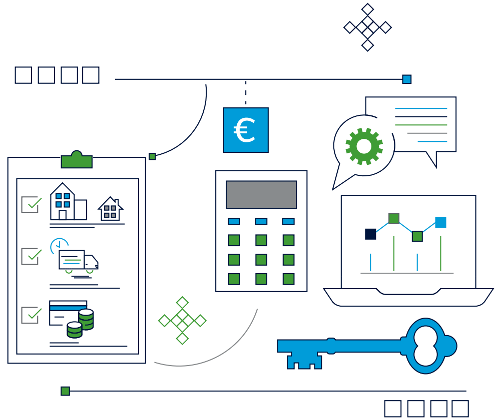
6.10 Distinction between applicability of Chapter X to International Transactions and Specified Domestic Transactions:

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. inter-units transfers of goods and services in case of tax-holiday units, etc.	Applicable to related parties as defined in section 80A(6), 80IA(8), 80IA(10), etc.
Applicable to AEs as defined in section 92A	Applicable to related parties as defined in section 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 Arm's Length Price.



7.1.2 Further, as per Rule 10B, the comparability of an international transaction [or a specified domestic transaction] with an uncontrolled transaction shall be judged with reference to the following, namely:—

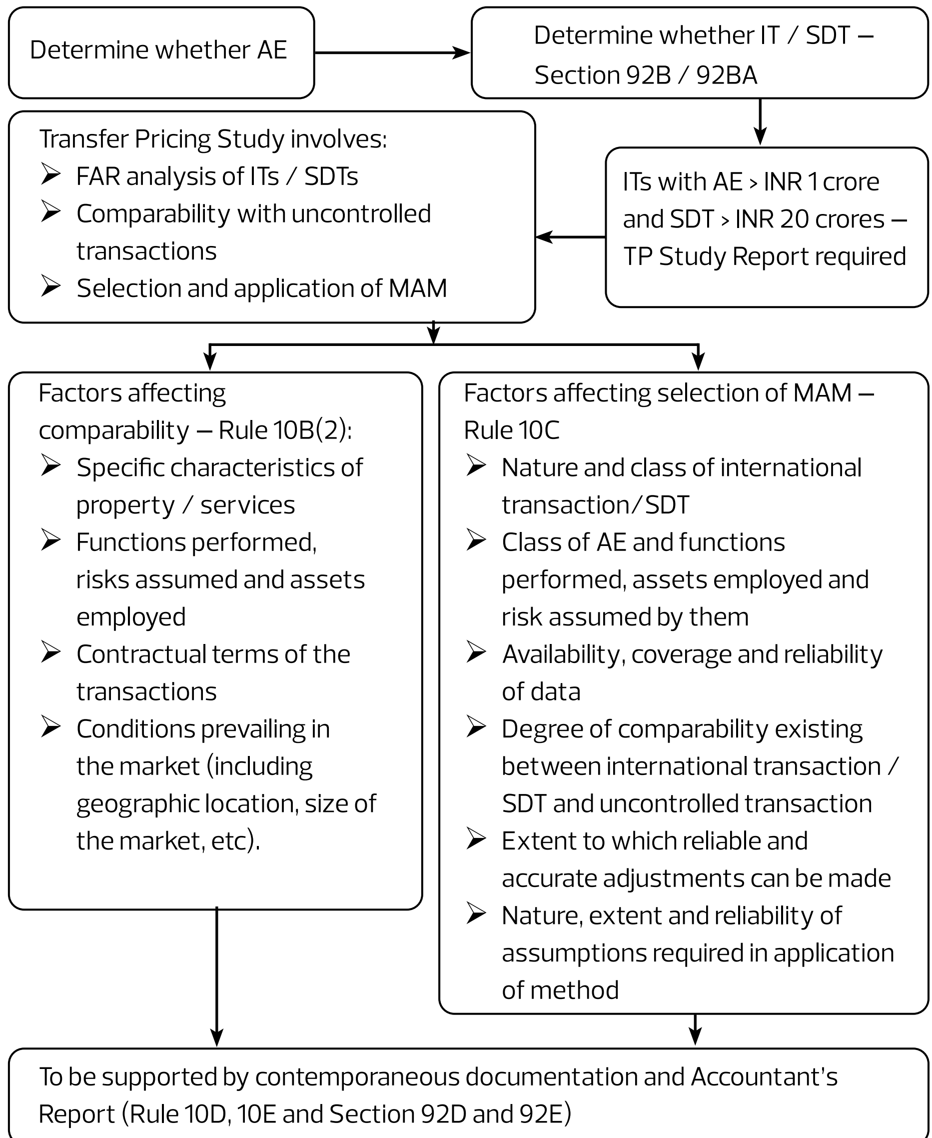
- the specific characteristics of the property transferred or services provided in either transaction;
- the functions performed, taking into account assets employed or to be employed and the risks assumed, by the respective parties to the transactions;
- the contractual terms (whether or not such terms 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.

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.

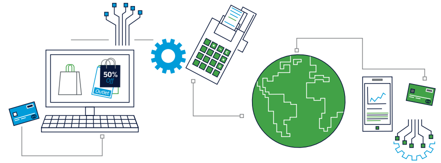
7.1.4 The following flowchart shows the process of transfer pricing regulations:



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.

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



- **Profit Based Methods**
  - 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 (CUP) 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

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.

The Hon'ble 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.

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 Hon'ble 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 Hon'ble 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 consequently 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 Hon'ble 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 Hon'ble Bombay High Court affirmed the above decision of the Hon'ble Tribunal accepting the taxpayers' use of the RPM for purpose of determination of arm's length price of its international transactions with respect to distribution activities.

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 cost plus method means actual costs and not estimated costs. The Hon'ble 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 cost plus method can be applied.
- Cost plus method does not contemplate estimation of costs.

The Hon'ble 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:

- **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. Similarly, Indian company providing software development services or back office services to the foreign AE where IPR in the software developed belongs to the foreign AE and the Indian company assumes limited market risk or credit risk.

- **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.

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 cannot be evaluated separately.

  E.g.: 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 to each of the AEs of the contribution made to the controlled transactions and further, the approach will often depend on the facts and circumstances in each of such cases.

➢ **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 Hon'ble 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 Hon'ble 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.

7.2.6 Transactional Net Margin Method ('TNMM'):

a) TNMM examines the net profit margin in relation 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 independent uncontrolled party which is 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 profit margins by using certain Profit Level Indicators (PLIs) to express the net profit as a % of an appropriate base which generally includes operating cost, operating income, total assets, operating expenses, etc.

In this respect, it is to be noted that the Hon'ble 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 Hon'ble 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 Hon'ble 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.

7.2.7 Other Methods 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 was 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) Other Method is useful when the application of 5 specific methods is not possible due to certain difficulties faced in obtaining comparable data due to uniqueness or complexity of the 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 permits the application of any Other Method and further states that the taxpayer has the freedom to apply any method not described in OECD Guidelines to establish prices, provided that those prices satisfy the arm's length principle.

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 which is 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 for comparability of an international transaction/ specified domestic transaction 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.

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

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

"Provided further that if the variation between the arm's length price so determined and price at which the international transaction has actually been undertaken does not exceed five per cent of the latter, the price at which the international transaction has actually been undertaken shall be deemed to be the arm's length price".

The above proviso was applicable from AY 2009-10 (i.e. 1 October 2009).

It is important to note here that the range of +/-5% is to be applied to the value of the international transactions and not to the ALP [as stated in erstwhile Proviso 92C(2)].

The Finance Act 2012 amended the tolerance band and replaced the +/-5% range with the range of 1% to be applicable in case of wholesale trader and 3% range for others. The said range of ALP was applicable from AY 2013-14 onwards.

7.2.12 Use of multiple year data and adoption of Range Concept

CBDT issued a notification on 19 October 2015, 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 were applicable with effect from 1 April 2014 and was applicable for both international transactions as well as specified domestic transactions from FY 2014-15 prospectively.

a) Use of multiple-year data

In case where the Resale Price Method, Cost Plus Method or Transactional Net Margin Method is used as most appropriate method for determination of the ALP of IT/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.

b) Adoption of the Range concept - Rule 10CA

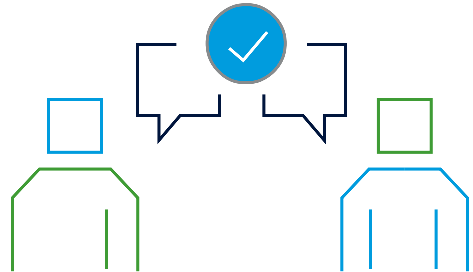
The concept of range is applicable in case of all methods except the Profit Split Method and Other Method. The steps to be followed for constructing the range are as under:

- 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.
  - o 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.
  - o 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% percent (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 6.

7.2.13 Tested Party



a) Tested Party means the party from whose perspective the ITs/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 – Hon'ble Mumbai Tribunal
- **General Motors India (P.) Ltd. vs. DCIT** [2013] 37 taxmann.com 403 – Hon'ble Ahmedabad Tribunal
- **Development Consultants Pvt. Ltd. vs. DCIT** [(2008) 23 SOT 455 – Hon'ble Kolkata Tribunal

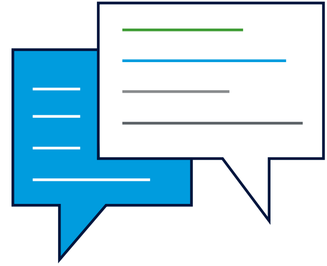
e) The tested party should be selected based on the criterion as mentioned above and the reasons for selection of tested party should be adequately documented in the TP Study. If foreign entity is selected as the tested party, then the assessee must ensure that the reliable comparable data is available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

7.2.14 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.

Chapter 8 Comparability Analysis



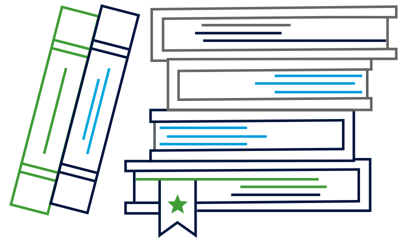
Comparability analysis is an important link between arm's length principle and operation of transfer pricing methods. The analysis is helpful to identify comparables and assess the degree of comparability of ITs/SDTs.

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

According to Rule 10A(a), "uncontrolled transaction" means a transaction between enterprises other than associated enterprises, 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 Certain filters applied in conducting the comparability analysis:

To ensure comparability of companies in public database with the tested party, various quantitative and qualitative filters are applied. The filters generally applied while conducting comparability analysis are based on the nature of industry, turnover, exclusions based on established rationale, etc. The CBDT in October 2015 published a notification[5] releasing the final rules for the use of range concept and multiple year data.

[5] CBDT Notification No 83/2015 dated 19 October 2015

Chapter 9 Documentation Requirements

9.1 Indian Transfer Pricing regulations prescribe robust documentation requirements. As per Section 92D of the Act, 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 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 – Local File:

Rule 10D of the Income Tax Rules, 1962 prescribes detailed information and documentation that has to be maintained by the assessee relating to IT / SDTs undertaken with AEs or related parties. The Indian Transfer Pricing regulations provide for 13 items of mandatory documents and additional 7 items of supporting documentation which inter alia include:

Rule	Description
10D(1)(a)	A description of the **ownership structure** of the assessee enterprise with details of shares or other ownership interest held therein by other enterprises

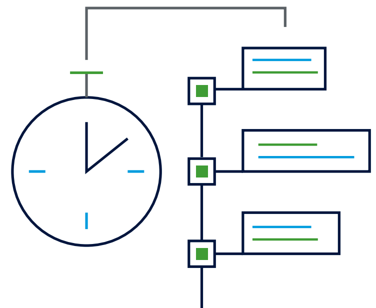
Rule	Description
10D(1)(b)	A **profile of the multinational group** of which the assessee enterprise is a part along with the name, address, legal status and country of tax residence of each of the enterprises comprised in the group with whom international transactions have been entered into by the assessee, and ownership linkages among them
10D(1)(c)	A broad **description of the business** of the assessee and the industry in which the assessee operates, and of the business of the associated enterprises with whom the assessee has transacted
10D(1)(d)	The **nature and terms (including prices)** of IT/SDT entered into with each associated enterprise, details of property transferred or services provided and the quantum and the value of each such transaction or class of such transaction
10D(1)(e)	A description of the **functions performed, risks assumed and assets** employed or to be employed by the assessee and by the associated enterprises involved in the IT/SDT
10D(1)(f)	A record of the **economic and market analyses, forecasts, budgets or any other financial estimates** prepared by the assessee for the business as a whole and for each division or product separately, which may have a bearing on the IT/SDT entered into by the assessee
10D(1)(g)	A record of uncontrolled transactions taken into account for analysing their **comparability** with the international transactions entered into, including a record of the nature, terms and conditions relating to any uncontrolled transaction with third parties which may be of relevance to the pricing of the IT/SDT
10D(1)(h)	A record of the analysis performed to evaluate comparability of uncontrolled transactions with the relevant IT/SDT
10D(1)(i)	A description of the methods considered for determining the arm's length price in relation to each IT/SDT or class of transaction, the method selected as the **most appropriate method** along with explanations as to why such method was so selected, and how such method was applied in each case

Rule	Description
10D(1)(j)	A record of the actual working carried out for determining the arm's length price, including details of the **comparable data** and financial information used in applying the most appropriate method, and adjustments, if any, which were made to account for differences between the IT/SDT and the comparable uncontrolled transactions, or between the enterprises entering into such transactions
10D(1)(k)	The assumptions, policies and price negotiations, if any, which have critically affected the determination of the arm's length price
10D(1)(l)	Details of the **adjustments**, if any, made to transfer prices to align them with arm's length prices determined under these rules and consequent adjustment made to the total income for tax purposes
10D(1)(m)	Any other information, data or document, including information or data relating to the associated enterprise, which may be relevant for determination of the arm's length price

9.3 Documentation – Master File

There are specific requirements regarding documentation for Master File.

9.4 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 Transfer Pricing 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.

However, as per the recent amendment pronounced in Finance Act, 2023 the minimum time limit as mentioned above to furnish information or document before

the Transfer Pricing Officer has been reduced from 30 days to 10 days. However, the assessee may on application, extend the period of 10 days by further period not exceeding 30 days.

It is also mentioned in Section 92D that the information and document to be kept and maintained by a constituent entity of an international group, and filing of required form, shall be applicable even when there is no international transaction undertaken by such constituent entity.

9.5 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. 31st October each year. If the assessee is required to furnish Form No.3CEB then the due date to submit income tax returns is 30th November. From AY 2013-14 and onwards, online filing of Form No. 3CEB was made mandatory.

9.6 Certain issues on maintaining the Documentation:

9.6.1 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.

9.6.2 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 Hon'ble 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.

Chapter 10 Penalties

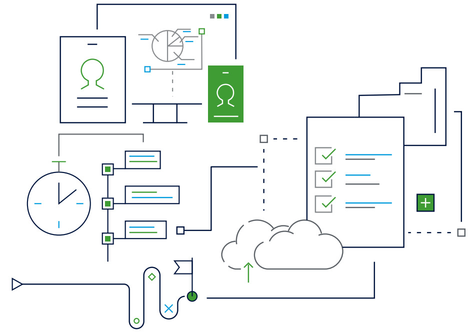
Indian Transfer Pricing regulations prescribe stringent penalties for various defaults which are summarized below:

Sections under IT Act	Particulars of Default	Quantum of Penalty
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
271AA	Fails to furnish the information and the documents as required under sub-section (4) of Section 92D i.e. Master File	INR 500,000
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
271BA	Failure to furnish accountant's report as required by section 92E (i.e. Form No 3CEB)	INR 100,000
271J	Furnishing of incorrect information in any report or certificate by an accountant or merchant banker or a registered valuer	INR 10,000 for each such report or certificate
271GB	**Non-furnishing of the CbCR 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
271GB	**Timely non-submission of information and documents before prescribed authority with respect to CbCR**	

Sections under IT Act	Particulars of Default	Quantum of Penalty
	(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
271GB	**Providing Inaccurate information in the CBCR Report**	
	(a) Entity is aware of the inaccurate information in report at the time of filing report but fails to inform prescribed authority	INR 500,000
	(b) Entity discovers the inaccuracy after the report is filed but fails to intimate prescribed authority and also fails to file correct report within a period of 15 days of such finding	
	(c) Entity files inaccurate information or document in response to the notice issued under section 286(6)	
270A	Under-reporting or mis-reporting of Income (Applicable from AY 2017-18)	When the "under-reporting" is not because of misreporting, the penalty would be 50% of tax payable on the under-reported income. When the "under-reporting" is because of misreporting, the penalty would be 200% of the tax payable on the under-reported income.

Chapter 11 Transfer Pricing Assessment Procedure

Transfer pricing litigation has been a major concern for the taxpayers in India. Further, since transfer pricing audits have resulted in huge tax demands in India, the same as cause a dispute between the Indian Revenue Authorities and taxpayers.



Government is trying its best to get the transfer pricing regulations in coherence with the best global practices. Government has come up with different various operational and procedural guidelines for transfer pricing assessment.

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 IT 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 IT / SDTs to the TPO.

11.1.2 CBDT vide ***Instruction 3/2016 dated 10th March, 2016*** had issued guidelines for implementation of transfer pricing provisions by replacing instruction no 15/2015. The said guidelines were applicable for both IT as well as SDT. The key features of the guidelines are as under:

Selection Criteria	Action to be taken
All cases selected under Computer Assisted Scrutiny Selection (CASS) system or under the compulsory manual selection system	Mandatorily referred to the TPO by the AO after obtaining approval of the PCIT or CIT.
All cases selected under non-transfer pricing risk parameters	**Referred to the TPO only in the following circumstances:**
	Where the taxpayer has entered in to an IT

Selection Criteria	Action to be taken
	or SDT, however the taxpayer has not filed Form No. 3CEB or has not disclosed all the IT's or SDT's in the report so filed.
	Where there has been a transfer pricing adjustment of INR 10 crores or more in any 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.

11.1.3 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.

11.1.4 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 arm's length price in relation to the ITs /SDTs.

11.1.5 If any other IT/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 was pursuant to the insertion of sub-section (2B) in section 92CA by Finance Act, 2012 with retrospective effect from 1 June, 2012.

The Hon'ble 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.

11.1.6 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.

11.1.7 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.

Order of the AO / TPO

11.1.8 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.

11.1.9 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

11.1.10 The Finance Act, 2016 has substituted Section 153 of the Act w.e.f 1st 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 instead of January.

11.1.11 The Finance Act 2017 further reduced the time limit for completion of assessment from thirty-three months to thirty months for AY 2018-19 and to 24 months for AY 2019-20 respectively.

11.1.12 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 sixty days, then the remaining period for passing an order shall be extended to sixty days.

Subsection (8) to Subsection (10) of Section 92CA was inserted by Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act, 2020 which is mentioned below :-

As per Section 92CA(8), the Central Government may make a scheme by notification in the Official Gazette to determine the arm`s length price by delivering greater efficiency which is achieved by executing in the following manner :-

(a) removing interface between the Transfer Pricing Officer and the assessee or any other person to the extent it is technologically feasible.

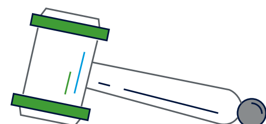
(b) achieving best utilisation of the resources through economies of scale and functional specialisation.

(c) initiating a team-based determination of arm`s length price with dynamic jurisdiction.

Section 92CA(9) provides that Central Government may by notification in the Official Gazette can give effect to the scheme under sub-section (8) by directing that any of the provisions of the Act shall not apply or shall apply with such exceptions, modifications and adaptations as specified in the notification. No direction shall be issued after the 31st March 2024.

As per Section 92CA(10) the notification which is issued under sub-section (8) and sub-section (9) shall be laid before each House of Parliament.

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 Hon'ble Tribunal against an order passed in pursuance and directions of the DRP.

11.2.7 In order to minimize litigation, the Finance Act 2016 had 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.

Chapter 12 Transfer Pricing Compliance Calendar

Comprehensive Transfer Pricing Compliance Calendar is provided below. The table summarises the following:

- Events to be carried out
- Relevant legal sections
- Requisite Form numbers.
- Respective deadlines that must be adhered to ensure compliance (the deadlines provided here are for FY 2023-24)

Events	Section	Form No	Due Date
Transfer Pricing Audit	92E	Form 3CEB	31 October 2024
Transfer Pricing Documentation	92D	-	31 October 2024
Return of Income (in case where transfer pricing audit is applicable)	139	ITR form	30 November 2024
Tax Audit Report (in case where transfer pricing audit is applicable)	44AB	Form 3CD	31 October 2024
Master File	92D (4)	Form 3CEAA	30 November 2024
Intimation by Designated Constituent Entity ('DCE')	92D (4)	Form 3CEAB	31 October 2024
Intimation by DCE	286(1)	Form 3CEAC	2 months prior to the due date for furnishing of report. The due date to furnish report is a period of 12 months from the end of the accounting year.
Country-by-Country Reporting (CbCR)	286(2)	Form 3CEAD	12 months from the end of reporting accounting year.
Safe Harbour Application for International Transactions	92CB	Form 3CEFA	30 November 2024
Safe Harbour Application for Specified Domestic Transactions	92CB	Form 3CEFB	30 November 2024

Part C :
BEPS & Secondary Adjustment

Chapter 13 Base Erosion and Profit Shifting (BEPS)

13.1 Overview

13.1.1 The integration of national economies and markets 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. The G20 along with OECD agreed to implement recommendations of BEPS project.

13.1.2 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 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 is effective from the Assessment year 2017-18 (financial year commencing 1 April 2016) and subsequent assessment years.

13.1.3 Action 13 of the Action Plan on BEPS requires the development of "*rules regarding transfer pricing documentation to enhance transparency for tax administration, taking into consideration the compliance costs for business. The rules to be developed will include a requirement that MNEs provide all relevant governments with needed information on their global allocation of the income, economic activity and taxes paid among countries according to a common template*".

13.2 Action Item 13 — Transfer pricing documentation and Country-by-Country Reporting

13.2.1 Significant changes have been agreed upon by the G20 / OECD, in respect 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 C**ountry-by-Country ('CbC') reporting** of income, earnings, taxes paid and certain measure of economic activity.

A three-tiered structure has been mandated consisting of:

- a Master File containing standardized 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.

13.2.2 There are three objectives of transfer pricing documentation as follows (as per OECD Transfer Pricing Guideline 2022):

- to ensure that taxpayers give appropriate consideration to transfer pricing requirements in establishing prices and other conditions for transactions between associated enterprises and in reporting the income derived from such transactions in their tax returns;
- to provide tax administrations with the information necessary to conduct an informed transfer pricing risk assessment; and
- to provide tax administrations with useful information to employ in conducting an appropriately thorough audit of the transfer pricing practices of entities subject to tax in their jurisdiction, although it may be necessary to supplement the documentation with additional information as the audit progresses.

➢ **Signatories of the Multilateral Competent Authority Agreement on the exchange of CbC reports**

The following 100 countries have entered into Multilateral Competent Authority

Agreement for exchange of CbCR report. The list is updated till 21st March 2024[6].

Country Name	Country Name	Country Name	Country Name
1. Andorra	23. Croatia	45. Ireland	67. Morocco
2. Anguilla	24. Curaçao	46. Isle of Man	68. Netherlands
3. Argentina	25. Cyprus	47. Israel	69. New Zealand
4. Aruba	26. Czech Republic	48. Italy	70. Nigeria
5. Australia	27. Denmark	49. Japan	71. Norway
6. Austria	28. Dominican Republic	50. Jersey	72. Oman
7. Azerbaijan	29. Estonia	51. Kazakhstan	73. Pakistan
8. The Bahamas	30. Faroe Islands	52. Kenya	74. Panama
9. Bahrain	31. Finland	53. Korea	75. Papua New Guinea
10. Barbados	32. France	54. Latvia	76. Peru
11. Belgium	33. Gabon	55. Liberia	77. Poland
12. Belize	34. Georgia	56. Liechtenstein	78. Portugal
13. Bermuda	35. Germany	57. Lithuania	79. Qatar
14. Brazil	36. Gibraltar	58. Luxembourg	80. Romania
15. British Virgin Islands	37. Greece	59. Macau, China	81. Russian Federation
16. Bulgaria	38. Guernsey	60. Malaysia	82. San Marino
17. Canada	39. Haiti	61. Maldives	83. Saudi Arabia
18. Cayman Islands	40. Hong Kong, China	62. Malta	84. Senegal
19. Chile	41. Hungary	63. Mauritius	85. Seychelles
20. China (People's Republic of)	42. Iceland	64. Mexico	86. Singapore
21. Colombia	43. India	65. Monaco	87. Slovak Republic
22. Costa Rica	44. Indonesia	66. Montserrat	88. Slovenia

[6] Source: https://www.oecd.org/ctp/exchange-of-tax-information/CbC-MCAA-Signatories.pdf

Country Name	Country Name	Country Name	Country Name
89. South Africa	92. Switzerland	95. Türkiye	98. United Kingdom
90. Spain	93. Thailand	96. Turks and Caicos Islands	99. Ukraine
91. Sweden	94. Tunisia	97. United Arab Emirates	100.Uruguay

13.3 Introduction of Action Plan 13 in India

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

- In keeping with India's commitment to implement the recommendations of Action Plan 13 of Base Erosion and Profit Shifting ('BEPS'), the Finance Act 2016 inserted section 286 in the IT Act to provide a specific reporting regime in respect of CbC reporting and also the Master File.

- The reporting provision applies in respect of an international group having consolidated group revenue, based on consolidated financial statements for the accounting year preceding such accounting year, if it exceeds the prescribed threshold. The current international consensus is for a threshold of €750 million equivalent in local currency.

- The parent entity of an international group, if it is resident in India is required to furnish Master File 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 is 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 monetary threshold for applicability of CbC report is when the consolidated group turnover in the previous accounting year exceeds INR 64,000 million.

- The CbC 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 due date for filing the CbC report is within a period of 12 months from the end of the reporting accounting year of the ultimate parent entity.

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

    - where the parent entity is not obligated to file the report ***(inserted in Finance Act 2018)***

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

    - there has been a systemic failure of that country and the said failure has been intimated by the prescribed authority to such constituent entity

- 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 CBC report on behalf of the group. This entity would then furnish the CbC report.

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

- If any other alternate reporting entity of the international group has furnished the CbC report with the tax authority of their country, there will be no need for the local constituent entity to furnish the same again locally if the following conditions are satisfied:

    - o the CbC report is required to be furnished under the local laws of that country;

    - o that country has entered into an agreement with India providing for exchange of the CbC report in respect of the international group;

    - o that country's prescribed authority has not conveyed any systemic failure in respect of the said country to any constituent entity resident in India;

    - o the said country or territory has been informed in writing by the constituent entity that it is the alternate reporting entity on behalf of the international group.

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

13.3.2 Criteria for applicability of CbC report and Master File

Nature of Document	Criteria	Evaluation Period	Threshold exceeding*
Master File	(i) Consolidated revenue of the international group	Accounting Year	INR 500 Crores (INR 5000 million) (i.e. approx. USD 61 million)
	AND		
	ii) A. Value of international transactions of the constituent entity	Accounting Year under consideration	INR 50 Crores (INR 500 million) (i.e. approx. USD 6 million)
	OR		
	(ii) B. Value of international transactions involving intangibles of the constituent entity	Accounting Year under consideration	INR 10 Crores (INR 100 million) (i.e. approx. USD 1 million)
CbCR	Total consolidated group revenue of the international group	Immediately preceding previous Accounting Year	INR 6,400 Crores (INR 64,000 million) (i.e. approx. USD 78 million)

*Exchange rate considered INR 1 = USD 82

12.3.3 Applicable Forms

Form	Description	In relation to	Who needs to file	Prescribed Due Dates
Form No. 3CEAA **PART A**	Every person, being a constituent entity of an international group	All constituent entities of an international group whether or not it satisfies the cumulative thresholds mentioned in above table		30 November of the assessment year
Form No. 3CEAA **PART B**	Constituent entity of an international group, in those cases where the conditions as provided in Rule 10DA(1) are satisfied	Master File	Designated Constituent entity of an international group	

Form	Description	In relation to	Who needs to file	Prescribed Due Dates
Form No. 3CEAB	Where there are more than one constituent entities resident in India of an international group, then the international group may designate any one constituent entity and the intimation to be filed only by that constituent entity	Master File	Designated Constituent entity irrespective of whether the parent entity is resident in India or not	31 October of the assessment year
Form No. 3CEAC	Intimation by a constituent entity, resident in India, for the purposes of section 286 (2) of the Act	CbC Report	Constituent entity resident in India but parent entity is non-resident in India	31 October of the assessment year
Form No. 3CEAD	Report by a parent entity or an alternate reporting entity or any other constituent entity, resident in India, for the purposes of sub-section (2) or sub-section (4) of section 286 of the Act	CbC Report	Parent or Alternative reporting entity resident in India	31 March of the assessment year (i.e. within a period of 12 months from the end of the reporting accounting year)
Form No. 3CEAE	Intimation on behalf of the international group for the purposes of the proviso to sub-section (4) of section 286 of the Act	CbC Report	Designated Constituent entity irrespective of whether the parent entity is resident in India or not	Due date for filing of intimation by the designated entity is not yet prescribed

13.4 Certain Aspects

The Indian Master File and CbC reporting Final Rules released by CBDT are broadly in-line with OECD guidance on BEPS Action Plan 13. While the Final Rules require the Indian constituent entities to furnish few additional details in the Master File which deviates from the BEPS Action Plan 13 recommendation, it appears that the CBDT has considered such requirement to be relevant for risk assessment purpose from India perspective.

International groups should focus on the new reporting requirements and should assess readiness as to whether the necessary data is available, what must be done to ensure that data can be sourced and presented in an effective, efficient and clear manner and also analyze how tax authorities are likely to assess such information. Taxpayers will need to adopt a consistent and harmonized approach to preparing their Master File and Local File as well as CbC Report and be prepared for more detailed information or document requests during an audit.

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

Finance Act 2016 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 IT Act and amending section 271AA of the IT Act. The details have been provided in Chapter 7 above.

Chapter 14 Secondary Adjustment

14.1 Overview

14.1.1 The Finance Act 2017 introduced some significant changes to the IT Act with the objective of strengthening anti-abuse measures as well as to align the IT Act with international practices. One of the changes included the introduction of secondary adjustments in the TP regulations. The secondary adjustment rules are an internationally recognized approach and are already part of the TP regulations in many leading economies.

14.1.2 Secondary Adjustment means an adjustment in the books of accounts of the assessee and its AEs to reflect that the actual allocation of profits between the assessee and its AEs are consistent with the transfer price determined as a result of primary adjustment, thereby removing the imbalance between cash account and actual profit of the assessee. As per the OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD transfer pricing guidelines), secondary adjustment may take the form of constructive dividends, constructive equity contributions, or constructive loans.

14.1.3 Whilst the approaches to secondary adjustments by individual countries vary, they represent an internationally recognized method to align the economic benefit of the transaction with the arm's length position. In order to align the transfer pricing provisions in line with OECD transfer pricing guidelines and international best practices, Finance Act 2017 introduced the "secondary adjustment" provision under section 92CE in the IT Act.

14.2 Meaning of Primary adjustment and Secondary adjustment

14.2.1 Primary adjustment is defined to mean determination of the transfer price in accordance with the arm's length principle resulting in an increase in the total income or reduction in the loss, as the case may be, of the taxpayer. Primary Adjustment is known in common parlance as Transfer Pricing Adjustment or TP Adjustment.

14.2.2 Secondary adjustment has been defined to mean an adjustment in the books of accounts of the taxpayer and its AE to reflect the actual allocation of profits between the taxpayer and its AE consistent with the transfer price determined as a result of primary adjustment, thereby removing the imbalance between cash account and actual profit of the taxpayer.

14.3 Applicability of Secondary adjustment

14.3.1 The provisions are applicable in cases where the primary TP adjustment to the transfer price:

- has been made suo moto by the assessee in his return of income; or
- has been made by AO and accepted by assessee; or
- is determined by APA entered into by assessee under section 92CC of the Act; or
- is made as per the SHR framed under section 92CB of the Act; or
- is arising as a result of resolution of an assessment by way of mutual agreement procedure (MAP) under agreement entered into under Section 90 / 90A of the Act for avoidance of double taxation.

14.3.2 The secondary adjustment provisions provides that, where as a result of a primary adjustment to the transfer price, there is an increase in the total income or reduction in the loss of the taxpayer, as the case may be, the "excess money" (i.e. the difference between the arm's length price determined in the primary adjustment and the price at which the international transaction was actually undertaken) or part thereof which is available with its AE, needs to be repatriated into India within the prescribed time.

14.3.3 In case the "excess money" is not repatriated within the prescribed time, such excess money shall be deemed to be an advance made by the taxpayer to such AE. Further, interest on such advances shall be computed as the income of the taxpayer in the prescribed manner as per Rule 10CB(2) of the Rules.

14.3.4 The above provisions shall not be applicable in the following situations:

- The amount of primary adjustment made is less than INR 1 crore: or
- The primary adjustment relates to FY 2015-16 or prior years.

14.4 Time limit for repatriation of excess money and interest rate pursuant to secondary adjustment

14.4.1 Rule 10CB covers 2 aspects of computation of interest on secondary adjustment, namely, time limit for repatriation of excess money and imputed per annum interest on excess money. Tabulated below is the interest to be charged in case money is not repatriated within the prescribed time period:

<table>
<tr><th rowspan="2">Type of Primary adjustment</th><th rowspan="2">Time Limit for repatriation</th><th colspan="2">Applicable Interest rate for imputation for delayed receipts</th></tr>
<tr><th>For rupee (INR) denominated transactions</th><th>For Foreign Currency denominated transactions</th></tr>
<tr><td>Adjustment made by the Indian Tax Authority and accepted by the taxpayer</td><td>On or before 90 days from the date of relevant order</td><td rowspan="3">1-year MCLR* + 325 basis points
MCLR of State Bank of India as of 1 April of the relevant FY</td><td rowspan="3">6 months LIBOR + 300 basis points
*LIBOR as of 30 September of the relevant FY</td></tr>
<tr><td>Suo-moto adjustment by the taxpayer</td><td rowspan="2">On or before 90 days from the due date of filing return of income under Section 139(1) of the Act or (in case of APA, the due date of filing of modified return</td></tr>
<tr><td>Adjustment pursuant to APA, Safe Harbour or MAP</td></tr>
</table>

14.5 Additional tax liability in case of non-repatriation of excess money

14.5.1 In case where the excess money or part thereof has not been repatriated in time, the taxpayer will have the option to pay additional income-tax @ 18% on such excess money or part thereof. The additional tax shall be increased by a surcharge of 12%.

14.5.2 Where the excess money or part thereof has not been repatriated within the prescribed time, the taxpayer may, at his option, pay additional income tax @ 18% on such excess money or part thereof, as the case may be.

14.5.3 The tax on the excess money or part thereof so paid by the taxpayer as above shall be treated as the final payment of tax in respect of the excess money or part thereof not repatriated.

14.5.4 No further credit therefore shall be claimed by the taxpayer or by any other person in respect of the amount of tax so paid.

14.5.5 No deduction under any other provision of this Act shall be allowed to the taxpayer in respect of the amount on which tax has been paid in accordance with the provisions of sub-section (2A).

14.5.6 Where additional income tax as above is paid by the taxpayer, he shall not be required to make secondary adjustment and compute interest from the date of payment of such tax.

14.5.7 If not so repatriated, such excess money shall be deemed to be an advance made by the taxpayer to such AE and the interest on such advance, shall be computed as the income of the taxpayer, in the manner as may be prescribed.

<table>
<tr><th rowspan="2">Type of Primary adjustment</th><th rowspan="2">Time Limit for repatriation</th><th colspan="2">Applicable Interest rate for imputation for delayed receipts</th></tr>
<tr><th>For rupee (INR) denominated transactions</th><th>For Foreign Currency denominated transactions</th></tr>
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MCLR of State Bank of India as of 1 April of the relevant FY</td><td rowspan="3">6 months LIBOR + 300 basis points
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<tr><td>Suo-moto adjustment by the taxpayer</td><td rowspan="2">On or before 90 days from the due date of filing return of income under Section 139(1) of the Act or (in case of APA, the due date of filing of modified return</td></tr>
<tr><td>Adjustment pursuant to APA, Safe Harbour or MAP</td></tr>
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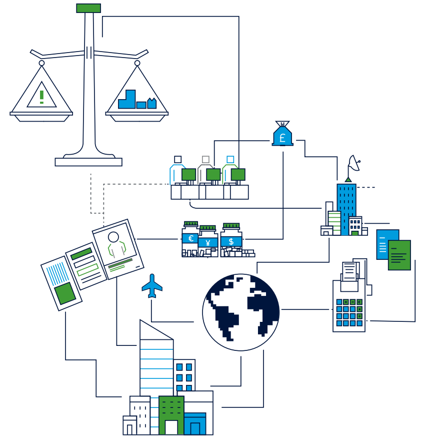
Part D : Alternate Resolution Mechanism

15.1 Background



To reduce the increasing number of transfer pricing audits and prolonged disputes, the CBDT issued the Safe Harbour Rules ('SHR') on 18 September 2013 under Finance (No.2) Act, 2009 with retrospective effect from 1 April 2009. SHR is covered under section 92CB of the Act and the Rules are comprehended in Rules 10TA to 10TG.

A "safe harbour" is defined in the Act as circumstances in which the tax authority shall accept the transfer price declared by the assessee.

The CBDT vide ***Notification No. 58/2023/F.NO. 370142/26/2023-TPL*** extended the safe harbour rules to AY 2023-24 i.e. relevant to the fiscal year, ended 31 March 2023. Further, it is anticipated that the same shall be extended for subsequent years too.

15.2 Who is eligible to apply for SHR?

The SHR mechanism is available only for the following assessee (**"eligible assessee"**):

- ➢ Engaged in provision of Software Development Services or Information Technology Enabled Support Services or Knowledge Process Outsourcing services with insignificant risk to foreign principal;
- ➢ Has provided corporate guarantee;
- ➢ Engaged in provision of 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), where the amount of loan is denominated in Indian Rupees (INR) or foreign currency
- Has received low value-adding intra-group services
- Has entered into SDT and –
  - is a Government company engaged in the business of generation, supply, transmission or distribution of electricity,
  - is a co-operative society engaged in business of procuring and marketing milk and milk products.

15.3 Revised Safe Harbour Rules for various sectors are prescribed which is tabulated as under:

No comparability adjustment and allowance under second proviso to 92C(2) shall be made to the transfer price declared by the eligible assessee and accepted under the revised Safe Harbour Rules.

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 transaction's:

Sr. No.	Eligible International Transaction	Safe Harbour ratios
1.	Software development services (Information Technology services); and Information Technology Enabled Support Services (ITES), with insignificant risks –	Operating profit margin to operating expenses

Sr. No.	Eligible International Transaction	Safe Harbour ratios
	• where aggregate value of international transactions ≤ INR 100 crores (INR 1 billion) • Where aggregate value of international transactions > INR 100 crores (INR 1 billion) but ≤ INR 200 crores (INR 2 billion)	• ≥ 17% • ≥ 18%
2.	Knowledge Process Outsourcing services (KPO Services), with insignificant risk • where aggregate value of such transactions ≤ INR 200 crores (INR 2 billion)	Operating profit margin to operating expense • ≥ 24% and the Employee Cost in relation to the Operating Expense is at least 60% • ≥ 21% and the Employee Cost in relation to the Operating Expense is 40% or more but less than 60% • ≥ 18% and the Employee Cost in relation to the Operating Expense does not exceed 40%
3.	Intra-group loans to Wholly Owned Subsidiary ('WOS') **where the amount of loan is denominated in Indian Rupees (INR).** • where the AE has credit rating between AAA to A or its equivalent • where the AE has credit rating of BBB-, BBB or BBB+ or its equivalent; • where the AE has credit rating between BB to B or its equivalent;	The interest rate declared in relation to the eligible international transaction is not less than the one-year marginal cost of funds lending rate of State Bank of India as on 1 April of the relevant previous year plus, – • 175 basis points • 325 basis points • 475 basis points

Sr. No.	Eligible International Transaction	Safe Harbour ratios
	• where the AE has credit rating between C to D or its equivalent; or • where credit rating of the AE is not available and the amount of loan advanced to the AE including loans to all AE in Indian Rupees does not exceed a sum of INR 100 crore in the aggregate as on 31 March of the relevant previous year.	• 625 basis points • 425 basis points
4.	Intra-group loans referred to in clause (iv) of rule 10TC where the amount of loan is denominated in foreign currency (a) If amount of loan advanced to the associated enterprise including loans to all associated enterprises does not exceed a sum equivalent to two hundred and fifty crore Indian rupees in the aggregate as on 31st March of the relevant previous year:	• 150 basis points, where the associated enterprise has a credit rating of AAA, AA+, AA, AA-, A+, A, A- or equivalent; • 300 basis points, where the associated enterprise has credit rating of BBB+, BBB, BBB- or equivalent; • 400 basis points, where the associated enterprise has a credit rating of BB+, BB, BB-, B+, B, B-, C+, C , C-, D or equivalent or where the credit rating of the associated enterprise is not available;
	(b) If amount of loan advanced to the associated enterprise	• 150 basis points, where the associated enterprise has a

Sr. No.	Eligible International Transaction	Safe Harbour ratios
	including loans to all associated enterprises exceeds a sum equivalent to two hundred and fifty crore Indian rupees in the aggregate as on 31st March of the relevant previous year:	credit rating of AAA, AA+, AA, AA–, A+, A, A– or equivalent; ● 300 basis points, where the associated enterprise has credit rating of BBB+, BBB, BBB– or equivalent; ● 450 basis points, where the associated enterprise has a credit rating of BB+, BB, BB–, B+, B, B– or equivalent; ● 600 basis points, where the associated enterprise has credit rating of C+, C , C–, D or equivalent or where the credit rating of the associated enterprise is not available.'';
5.	Provision of corporate guarantee to WOS	The commission or fee declared is @ ≥ 1% p.a. on the amount guaranteed.
6.	Specified contract research and development services **(Contract R&D services),** with insignificant risks, wholly or partly **relating to software development,** ● where the value of the international transaction is ≤ INR 200 crores (INR 2 billion)	Operating profit margin to operating expense ≥ 24%
7.	**Contract R&D** services, with insignificant risks, wholly or partly **relating to generic pharmaceutical drugs,**	Operating profit margin to operating expense ≥ 24%

Sr. No.	Eligible International Transaction	Safe Harbour ratios
	• where the value of the international transaction is ≤ INR 200 crores (INR 2 billion)	
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%
9.	Receipt of low value-adding intra-group services • where entire value of the international transactions (including mark-up) ≤ INR 10 crores (100 million)	• mark-up ≤ 5% Provided that the method of cost pooling, the exclusion of shareholder costs and duplicate costs from the cost pool and the reasonableness of the allocation keys used for allocation of costs to the assessee by the overseas AE, is certified by an accountant.

15.4 Safe Harbour Rules for Specified Domestic Transactions

15.4.1 The CBDT vide notification 11/2015 dated 4 February 2015 announced the applicability of Safe Harbour Rules for SDTs undertaken by *Government companies*[7] engaged in business of generation, supply, transmission and distribution of electricity.

SDTs, in relation to above, includes:

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

[7] 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)

15.4.2 Further, the CBDT vide notification 90/2015 dated 8 December 2015 also announced the applicability of Safe Harbour Rules for SDTs undertaken by co-operative society engaged in the business of procuring and marketing milk and milk products. SDTs, in relation to above, includes purchase of milk or milk products by a co-operative society from its members.

15.4.3 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 10THB, 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*[8] 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."

15.5 Revision in definition of Certain Terms as per revised SHR

- The definition of contract R&D services relating to software development is amended to exclude services which involve making available source code to carry out routine functions.

- The definition of operating costs and operating income has been expanded to include costs relating to stock based compensation provided to employees and reimbursement of expenses.

15.6 Validity

The Safe Harbour Rules are applicable for 5 assessment years beginning from assessment year 2013-14. An assessee can opt for SHR for a period of his choice in Form No. 3CEFA but not exceeding 5 assessment years.

The revised SHRs have been extended annually upto FY 2023-24 and further extension is awaited for subsequent years.

15.7 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.

15.8 Non-Applicability of Safe Harbour:

SHR shall not apply even for the eligible international transactions if such transactions are entered into with an AE located in any country or territory notified under section 94A or in a no tax or low tax country.

15.9 Safe Harbour Regulations (SHR) as a Tool of Tax Exposure Management

Safe Harbour 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 ITeS services and auto component sector

Chapter 16 Advance Pricing Agreements & Mutual Agreement Procedure

16.1 Background

To bring down Transfer Pricing disputes and provide tax certainty, the Finance Act, 2012 introduced the provisions of Advance Pricing Agreement ('APA') w.e.f. 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 IT. Thus, once APA has been entered into with respect to an international transaction, the ALP shall be determined for that international transaction in accordance with the APA entered for the specified period.

16.2 Definition and Applicability

Advance Pricing Agreement is an agreement between a taxpayer and a taxing authority on an appropriate transfer pricing methodology for a set of transactions over a fixed period of time in future. APAs shall include determination of the arm's length price or specify the manner in which arm's length price shall be determined (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 on 30 August 2012.

16.3 Current Status of APA Scheme[9]

CBDT Signs Record Number of 125 Advance Pricing Agreements in FY 2023-24

[9] https://incometaxindia.gov.in/Lists/Press%20Releases/Attachments/1188/Press-Release-CBDT-Signs-Record-Number-of-125-Advance-Pricing-Agreements-in-FY-2023-24.pdf

(CBDT press release dated 16 April 2024).

In the financial year 2023-24, the Central Board of Direct Taxes (CBDT) set a new record by entering into 125 Advance Pricing Agreements (APAs) with Indian taxpayers, comprising 86 Unilateral APAs (UAPAs) and 39 Bilateral APAs (BAPAs). This achievement marks the highest number of APA signings in any financial year since the inception of the APA programme. Compared to the previous fiscal year, there has been a significant increase of 31% in the number of APAs signed. This brings the total number of APAs since the initiation of the programme to 641, consisting of 506 UAPAs and 135 BAPAs.

During FY 2023-24 CBDT also signed the maximum number of BAPAs in any financial year till date. The BAPAs were signed as a consequence of entering into Mutual Agreements with India's treaty partners namely Australia, Canada, Denmark, Japan, Singapore, the UK and the US.

The APA Scheme endeavours to provide certainty to taxpayers in the domain of transfer pricing by specifying the methods of pricing and determining the arm's length price of international transactions in advance for a maximum of 5 future years. Further, the taxpayer has the option to roll-back the APA for 4 preceding years, as a result of which, tax certainty is provided for 9 years. The signing of bilateral APAs additionally provides the taxpayers with protection from any anticipated or actual double taxation.

The APA programme has contributed significantly to the Government of India's mission of promoting ease of doing business, especially for MNEs which have a large number of cross-border transactions within their group entities. CBDT appreciates the taxpayers for their cooperative attitude and for being equal partners in this programme.

16.4 Who is eligible to apply for APA?

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

16.5 Time involved

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

16.6 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

16.7 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.

Further, the APA shall prescribe the manner for determining the ALP or the ALP 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 becomes applicable.

16.8 APA Tenure

The tenure of APA can be up to 5 years for onward determination of ALP. In the 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 upto 9 years.

16.9 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 must 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.

16.10 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;
- 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.

16.11 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 the options available under domestic laws.

A Framework Agreement was signed with United States under the MAP provision of the India-US Double Taxation Avoidance Convention (DTAC). This was a major positive development. About 200 past transfer pricing disputes between the 2 countries in Information Technology (Software Development) and ITeS services segments have been resolved under this Agreement during the year 2015.

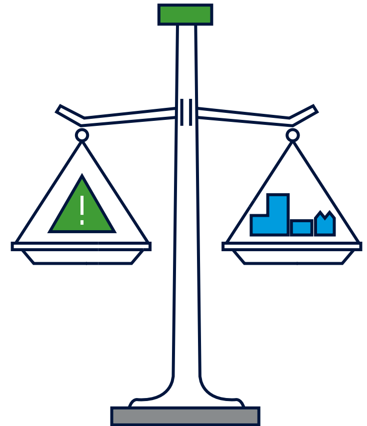
Part E:
Judicial Pronouncements & Other Developments

Chapter 17 Landmark Judicial Pronouncements

Chapter 2 contains updates of recent transfer pricing rulings on important issues. The issues covered in this chapter pertain to significant transfer pricing issues that are dealt in by earlier judicial rulings.

17.1 Comparability Analysis for Determining the ALP

17.1.1 Issue



The process of identifying a comparable uncontrolled transaction and determination of ALP involves various aspects- such as selection of the most appropriate method, comparability parameters and filters, a comparable company, comparability adjustments, etc. The ALP determination, because of its significance in TP analysis, has given rise to a substantial number of TP disputes. These disputes originate at the Transfer Pricing Officer ('TPO')/ Assessing Officer ('AO') level and then make their way to Income-Tax Appellate Tribunal ('Tribunal') wherein the Hon'ble Tribunal is usually considered as the final 'fact finding' authority on such ALP disputes. The issue under consideration was that in every case where the Hon'ble Tribunal determines the ALP, the same shall attain finality and Hon'ble High Court ('HC') is precluded from considering the determination of the ALP determined by the Hon'ble Tribunal , in exercise of powers under Section 260A of the Act.

17.1.2 Judicial Pronouncements

Recently in case of **SAP Labs India Pvt. Ltd. [TS-225-SC-2023-TP],** the Hon'ble Supreme Court ('SC') held that any determination of the ALP under Chapter X of the Act de hors the relevant TP provisions in the Act and the Rules, can be considered as perverse and it may be considered as a substantial question of law as perversity itself can be said to be a substantial question of law. It was held that there cannot be any absolute proposition of law that in all cases where the Hon'ble

Tribunal has determined the ALP, the same shall be final and cannot be the subject matter of scrutiny by the Hon'ble HC in an appeal under Section 260A of the Act. The Hon'ble HC should examine whether the TP guidelines laid down in the Act and the Rules are followed while determining the ALP and therefore, the determination of the ALP by the Hon'ble Tribunal would not be final and can be a subject matter of scrutiny.

17.1.3 Precautionary measure

In view of the above Hon'ble SC judgement, taxpayers need to ensure that they are documenting and clearly distinguishing factual contentions and legal contentions before the Indian tax authorities. Taxpayers with a history of TP litigation should evaluate the feasibility of alternative options for dispute resolution/ prevention, such as safe harbour APAs etc. to avoid the long-drawn litigation process.

17.2 Marketing Intangibles

17.2.1 Issue

The contours of the controversy are that the taxpayer has incurred Advertising Marketing Promotion ('AMP') expenditure in the course of its business operations. The issue herein pertains to the following legal and economic considerations:

- The AMP expenditure incurred is an international transaction of provision of service by the taxpayer to its overseas AE, for which the taxpayer should have been compensated by the AE.
- The AMP expenditure has been incurred for and on behalf of AE who is the legal owner of the brand which the taxpayer is promoting in India.
- The taxpayer is creating a marketing intangible by enhancing the value of the brand owned by the AE.
- Any excess expenditure incurred (non-routine) in comparison to expenditure incurred by other comparable companies is regarded as a separate international transaction of provision of service (based on the Bright Line Test).

17.2.2 Judicial Pronouncements

The said issue was first legally examined in 2013 by the Special Bench of the Hon'ble Delhi Tribunal in the case of **L.G. Electronics India Private Limited [(2013) 29 taxmann.com 300],** wherein, the Hon'ble 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. On AMP expenses, the Hon'ble Tribunal held 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 Hon'ble Tribunal further concluded that the transaction of brand building by the taxpayer for AE is in the nature of the "provision of service" requiring a mark-up. Moreover, the Hon'ble Tribunal also endorsed the use of bright line test to determine the transaction value of such AMP expenses. The Hon'ble Tribunal held that Section 92 of the Act is much wider in its ambit and TP provisions are special provisions and once there is an international transaction, these provisions shall prevail over the general provisions of section 37(1) of the Act. The Hon'ble 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.

In 2015 the Hon'ble Delhi HC in the case of **Sony Ericsson Mobile Communications India Pvt. Ltd. [(2015) 55 taxmann.com 240 (Delhi)]** adjudicating on the issue of marketing intangibles for taxpayers engaged in marketing and distribution functions held that AMP expenses incurred by a subsidiary of multinational enterprise can be categorised as an international transaction subject to TP provisions. It held that marketing and distribution activities 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. The Hon'ble HC overruled the application of the bright line test and concluded that it would be illogical and improper to treat AMP expenses as a separate transaction using the bright line test method.

Hon'ble Delhi HC also recognised the concept of economic ownership of trade name/ trademark is acceptable in international taxation as one of the components or aspects for determining TP. The Hon'ble HC 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.

However, later in 2015 a contrary view was held by the Hon'ble Delhi HC in case of **Maruti Suzuki Ltd. [ITA No. 110/2014]**, on the issue of marketing intangibles for licensed manufacturers wherein it concluded that the AMP expenses incurred cannot be considered as an international transaction and therefore no TP 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.

Hon'ble Mumbai Tribunal in the case of **L'Oreal India Pvt Ltd [TS-829-ITAT-2019(Mum)-TP],** deleted the AMP adjustment finding that the Indian tax authorities failed to prove that the assessee had agreed to incur AMP expenses for brand building of its AE, viz. L'Oreal S.A, France. The Hon'ble Tribunal held that the mere fact that the taxpayer was permitted to use the brand name of its AE, would not automatically lead to an inference that any expense incurred towards AMP was only to enhance the brand of its AE.

While the Hon'ble SC has admitted a special leave petition filed by the Indian tax authorities against the Hon'ble Delhi HC judgment in Maruti Suzuki India Ltd., the same is yet to be adjudicated upon.

Some of the other relevant judicial pronouncements in context of AMP expenses are as under:

- Kellogg India (P.) Ltd.v.Assistant Commissioner of Income-tax [(2022) 139 taxmann.com 205]
- Lenovo India (P.) Ltd.v.Deputy Commissioner of Income-tax [(2023) 148 taxmann.com 237]

- Perfetti Van Melle India (P.) Ltd.v.Deputy Commissioner of Income-tax [(2023) 149 taxmann.com 27]
- Whirlpool of India Ltd. [(2023) 146 taxmann.com 136]
- Xerox India Ltd.v.Deputy Commissioner of Income-tax [(2022) 145 taxmann.com 416]

17.2.3 Precautionary Measure

The emphasis of the rulings is on substance over legal form. Accordingly, it is advisable for taxpayers to analyse as part of their inter-company policies and actual business conduct that there is no arrangement/ agreement implied or otherwise with the AE and the AMP related decisions are independently taken for the benefit of the taxpayer's business. Taxpayers should also evaluate their TP policy in light of detailed analysis of roles / responsibilities undertaken, risks borne/ reward reaped and robust documentation including legal contracts etc. needs to be maintained by the taxpayer.

17.3 Issuance of Corporate Guarantee on behalf of the AE

17.3.1 Issue

The Indian tax authorities are of the view that by providing a corporate guarantee to its AE, the Indian taxpayer has rendered service or provided a benefit to its AE, for which the Indian taxpayer should charge a guarantee fee. The rate/ quantum of guarantee fee that the taxpayer should receive is also a litigative question in the absence of any directive in the Indian TP regulations.

17.3.2 Judicial Pronouncements

The Hon'ble Delhi Tribunal in the case of **Bharti Airtel Limited Vs. ACIT [TS-76-ITAT-2014(DEL)-TP]** observed that under 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 Hon'ble 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 Hon'ble Tribunal noted that the corporate 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. Accordingly, the Hon'ble Tribunal deleted the addition made on account of issuance of corporate guarantees stating that it does not constitute 'international transaction' within meaning of section 92B of the Act.

In the case of **Everest Kanto Cylinders Ltd [TS-714-ITAT-2012(Mum)-TP]** the Hon'ble Tribunal 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. It was 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.

Hon'ble Ahmedabad Tribunal in the case of **AIA Engineering Ltd [TS-9-ITAT-2021(Ahd)-TP]** held that the issue of corporate guarantee was in the nature of shareholder activity and the same could not be included in the provision for services under the definition of international transaction under section 92B of the Act. Placing reliance on **Micro Ink Limited [TS-568-ITAT-2015(Ahd)-TP]** the Hon'ble Tribunal held that these guarantees do not have any impact on profit, losses or assets of the assesse and therefore it is outside the ambit of international transaction under section 92B of the Act. It was further held that there can be a hypothetical situation in which a guarantee default takes place and therefore the enterprise may have to pay the guarantee amount but such a situation, even if that can be so, is only a hypothetical situation.

In the case of **Berger Paints India Ltd [TS-491-ITAT-2022(Kol)-TP],** Hon'ble Kolkata Tribunal upheld the adjustments made on guarantee commissions, stating that there was an inherent risk in providing guarantees and guarantee commissions payment is liable. The Hon'ble Tribunal rejected the contention that the transaction cannot be considered an international transaction as it did not involve any cost and is a shareholder activity.

The Hon'ble Mumbai Tribunal in the case of **Macrotech Developers Ltd [TS-237-**

ITAT-2023 (Mum)-TP] upheld the alternative benchmarking of taxpayer based on yield approach, derived after considering proper credit rating of AEs as TPO failed to account for tenor adjustment, currency swap and attribution of interest saved to contracting parties.

17.3.3 Precautionary measure

Considering that the corporate guarantee provided by the taxpayer to its AE is a subject matter of litigation, it is advisable to document the terms of guarantee, rate charged, duration of guarantee etc. in the intercompany agreements.

17.4 Intra Group Loans

17.4.1 Issue

In cross-border loans advanced among group entities- benchmarking of such intra group loans is a litigative issue in respect to the interest rate charged, repayment terms, methodology used, etc.

17.4.2 Judicial Pronouncements

Hon'ble Delhi HC in **Cotton Naturals India Private Ltd [TS-117-HC-2015(DEL)-TP]** held that the ALP of interest rate should be market determined and computed to currency concerned in which the loan has to be repaid.

Hon'ble Bombay HC in **Tata Autocomp Systems Ltd [TS-45-HC-2015(BOM)-TP]** held that the ALP in the case of loans advanced to associate enterprises would be determined on the basis of rate of interest being charged in the country where the loan is received/consumed.

The Hon'ble Mumbai Tribunal in the case of **S B & T International Ltd [TS-969-ITAT-2016(Mum)-TP]** held that LIBOR +2% to be the arm's length interest rate for an interest-free loan provided by the company in foreign currency to its non-resident AE.

17.4.3 Precautionary measure

It is advisable for the TP purposes, where interest is charged or not, to document all relevant economic factors to substantiate various aspects of the loan, like rate

of interest, tenure, etc. along with supportings. It must be noted that with effect 31 December 2021, LIBOR has been phased out and to replace LIBOR alternative rates maybe such as Secured overnight financing rate ('SOFR') for USD loans, Sterling Overnight Interbank Average ('SONIA') for GBP loans etc. may be used.

17.5 Foreign AE as Tested Party

17.5.1 Issue

In certain classes of international transactions, the foreign AE is the least complex entity whose profitability can be determined with least adjustments and is therefore considered as the tested party. In the absence of clear guidelines in the Act, it has always been a litigative issue as to whether foreign AE can be selected as a tested party.

17.5.2 Judicial Pronouncements

In the case of **Virtusa Consulting Services Private Limited vs DCIT [TS-45-HC2021(MAD)-TP],** the Hon'ble Madras HC noted that the principles that emerged in selection of tested party had been culled out wherein it had been held that the tested party normally should be the least complex party to the controlled transaction. Also, there was no bar either in the Act or the guidelines on TP for selection of local or foreign tested party.

In **Almatis Alumina Pvt. Ltd [TS-109-HC-2022(CAL)-TP]**, the Hon'ble Calcutta HC opined that the Hon'ble Tribunal was right in holding that the assessee was a more complex entity when compared to its AE. The AE performed simpler functions and did not assume any significant risks, and hence, could be treated as a tested party being the least complex party. The Hon'ble HC upheld that there is no bar for selection of tested party and also gave importance to the Hon'ble Tribunal's factual finding that the assessee was a more complex entity as its operation entailed entrepreneurial function and related risks and thus, should not be considered as a tested party,

In case of **IZMO Ltd (formerly Logix Microsystems Ltd) [TS-75-ITAT-2020(Bang)-TP],** the Hon'ble Tribunal rejected foreign AE as a tested party on the basis that the geographical and other economic circumstances of the comparable companies

outside India would be different and cannot reflect the correct ALP.

17.5.3 Precautionary measure

Taxpayers need to analyse the functional complexity of both the parties before selection of the appropriate tested party. In case, taxpayers consider the foreign AE as the tested party, it is advisable to holistically document the reasons for such selection of foreign AE, as well as rejection of the Indian AE to avoid litigation.

17.6 Charging notional interest for delay in realization of sales proceeds from AEs.

17.6.1 Issue

In case of excessive credit period allowed to AEs and delay in realization of sales as compared to non-AEs, the Indian tax authorities are of the view that the Indian entity is passing the benefits of prolonged credit to its AE. proceeds from AEs 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.

17.6.2 Judicial Pronouncements

The Hon'ble Delhi Tribunal in the case of **Kusum Healthcare Pvt Ltd. [TS-129-ITAT-2015(DEL)-TP]** 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.

The Hon'ble Delhi HC in the case of **Mckinsey Knowledge Centre India (P.) Ltd [TS-518-HC-2021(DEL)-TP],** held that under no TP norm, principle or evaluation of any "benefit" can there be a one-sided adjustment taking into account delayed invoices while at the same time ignoring invoices/payment received in advance. Since amount received by assessee in advance from its AE far outweighed amount received late, thus there was no outstanding receivable from AEs to assessee, adjustment on account of notional interest was to be set aside.

The Hon'ble Ahmedabad Tribunal in the case of **Effective Teleservices Pvt Ltd [TS-223-ITAT-2023(Ahd)-TP]** held that where working capital adjustment takes into

account the impact of outstanding receivables no further adjustment is required of interest on outstanding receivables of AEs beyond the agreed credit period if the margin of the assessee is comparable to that of external comparables. It was further held that there may be a delay in collection of money due to a variety of factors which will have to be investigated on case-to-case basis.

17.6.3 Precautionary measure

It is advisable to maintain robust documentation to prove that the excess credit period, if allowed to AE is due to specific business reasons and not with the intention of passing on any benefits to AEs.

17.7 Intra Group Services

17.7.1 Issue

In the context of intra-group services availed by the taxpayer from the AEs, thereby warranting a payment to the AEs, the Indian tax authorities allege the following:

- Need for availing such intra group services by the Indian entity i.e., whether an independent enterprise in a similar circumstance would have paid for availing such services if provided by an independent enterprise or would it have performed such activity in-house.
- Whether the amount charged by AE for the intra-group services is commensurate with the benefit derived by the Indian entity by availing such services. The Indian tax authorities generally determine the service charges as NIL.
- 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.

17.7.2 Judicial Pronouncements

The Hon'ble Mumbai Tribunal in the case of **L'Oreal India (P.) Ltd [(2021) 133 taxmann.com 487 (Mumbai – Trib.)]** held that the jurisdiction of TPO is limited to

ascertain whether the international transaction carried out by the assessee with its AE is at arm's length by applying most appropriate method as specified under section 92C(1) of the Act and make suitable adjustments after benchmarking the transaction. The TPO can neither question commercial expediency of the transaction nor examine whether service was needed or is duplicate in nature. Further, the TPO cannot question the quantum of benefit derived by the assessee from the payment made for international transaction and disallow the expenditure for any extraneous reasons.

The Hon'ble Bangalore Tribunal in the case of **SKF Engineering and Lubrication India (P.) Ltd. [(2022) 140 taxmann.com 191]** held that the assessee is duty bound to benchmark services by comparing it with uncontrolled transaction by independent enterprises where similar services are received. The Hon'ble Tribunal stated that it is not open for the TPO to consider that there was no benefit received by the assessee without verifying the documentation submitted by the assessee.

The Hon'ble Chennai Tribunal in the case of **International Flavours Fragrances India Pvt Ltd, [TS-251-ITAT-2023(CHNY)]** noted that the assessee failed to demonstrate the receipt of services and benefits. Although the assesee paid 'management service charges' to its AE under a Corporate Service Agreement, no actual receipt of services and benefits could be demonstrated. The Hon'ble Tribunal also noted that the aggregation approach is only permissible for closely linked transactions, and since the assessee applied more than one method to benchmark certain transactions in its TP study report, no fault could be attributed to the TPO for rejecting the aggregation approach and benchmarking the transactions under the CUP method. As a result, the TPO's proposed TP adjustment of Nil for management and marketing service fees was upheld by the Hon'ble Tribunal .

Hon'ble Mumbai Tribunal in case of **MWH India Pvt Ltd [TS-138-ITAT-2023(Mum)-TP]** rejects Nil ALP determination of management fee payment made by assessee with a direction to the assessee to substantiate all the five tests (need test, rendition test, benefit test, duplicative test and shareholders activity test) and justify that they are at arm's-length. The Hon'ble Tribunal noted that most of the services are low value-adding services and hence the focus should be more to the

process adopted by the assessee and associated enterprises than evaluation of evidence such as email, reports as well as other correspondences.

17.7.3 Precautionary Measure

It is advisable to design a proper Group TP policy, considering the 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.

Further, it is advisable to maintain robust documentation in order to demonstrate the actual receipt of services and fulfillment of the benefit test i.e., to justify that the compensation paid by the Indian entity is proper and would have been the same if it involves payment to independent third party and similar benefit received from such services.

17.8 Determination of arm's length price for a non-resident in India

17.8.1 Issue

Whether the TPO was correct in making an ALP adjustment to the income of the non-resident in India with respect to interest free loan granted to its wholly owned subsidiary in India that constitutes international transactional under the Indian TP laws.

17.8.2 Judicial Pronouncements

The Hon'ble Kolkata Tribunal Special Bench ruled in favor of the Indian tax authorities, in the case of **Instrumentarium Corporation Limited [TS-467-ITAT-2016(Kol)-TP]** by rejecting the argument of base erosion with respect to the interest free loan advanced by a non-resident assessee to its wholly owned subsidiary in India.

The assessee argued that the case was covered within the purview of section 92(3) of the Act, which states that the TP provisions shall not apply if the adjustment has the effect of reducing income or increasing losses of the assessee. Further, assessee contended that since there is no erosion of tax base in India on account of receiving interest free loans from a non-resident entity, the provisions

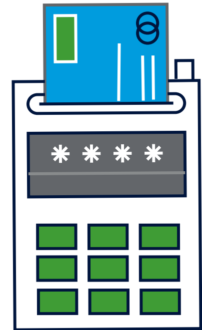
of TP could not be pressed into service in this case. Assessee also stated that the ALP adjustment could not be made in respect of income that has not been reported as international transactions.

Special Bench rejected the arguments of the assessee stating that second proviso to section 92C(4) constitutes a bar against lowering income of the non-resident AE, as a result of lowering the deduction in the hands of the Indian AE, rather than as enabling a higher deduction in the hands of the Indian AE as a result of increasing non-resident AE's income. The Special Bench further noted that the interest earned by the non-resident shall be taxable in India and accordingly, there is a loss to Indian tax authorities. The bench is of the view that it is quite uncertain for the Indian entity to earn sufficient profits in the coming eight assessment years that would subsume the losses within the purview of the Act. Special Bench opined that benefit of loss is not real and contingent on uncertain future event. Further, Special Bench taking plea of Vodafone India Services (P.) Ltd. v. Union of India **[TS-621-HC-2015(BOM)-TP]** rejected the view of the assessee and stated that even when no income is reported in respect of an item in the nature of income, such as interest, but the substitution of transaction price by arm's length price results in an income, it can very well be brought to tax under section 92 of the Act. Under the light of above arguments, Special Bench concluded the transactions under the purview of TP and accordingly, adjudicated the matter in favour of Indian tax authorities.

17.8.3 Precautionary measure

In view of the above, it is advisable to carefully frame the TP policy with respect to the international transactions between AEs. It is clear from the above verdict that the arm's length principle is to be separately applied on assessee as well as the non-resident AE. Going forward, taxpayers should resort to entering into bilateral APAs to avoid uncertainty.

17.9 Re-imbursement of expenses



17.9.1 Issue

- The Indian tax authorities allege that reimbursements are in fact services rendered to the AE on which markup should be charged by the Indian taxpayer.
- The transactions involving cost to cost reimbursements also require a TP analysis (including benchmarking) for determination of ALP.

17.9.2 Judicial Pronouncements

In case of **Cushman and Wakefield India Pvt Ltd [TS-150-HC-2014(DEL)-TP],** Hon'ble Delhi HC 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 Hon'ble HC 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 Hon'ble HC remanded the case back to the files of AO and TPO.

In the case of **India Medtronics (P.) Ltd. [TS-898-ITAT-2019(Mum)-TP],** the Hon'ble Tribunal held that if the AEs were reimbursed on cost-to-cost basis by the assessee for the expenses (in the nature of travelling expenses pertaining to the employees of the assessee) which were incurred by them for an on behalf of the assessee purely on account of administrative convenience, then no adjustment would be warranted in respect of the same.

In case of **Ness Digital Engineering (India) Private Limited [TS-142-ITAT-2023(Mum)-TP],** the Hon'ble Tribunal held that when ALP of international transactions of rendering services by assessee to its AEs, is compensated on cost plus mark-up basis have already been benchmarked separately, then the recoveries by the assessee for the day to day pocket expenses are to be reimbursed on cost to cost basis; When there is no element of profit or mark up in the hands of the AE in incurring the day to day pocket expenses the same is not to be bench marked.

17.9.3 Precautionary measure

It is advisable to carefully frame the policy for re-imbursement of expenses and to maintain documentation in support of expenses incurred, the benefit derived by the AE, rationale for incurring the expenses by Indian entity, arrangement/agreement with the AE in respect of the same, etc.

Further, it is essential to document that the reimbursement is cost to cost without any service element, for administrative convenience and neither of the parties have performed any specific functions or assumed any risks.

17.10 Payment of Royalty

17.10.1 Issue

The Indian tax authorities reject the taxpayers aggregation approach of benchmarking royalty and analyse the same on a transaction-by-transaction basis. The Indian tax authorities also disallow payments of royalty based on the following grounds:

- The payment of royalty does not result in any benefit to the taxpayer
- The taxpayer is a contract manufacturer and therefore the need to pay royalty does not arise due to its functional characterisation.

17.10.2 Judicial Pronouncements

The Hon'ble Delhi HC in the case of **Keihin Panalfa Ltd. [(2016) 70 taxmann.com 328 (Delhi)]** held that an assessee company that acted like an Original Equipment Manufacturer (OEM) could not be treated as a contract manufacturer

for determining the ALP of royalty payments. The functions performed by the assessee, including procurement and inventory management, production and manufacturing planning, coordination of production and sales, import of goods, maintenance of production facilities, and quality control, indicated that it was an OEM and not a contract manufacturer. TPO erred in holding that no royalty was payable, and the Commissioner of Income Tax (Appeals) and the Hon'ble Tribunal were correct in their view that the assessee had acted like any other OEM and could not be treated as a job worker or a contractor.

The Hon'ble Bombay HC in the case of **SI Group India Limited ([2019] 107 taxmann. com 314 (Bombay)]** held that the TPO erred in making an addition by questioning the business decision of the assessee stating that the payment of royalty does not bring incremental benefit to the business of the assessee and accordingly, computed the ALP of royalty as NIL. In this regard, Hon'ble Bombay HC held that it is not in the purview of TPO to question the business decision of the assessee. TPO could have been applied any of the specified methods for determining ALP of the transaction, in case where the TPO was of the view that the underlying transaction was not at ALP.

In **Johnson Matthey India Private Ltd [TS-173-ITAT-2018(DEL)-TP],** the Hon'ble Delhi Tribunal rejected assessee's aggregated approach for benchmarking royalty payment AE under TNMM and upheld external CUP as most appropriate method. Noting that royalty is flowing from a separate agreement and is payable irrespective of any services or goods received, the Hon'ble Tribunal held it to be treated as a separate transaction, opining that the mere fact that relevant payment (royalty, services, material) was utilized for manufacture of final product is not decisive for adopting aggregated approach, but whether the transactions are entered as 'package deal' or whether they can stand without other transaction are relevant considerations.

The Hon'ble Ahmedabad Tribunal in the case of **KHS Machinery Pvt. Ltd. [TS-428-ITAT-2022(Ahd)-TP]** held that the AO cannot treat the ALP of a royalty transaction as Nil solely based on the premise that the AE did not charge any such payment from its other AEs. The Hon'ble Tribunal also noted that comparing the royalty charged by the AE of the assessee from its other AEs cannot result

in determining the ALP of the transaction. The Hon'ble Tribunal clarified that determining the ALP of a transaction requires a thorough TP analysis and cannot be based solely on a comparison with the AE's transactions with other parties.

17.10.3 Precautionary measure

It is recommended that taxpayers carry out a detailed analysis of royalty payment transactions with AEs and appropriately document the results of the analysis to reduce the likelihood of possible tax consequences resulting from TP adjustments. It is also recommended to document and analyse the benefit arising from the use of unique intangibles for which royalty payments are made.

17.11 Use of Profit Split Method

17.11.1 Issue

Where Indian taxpayers use the profit split method ('PSM') as the most appropriate method to benchmark international transactions, the Indian tax authorities in certain instances are of the view that:

- The taxpayer has adopted PSM to camouflage losses.
- The benchmarking methodology of the taxpayer is inconsistent with the functional profile.

17.11.2 Judicial Pronouncements

The Hon'ble Tribunal in the case of **Infogain India Pvt Ltd [TS-392-ITAT[1]2015(DEL)-TP]** held that the activities performed by both entities were significantly linked, with each contributing significantly to the value chain of providing software services to end customers. The Hon'ble Tribunal rejected the TPO's argument that the PSM was adopted to mask losses and clarified that the appropriateness of a TP method is not dependent on whether an assessee has profits or losses. The relative contribution of each entity is to be determined based on key value drivers in the absence of comparables. The taxpayer's profit split ratio of 40:60 was accepted by the revenue authorities in the preceding and succeeding assessment years and directed that no deviation from the 40:60 split ratio was warranted if the facts were similar.

Hon'ble Bangalore Tribunal in case of **Google India Private Limited [TS-335- ITAT-2018(Bang)-TP]** adopted PSM as the most appropriate method, clarifying that characterization of functions cannot be based merely on terms of contract or description of the services given by the assessee and has to be determined having regard to the actual conduct of the parties. PSM was considered appropriate to benchmark the aggregated transactions since it required deployment of assets and functions of different entities located in different geographical locations in order to ultimately deliver services as the combined effort generate revenues.

17.11.3 Precautionary measure

Where PSM has been selected as the most appropriate method, it is crucial for the taxpayers to document the reasons for the same as well as maintain robust TP documentation with detailed functions performed, assets employed, and risks assumed as well as the basis for the profit split. Taxpayers should also ideally perform and document the value chain analysis giving credence to the selection of PSM.

17.12 Economic Adjustments

17.12.1 Issue

There may be certain circumstances wherein comparables identified may require adjustments for differences in working capital, risk profile, capacity utilization, etc. for determining the ALP. Such adjustments are referred to as comparability adjustments or economic adjustments in TP parlance. Quantification of economic adjustments have been a subject matter of litigation in India.

17.12.2 Judicial Pronouncements

Capacity Adjustment: Capacity utilisation adjustment adjusts profit margins of the comparable companies on the basis that disparity between the capacities utilized by the taxpayers and comparable companies impacts profit margins and therefore does not provide reliable comparison to determine the ALP.

The Hon'ble Mumbai Tribunal in the case of **Petro Araldite [TS-201-ITAT-2013(Mum)-TP]** 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 utilization on the profit margin. The Hon'ble Tribunal held that the adjustment on account or difference in capacity utilization 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 the decision of **Claas India Pvt. Ltd. [TS-371-ITAT-2015(Del)-TP]**, the Hon'ble Tribunal held that capacity adjustment is called for only in respect of fixed operating costs as variable operating costs remain unaffected due to any under or over utilization of capacity. The correct course of action is to adjust the operating costs of the comparable, not the assessee, and their resultant operating profit and the fixed operating costs have to be proportionately scaled up or down by considering the percentage of capacity utilization by the assessee and comparable company.

The Hon'ble Bangalore Tribunal in the case of **Dell International Services India (P.) Ltd. [(2023) 149 taxmann.com 241]** held that adjustment on account of under-utilisation capacity was to be rejected as the assessee was not in the initial year of operation and therefore, capacity adjustment cannot be granted without analyzing additional factors.

Working Capital Adjustment: Enterprise level differences in working capital need to be taken into consideration while applying TNMM because of differences in inventory, debtors and creditors need to be eliminated to reliably compare profit margins.

The Hon'ble Bangalore Tribunal in the case of **Quest Global Engineering Services Pvt Ltd [TS-160-ITAT-2022(Bang)-TP],** deleted negative working capital adjustment for captive service provider, by following the Hon'ble Tribunal ruling of **Lam Research (India) Private Limited [TS-203-ITAT-2015(Bang)-TP]** wherein it had been held that negative working capital adjustment shall not be made in case of a captive service provider as there was no risk and it was compensated

on a total cost plus basis; Accordingly, Hon'ble Tribunal directed that no negative working capital adjustment in the hands of the assessee would be made.

The Hon'ble Bangalore Tribunal in **Huawei Technologies India Pvt Ltd [TS-1318-ITAT-2018(Bang)-TP],** held that adjustment on account of working capital adjustment had to be based on opening and closing working capital deployed and insisting on daily balances of working capital adjustment requirements to compute adjustment was not proper and it was impossible to carry out such an exercise.

Risk Adjustment: The impact of risk arising of macroeconomic and micro economic factors on the profitability of the tested party vis-à-vis the comparable companies and the practical difficulty in quantifying the same have been highly litigated.

The Hon'ble Chennai Tribunal in the case of **India Trimmings (P) Ltd [TS-164-ITAT-2022(CHNY)-TP]** allowed for risk adjustment in remand proceedings and upheld deletion of TP adjustment post allowing risk adjustment to factor in various risks faced by assessee like challenging market, competitive price offer from foreign and Chinese manufacturers, necessity of retaining skilled manpower irrespective of fluctuation in volume of productions.

The Hon'ble Chennai Tribunal in the case of **Infac India Pvt Limited [TS-387- ITAT-2018(CHNY)-TP]** ruled that the assessee's calculation of the risk adjustments was on an estimation basis considering the difference in assessee's risk profile and that of comparable. Hon'ble Tribunal explained that though OECD guidelines allows a risk adjustment wherever necessary, it does not say that any such adjustment has to be given merely based on estimates or surmises. Hon'ble Tribunal rejected the plea of granting risk adjustment opining that the essential requirement for allowing a risk adjustment is that the assessee should have quantified and claimed the risk adjustment in its TP documentation based on clear and logical workings, considering the risk profile of tested party and comparables companies and not based on surmises.

17.12.3 Precautionary measure

It is advisable that the claim on account of differences should be supported with evidence and detailed workings of the adjustments claimed by the taxpayers.

17.13 Application of Certain Quantitative Filters

17.13.1 Issue

The application of the quantitative filters for selection of potential companies based on the similarity of turnover, RPT, etc. between the tested party and the comparable companies, though widely accepted, is also widely litigated due to the inherent subjectivity in the determination and application of such filters. Few of the commonly used quantitative filters include:

Turnover Filter: Companies which are operating in the same range of turnover would have similar share in the market and thus are more likely to have somewhat similar profit margins. On the other hand, companies with extremely high or low turnover would not provide an effective base for comparison since their margins would not only reflect the efficiency of their business but also the scale of the operations. The range of the filter is very subjective and varies with the facts of each case.

17.13.2 Judicial Pronouncements

The Hon'ble Bangalore Tribunal in the case of **McAfee Software (India) Pvt.Ltd [TS-136-ITAT2016(Bang)-TP]** held that fixed turnover range such as Rs. 1 to 200 crores cannot be taken and instead the turnover range should be considered basis the turnover/receipts of taxpayer and thus range of upper and lower limit be at ten times as that of taxpayer i.e., one tenth is considered appropriate. The Hon'ble Tribunal further stated that the criteria of range was adopted to avoid selection of high-end companies in a similar line of business and the range could not be fixed and varies case to case.

The Hon'ble Bombay HC in the case of **Pentair Water India Pvt Ltd [TS-566-HC-2015(BOM)-TP],** held that in the selection of comparable, turnover is obviously a relevant factor to consider. Turnover filter had to be basis of selection to exclude comparable companies and accordingly, companies having huge turnover were to be excluded as comparable companies.

Related Party Transaction Filter: This filter finds its application on the principle that if a potential comparable has substantial related party transactions, it can be

inferred that its margins are influenced with transactions which are not entirely governed by the market forces and thus such a company should be rejected in the search process. The Act does not specifically provide as to what percentage of a related party transaction has to be considered for exclusion of potential comparable. In the absence of the same, choosing an appropriate rate becomes a matter of factual choice. The common percentages range from 15% to 25% with no consensus on the same.

17.13.3 Judicial Pronouncements

The Tribunal in the case of **Mindteck (India) Ltd [TS-784-ITAT-2017(Bang)-TP]** dismissed assessee's plea for exclusion of a comparable on application of 25% RPT filter observing that the Hon'ble Tribunal has been taking RPT filter between 15-25% and moreover it is not a water tight compartment that if it crosses the threshold by a little bit, the comparable has to be excluded. Stating that RPT is only a criteria for elimination of comparables, the Hon'ble Tribunal opined that where the RPT in the case of comparable has just crossed the limit, there is no justification for the exclusion of the comparable.

The Hon'ble Bangalore Tribunal in case of **Maxim India Integrated Circuit Design Pvt Ltd [TS-265-ITAT-2016(Bang)-TP]** noted that CIT(A) had directed the TPO to exclude the comparables having any Related Party Transactions ("RPT") without specifying the exact percentage of RPT to be taken as threshold limit. Hon'ble Tribunal also observed that TPO had not applied any filter of RPT for selection of comparable companies. It was noted that in normal circumstances the Hon'ble Tribunal has considered 15% as threshold limit of RPT, when there is no difficulty of finding the comparable companies. Thus, Hon'ble Tribunal directed AO/TPO to adopt 15% RPT as threshold limit for the purpose of selecting comparables and modified the order of the CIT(A) to that effect.

Other judicial pronouncements adjudicated the issue of RPT filter are as follows:

- Chrys Capital Investment Advisors (India) Pvt Ltd [TS-171-HC-2018(DEL)-TP]
- Actis Advisers Pvt Ltd v. DCIT (2013) 146 ITD 314 (Delhi)

- DSM Anti-Infectives India Ltd. v. DCIT [TS-243-ITAT-2013 (Chand)TP]

17.13.4 Precautionary measure

In light of the aforesaid, it is advisable to carefully evaluate the quantitative parameters viz., turnover, service/manufacturing entity, employee expense, etc. of the tested party so as to apply appropriate quantitative filters while selection of potential comparable companies.

17.14 Indian Tax Authorities cannot question the commercial rationale of legitimate business expenses incurred.

17.14.1 Issue

In certain cases, the taxpayer makes payment to its AE and the Indian tax authorities generally disallow such payment by questioning the commercial rationality, business decisions and perpetual losses suffered by the Indian entity.

17.14.2 Judicial Pronouncement

The Hon'ble Delhi HC in the case of **EKL Appliance Ltd. Vs. CIT [2012] 24 taxmann.com 199]** held that any legitimate expenditure for business purposes 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 Hon'ble HC relying on OECD guidelines opined that TPO is expected to examine the international transaction 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 Hon'ble Mumbai Tribunal in the case of **Sulzer Tech India (P.) Ltd. [(2022] 142 taxmann.com 246 (Mumbai - Trib.)]** held that the TPO's jurisdiction was to only determine the ALP of an international transaction, method adopted and whether the comparables selected are appropriate or not. It is not part of the TPO's jurisdiction to consider whether or not the expenditure which has been incurred by the assessee passed the test of section 37 of the Act and/or genuineness of

the expenditure.

This exercise has to be done, if at all, by the AO in exercise of his jurisdiction to determine the income of the assessee in accordance with the Act.

17.14.3 Precautionary Measure

While various decisions highlight the fact that the Indian tax authorities per se cannot question the commercial rationale of legitimate business expenses incurred by the taxpayer. However, it also imperative for taxpayer to demonstrate that the international transaction is at arm's length by application of the prescribed methods with proper evidence/ documentation.

17.15 Use of Berry Ratio as a Profit Level Indicator

17.15.1 Issue

Berry ratio is the ratio of gross profits to operating expenses/ value added expenses. Berry ratio can be used as the PLI mainly in case of service providers like low risk / stripped distributors, commission agents, freight forwarders etc. since their functional profile is limited and hence pass-through costs (being economic costs of third parties, who bear the associated risk from performing functions) are therefore sought to be excluded.

In the absence of clear guidelines in the Act or Rules about what constitutes a PLI, the use of Berry ratio as a PLI is not widely accepted among Indian tax authorities.

17.15.2 Judicial Pronouncement

The Hon'ble Delhi Tribunal in the case of **Sumitomo Corporation India Pvt Limited vs ACIT [TS-1204-ITAT-2018(Del)-TP]** held that the taxpayer was acting as an indenting agent/service provider incurring mainly operating expenses and accordingly, the operating expenses represented the functions performed and risks undertaken by assessee. Under such situations, berry ratio (profit/ value added expenditure) was to be taken as base for computing PLI for TP benchmarking.

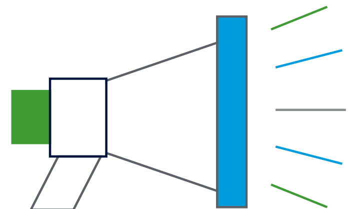
The Hon'ble Delhi HC in the case of **Mitsubishi Corporation India P Ltd. [TS-230-HC-2017(DEL)-TP]** held that the berry ratio was appropriate for benchmarking

of international transactions in the nature of provision of services, purchase of goods in cases where the taxpayer neither assumed any major inventory risk nor committed any significant assets and there was no value addition or involvement of unique intangibles.

17.15.3 Precautionary Measure

Berry ratio should be carefully applied after analyzing the nature of transaction and could be applicable in case of taxpayers having pure return on operating expenses. Thus, it is preferable to confine the use of this method to transactions involving limited risk distributors or service providers that employ no intangible assets.

17.16 Other Emerging Issues



17.16.1 Consideration received from non-resident

Vide Finance Act 2023, any income under section 56(2)(viib) of the Act arising to a non-resident investing in the shares of a closely held company at a value over and above the fair market value of such shares shall be chargeable to tax.

Currently, in the case both parties (closely held company and non-resident) are AEs, taxpayers can take a position that the transaction would not be covered under the ambit of the Indian TP Regulations and would therefore not require to be reported and computed having regard to the ALP in accordance with the provisions of section 92(1) of the Act[10]. This is in accordance with the view that was upheld in **Vodafone India Services Pvt. Ltd. v Union of India [2014] 50 taxmann.com 300 (Bombay)** wherein the transaction of issue of equity shares was considered to fall out of the ambit of the provisions of Chapter-X of Indian

[10] Another possible view can also be taken by the taxpayers, wherein the transaction of issue of shares is reported and benchmarked, to avoid the non-reporting penalty for taxpayers, however still espousing the view that the transaction of issue of shares is not an international transaction falling within the ambit of Chapter X provisions of the Act.

TP regulations and does not require any arm's length analysis. The income arising from the transaction of 'Issue of Shares' and the consequential applicability of TP provisions, are not applicable.

Post the Finance Act 2023 amendment ,the shelter of the Vodafone case may no longer be available to Indian taxpayers.

17.16.2 Attribution of profits to Permanent Establishment

The profits attributable to a PE are the profits that the PE would have derived if it were a separate and independent enterprise taking into account the functional analysis. The principle of attribution of profits is a question of law or fact.

Recently the Hon'ble SC in case of **Travelport Inc** [TS-218-SC-2023] held that any determination as to what proportion of profits arose or accrued in India is essentially question of fact and Hon'ble Tribunal is the final fact-finding authority. Hon'ble SC observes that Hon'ble Tribunal arrived at the quantum of Indian Tax accruing to assessee in India on the basis of functions, assets and risks analysis. Referring to Explanation 1(a) to Section 9(1)(i) of the Act which provides that only income reasonably attributable to operations carried out in India can be taken as income deemed to accrue/arise in India and holds that what portion of the income can be reasonably attributed to the operations carried out in India is obviously a question of fact, which was duly considered by Hon'ble Tribunal taking into account relevant factors.

Chapter 18 Transfer Pricing – Multiple Regulations – Income-tax Act, GST, Customs, Company Law & FEMA

India is emerging as one of the fastest-growing economies in the world backed by its robust economic policies and strong business partnerships. To ensure a fair and equitable business environment as well as transparency and integrity in business operations, various statutory laws are enacted, and taxpayers are expected to comply with all such laws as may be applicable. While every law is written with a different objective, the overall intent can be seen as one of transparency and fairness in conducting business and discharging appropriate tax obligations. To ensure compliance with all applicable statutory laws, it becomes vital for taxpayers to have a working level knowledge of such applicable laws and their interplay with such various other statutory laws. Any non-compliance or contravention to these applicable laws and regulations, even due to bonafide lack of knowledge or awareness could lead to unavoidable legal hassles for the taxpayer.

18.1 Nexus between Indian TP Regulations and Indirect Taxes-GST and Customs

18.1.1 Direct tax law and indirect tax law both can be viewed as primarily dealing with the payment and discharge of tax liabilities, Transfer Pricing under the direct tax law deals with the payment of taxes that help curb instances of tax avoidance and shifting of profits, whereas the indirect tax laws under the aegis of the Goods and Services Tax (GST) and Customs deals with the indirect levy of tax with the aim of removing the cascading tax effect.

18.1.2 An increase in the use of technology by the direct and indirect tax administration along-with an increased sharing of information between GST and Transfer Pricing authorities has made it imperative for the taxpayers to understand the inter-play between these two laws.

18.1.3 In the context of Transfer Pricing, valuation of transactions between related parties can be viewed as a binding factor between GST law and Transfer Pricing regulations. Therefore, it is important to determine the correct value of supply of goods and services to/ by related persons to avoid litigation. Taxpayers need to harmonise the differences between Transfer Pricing, GST and Customs law as applicable, as deviations in tax positions could potentially lead to adverse tax consequences.

Some of the specific issues that could arise as a result of the inter-play of Transfer Pricing, GST and Customs laws are provided in the ensuing table:

Basis	GST Law	Customs Law	TP Law
Definition of Related Party	● Common employees / directors ● Partners ● Employer / Employee ● Voting power >= 25% in both ● Two persons are controlled by a third person or control a third person ● Sole distributor / agent	● officers or directors of one another's business ● legally recognized partners in business ● employer and employee ● any person directly or indirectly owns, controls or holds 5% or more of the outstanding voting stock or shares or both of them ● one of them directly or indirectly controls the others ● both of them are directly or	● Voting power > 26% ● Voting power > 26% in both enterprises ● Loan > 51% of BV of total assets ● Guarantees > 10% of total borrowings ● Board of directors appointed > 50% ● Board of directors appointed > 50% in both enterprises ● Wholly dependent on use of intangibles ● Raw materials purchased > 90% ● Influence on sales and selling price

Basis	GST Law	Customs Law	TP Law
		indirectly controlled by a third person ● they directly or indirectly control a third person ● members of the family ● members of the same family.	● Jointly controlled entities by individual and relatives ● Jointly controlled entities by HUF and relatives ● Interest > 10%
Methods of Valuation of Related Party Transactions	1. Open Market Value 2. Value of supply of G/S of like kind and quality 3. Value of supply based on cost 4. Residual method 5. Valuation for specific cases	1. Transaction value of identical goods 2. Transaction value of similar goods 3. Deductive value 4. Computed value 5. Residual method	1. Comparable uncontrolled price method 2. Resale price method 3. Cost Plus Method 4. Profit Split Method 5. Transactional Net Margin Method 6. Other method
Hierarchy of Valuation Methods to be followed	As prescribed in the law	As prescribed in the law	No hierarchy prescribed in the law
Data applicability	At the time of transaction	At the time of transaction	Multiple Year Data
Functions performed, Assets employed, Risks assumed (FAR) Analysis	Not Applicable	Not Applicable	Conducting a FAR analysis is imperative

Basis	GST Law	Customs Law	TP Law
Point of Enquiry	At the time of transaction	At the time of transaction	After closure of Financial Year
Adjustments	Discounts, Rebates, etc.	commission/ brokerage, cost of containers etc.	Economic adjustments viz., working capital adjustments, capacity utilisation adjustments etc.
Tolerance Band	No such concept	No such concept	Wholesale traders 1%, Others 3%

18.1.4 Free of Cost Goods and Services

Sometimes, companies provide certain goods/services to their parent company as samples without charging any costs. In case of goods, free supply qualifies as export, and it is permissible, subject to customs and exchange control regulations. Further, in case of services, free services do not qualify as exports.

In certain instances, companies receive certain free goods/services from their parent company to cater to business needs without charging any costs. In such cases, no GST implications shall arise. However, in case of free services, as a conservative approach, GST can be payable on a reverse charge mechanism and therefore, input tax credit can be availed. From a Transfer Pricing perspective, taxpayers would have to evaluate whether in an arm's length scenario free of cost goods or services are justified and how the same has to be reported in Form No. 3CEB.

Contradiction between the laws may invite accuracy and correctness issues.

18.1.5 Intermediary Services

Intermediary means a third person like a broker/ agent who arranges or facilitates the supply of goods/ services between the two or more persons but excludes the person who facilitates on his own account. Generally, export of services

does not attract levy of GST liability and are zero rated. However, intermediary services are specifically excluded from the benefit of zero-rated supply. Based on the contractual arrangements and/ or actual conduct of the taxpayers, a service provided to an overseas related party may be re-classified as an intermediary service. While there may be no impact from a Transfer Pricing viewpoint, taxpayer maybe be exposed to a potential GST liability.

As a matter of prudence, from a taxpayer's perspective, it is advisable to be aware of the various regulations and their inter-play with other statutory laws. Inter-company policies must be periodically reviewed, and the taxpayer must carefully monitor contractual arrangements and its actual conduct in the light of various direct and indirect tax laws, as well as maintain proper documentation along with supporting evidence in order to remove difficulty at the time of future assessment/litigations.

18.2 Nexus between Indian TP Regulations and the Companies Act 2013

18.2.1 As per Section 188 of the Companies Act 2013, related party transactions (RPTs) should be undertaken at arm's length. Consequently, taxpayers need to assess whether any RPTs entered into, comply with the arm's length concept to ensure compliance with the Companies Act.

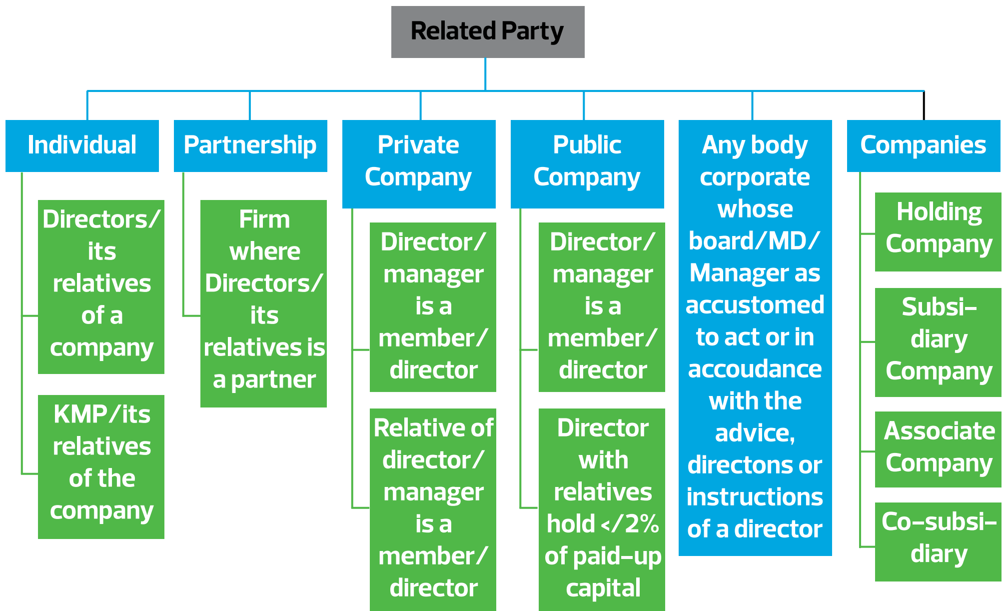
18.2.2 As per Section 188 of the Companies Act, 2013 where a company has undertaken RPTs on an arm's length basis in the ordinary course of business, the Company is not required to comply with the additional compliance requirements made thereunder. In other words, where RPTs are not undertaken in an arm's length manner, a Company would have to undergo additional compliances like prior approval of the Board by way of resolution. In some circumstances, prior approval of shareholders by way of passing an Ordinary Resolution (OR) is required along with approval of the Board of Directors in a Board Meeting as per section 188 of Companies Act, 2013.

18.2.3 Neither the Companies Act, 2013 nor any of the rules or regulations made thereunder, define what constitutes an arm's length price or how the same is to

be determined. In the absence of specific provisions, reference can be drawn from the Transfer Pricing provisions under the Act for determining the arm's length price of such RPTs. As a consequence, related party transactions covered under the provisions of the Companies Act, 2013 may now call for benchmarking and convergence with the India Transfer Pricing regulations.

18.2.4 The Audit Committee may approve the proposed RPTs considering the ALP of such transactions is computed using methods prescribed under Transfer Pricing regulations.

18.2.5 Companies also need to take into consideration that the basis of the constitution of a transaction as a 'related party' transaction under the Companies Act, 2013 and Indian Transfer Pricing provisions in the Act differs, however the mechanism to determine whether a RPT is at arm's length can be referred from the Act. Definition of Related party provided under the Companies Act, 2013 is as depicted in the ensuing chart-



18.2.6 Further, in the case of listed companies, a separate approval process for RPTs

is required to be followed under SEBI (LODR) Regulations, 2015. Approval for material transaction (10% of annual consolidated turnover) is required whether the transaction is with or without consideration.

18.3 Nexus between Indian TP Regulations and Foreign Exchange Management Act, 1999

18.3.1 The Foreign Exchange Management Act, 1999 (FEMA) Act is a regulatory framework that governs the movement of foreign exchange in and out of India. The primary objective of FEMA is to facilitate external trade and payments, maintenance of the foreign exchange market in India and to preserve the stability of Indian financial systems. FEMA regulates the following types of transaction involving the foreign exchange:

- **Current Account Transactions:** These transactions are related to imports and exports of goods and services, travel expenses, remittances by non-residents.
- **Capital Account Transactions:** These transactions are related to investment made by non-residents in India, repatriation of capital, transfer of shares or convertible debentures by non-resident and borrowing or lending in foreign currency.

18.3.2 The connection between Transfer Pricing and FEMA can be seen in their common objective-curbing cross-border shifting of profits and regulating cross border foreign exchange flow. Companies need to ensure that they comply with both TP regulations and FEMA to avoid any penalty, fines, or legal action.

Relevance of Arm's Length Principle

FEMA regulations require that the price charged for cross-border transactions must be reasonable and in compliance with the arm's length principle.

Rule 16 of Foreign Exchange Management (Overseas Investment) Rules, 2022 describes the pricing guidelines regarding issue or transfer of equity capital wherein Authorised Dealer (AD) bank shall ensure compliance with arm's length

pricing taking into consideration the valuation as per any internationally accepted pricing methodology.

18.3.3 Further, all the transactions involving foreign exchange must be conducted through ADs, authorised by the Reserve Bank of India (RBI). The ADs are required to ensure that the transaction is at arm's length as well as complies with FEMA regulations. If the transaction price is found to be above or below the ALP, the authorized dealer is required to report the same to RBI.

18.3.4 In the case of ECBs, FEMA regulations require that the pricing of ECBs should be in line with the FEMA/ RBI guidelines. The RBI has issued guidelines for determining the value of ECBs, which consider various factors such as the credit rating of the borrower, the country risk premium, and the liquidity premium. These guidelines ensure that ECBs are priced appropriately and do not result in any undue benefit or determent to the borrower or the lender.

18.3.5 Taxpayers who have availed ECBs from related parties should ensure that the interest and the pricing of ECBs meets the arm's length criteria as per Indian Transfer Pricing regulations.

18.3.6 Netting-off Trade Payables and Receivables

Reporting and benchmarking of trade payables and trade receivables is a contentious issue in Transfer Pricing. As per the FEMA notification dated December 04, 2020 on 'External Trade – Facilitation - Export of Goods and Services' ADs have the power to allow setting off outstanding export receivables against outstanding import payables within the same overseas group entities subject to the fulfilment of prescribed set of conditions. Taxpayers should analyse the impact of such netting-off of the trade receivables and payables on Transfer Pricing reporting and benchmarking.

18.3.7 Interest under Secondary Adjustment

Under Transfer Pricing regulations, Section 92CE(2) of the Act provides that in case of secondary adjustment, where the excess money is not repatriated

within the given timeline, in such case, the excess money would be deemed as an advance and notional interest shall be charged, and tax would is payable on such notional deemed advance. Since Transfer Pricing provisions deem the unpaid amount as an advance from a related party, taxpayers should analyse the impact of FEMA regulations, if any on such deemed advance.

18.3.8 As a best practice, taxpayers must be aware of FEMA implications on Transfer Pricing reporting and benchmarking and take appropriate measures to ensure that they are not in contravention of any of the regulations.

18.4 Nexus between Indian TP Regulations and IND AS

18.4.1 The Ministry of Corporate Affairs (MCA) notified the roadmap for companies in India to adopt Indian Accounting Standards (IND AS) from financial year 2016-17 onwards. Accordingly, companies that fall under the ambit of this prescribed roadmap are now required to prepare financial statements in accordance with the IND AS framework issued by the International Accounting Standards Board (IASB).

18.4.2 IND AS has brought about substantial changes in the reporting of components forming part of financial statements. For instance, on application of IND AS, certain components like gain/loss from investments, remeasurements of defined benefit plans, etc., are disclosed as a part of Other Comprehensive Income (OCI) but are however not recognized in the profit and loss account.

18.4.3 Undertaking an economic analysis is the bedrock Transfer Pricing analysis, which requires in-depth analysis of the information as presented in the financial statements of the taxpayer and we well as other companies. Application of a Transfer Pricing method and ALP is dependent on the financial data of the taxpayer and comparable companies. Accordingly, it become crucial for the taxpayers to analyse various parameters like the nature of the income/expense, characterization of such income/expense- notional or cash and determine whether the change in revenue/ expense accounting has an impact on Transfer Pricing benchmarking analysis.

18.4.4 The transactions reported in the Form No. 3CEB are taken from the related

party schedule forming part of the financial statements, accordingly, it becomes imperative to consider what accounting policies and principles have been followed by the taxpayer i.e., Indian Generally Accepted Accounting Principles (IGAAP) or IND AS, as it would have an impact on reporting and subsequent determination of ALP.

18.4.5 Certain practical issues could arise in ALP determination due to financial information presented using different accounting policies and methodologies i.e., IGAAP vs IND AS:

a. Under the IND AS framework, reporting of certain income/expenses in profit and loss is made through separate heading 'Other Comprehensive Income' and forms part of the reserve and surplus reported under balance sheet. However, no such concept exists under IGAAP. Difference in the reporting framework brings about difficulty in identifying such financial components and could lead to inconsistency in the margin computation for determination of ALP.

b. Under the IND AS framework, redeemable preference shares and likewise quasi-equity instruments are separately dealt under IND AS 109 'Financial Instruments' wherein the same is computed at fair value and interest thereon is computed. Under GAAP, such instruments are classified as equity and dividend is computed. This differing treatment could potentially bring differences in margin computation for ALP determination, as under one framework interest expense is deductible whereas under the other framework dividend would have no impact on the margin computation.

c. Under IND AS framework, reporting is primarily focused on the concept of fair valuation wherein notional interest and expenses are computed. For instance, under a lease arrangement, rental expense is not debited rather interest and depreciation are expensed off. However, under IGAAP, rental expenses are debited in profit and loss account. and accordingly, from a Transfer Pricing perspective, this difference could bring inconsistency while computing the arm's length margin.

d. As part of the quantitative analysis in Transfer Pricing benchmarking, exclusion/inclusion of comparable are based on certain filters computed using data from the profit and loss account. Following separate accounting frameworks IND AS vis-à-vis IGAAP would give rise to differences in revenue, expense, assets accounting and reporting. This could affect the computation of operating margins.

e. Change in the characterisation of an instrument from an accounting perspective could also potentially impact the treatment given for limitation of interest deduction as per Section 94B of the Act since under IGAAP redeemable preference capital is treated as equity whereas under IND AS redeemable preference shares are classified as debt and the dividend is treated as interest cost. In certain cases, optionally convertible debentures/ bonds are also required to be accounted for as a separate liability and equity component.

f. Taxpayers opting for APAs should consider the impact of transition to Ind AS on the arm's length margins agreed in the APA, specifically taking into account the APA margins agreed for roll-back years that coincide with the IND AS transition period.

18.4.6 Taxpayers need to analyse and review the various Transfer Pricing issues that could arise due to the adoption of IND AS. Understanding the implications of the transition to Ind AS for transfer pricing analysis and establishing a system to proactively identify and address such issues is paramount. Documenting the positions adopted to eliminate such differences, including assumptions made while undertaking benchmarking analysis and margin calculations can also be considered as a best practice. Further, guidance with respect to notional income/ expense recorded in books of accounts and their treatment under Transfer Pricing is much required and awaited to remove hardships faced by the taxpayers.

Abbreviations

Abbreviation	Term	Abbreviation	Term
AAR	Authority for Advance Ruling	ITES	Information Technology Enabled Services
ACIT	Assistant Commissioner of Income- tax	KMP	Key Management Personnel
AE	Associated Enterprise	KPO	Knowledge Process Outsourcing
ALP	Arm's Length Price	MAM	Most Appropriate Method
AMP	Advertising Marketing & Promotion	MAP	Mutual Agreement Procedure
AO	Assessing Officer	MNC	Multi National Company
AOP	Association of Persons	NJA	Notified Jurisdictional Area
APA	Advance Pricing Agreement	NPBT	Net Profit Before Tax
AY	Assessment Year	ODI	Outward Direct Investment
BOD	Board of Directors	OECD	Organization for Economic Co-operation and Development
BOI	Body of Individuals	PCCIT	Principal Chief Commissioner of Income-tax
CBDT	Central Board of Direct Taxes	PCIT	Principal Commissioner of Income-tax
CCA	Cost Contribution Arrangement	PE	Permanent Establishment
CGST	Central Goods & Service Tax	PLI	Profit Level Indicator
CIT	Commissioner of Income-tax	PSM	Profit Split Method
CPM	Cost Plus Method	R&D	Research and Development
CRISIL	Credit Rating Information Services of India Limited	RBI	Reserve Bank of India
CUP	Comparable Uncontrolled Price	ROI	Return of Income

Abbreviation	Term	Abbreviation	Term
DCIT	Deputy Commissioner of Income- tax	RPM	Resale Price Method
DGIT	Director General of Income- tax	RPT	Related Party Transactions
DIT	Director of Income-tax	SDT	Specified Domestic Transactions
Draft Order	Draft Assessment Order	SEBI	Security and Exchange Board of India
DRP	Dispute Resolution Panel	SEZ	Special Economic Zone
DTAA	Double Taxation Avoidance Agreement	SHR	Safe Harbour Rules
DTC	Direct Tax Code Bill, 2010	SLP	Special Leave Petition
FAR Analysis	Functions, Assets and Risk Analysis	SVB	Special Valuation Branch
FDI	Foreign Direct Investment	the Act	Income tax Act, 1961
FM	Finance Minister	the Rules	Income tax Rules, 1962
FMV	Fair market Value	TNMM	Transactional Net Margin Method
FY	Financial Year	TP	Transfer Pricing
GAAR	General Anti Avoidance Rule	TPO	Transfer Pricing Officer
GP	Gross Profit	UK	United Kingdom
GST	Goods & Service Tax	UN TP	United Nations practical Manual on Transfer Pricing
HUF	Hindu Undivided Family	US	United States of America
ICAI	The Institute of Chartered Accountants of India	WOS	Wholly Owned Subsidiary
INR	Indian Rupee		
IT	International Transaction		

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