Transfer Pricing Landscape in India

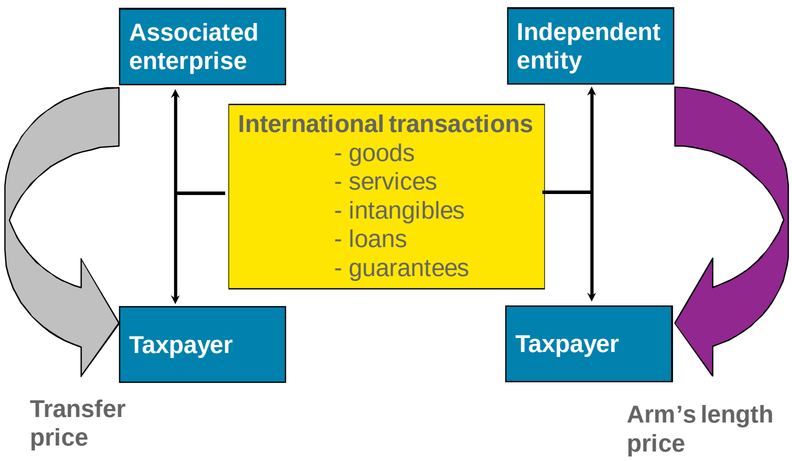
3 October 2015

CA Himanshu Tanna

Contents

Transfer Pricing analysis

Concept of transfer pricing



Rationale for regulating transfer prices

- Differences in tax rates across tax jurisdictions
- Pricing flexibility (between associated enterprises)
- Presumption: prices between associated enterprises are not at arm's length
- Every government wants to prevent erosion of their tax base and plug potential tax leakages

Applicability

- The provisions of **Section 92 to 92F** of the Act are applicable only if:
  - There are two or more enterprises (defined in Sec 92F); and
  - The enterprises are AEs (defined in Sec 92A); and
  - The enterprises enter into a transaction (defined in Sec 92F); and
  - The transaction is an International transaction (defined in Sec 92B).
- Further w.e.f. 1 April 2012, TP provisions shall also apply to specified domestic transactions (SDTs) (defined in Sec 92BA)
- Consequences of these provisions:
  - Computation of income/ allowance of expenses having regard to the Arm's length price [Section 92]
  - Maintenance of prescribed Documentation (Section 92D & Rule 10D)
  - Obtaining of Accountant's report (under Form 3CEB) (Section 92E)
  - To ensure compliance with the arm's length principle, stiff Penalties have been prescribed

Applicability (contd.)

- Section 92(1) –

  Any income arising from an international transaction shall be computed having regard to the arm's length price

  Explanation - the allowance for any expense or interest arising from an international transaction shall also be determined having regard to the arm's length price

- Section 92(3) –

  The provisions are not intended to be applied in case determination of arm's length price reduces the income chargeable to tax or increases the loss as the case may be

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Enhanced definition of International transaction (w.e.f. 1 April 2002)

International Transaction

Tangible Property
- Purchase, Sale, Transfer, Lease /Use of property/article/ product/ thing
- Includes Building, Vehicle, machinery etc.

Intangible Property
- Purchase, Sale, Transfer, Lease /Use of IP
- Includes Transfer of ownership/use of rights/other commercial right

Capital Financing
- Long/short term borrowing/ lending
- Guarantee
- Purchase/Sale Securities
- Advances/receivables, Payments/any debt etc

Provision of Services
- Market Research/ Development
- Technical Service
- Scientific Research
- Legal/Accounting Service etc.

Business Restructuring
- Transaction of Business restructuring/reorganization with AE irrespective of bearing profit/income/loss or assets – at the time of transaction/future date

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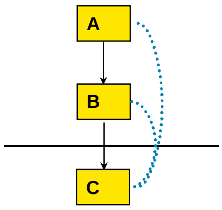
Definition of Intangible Clarified

Marketing	Trademarks, Trade Names, Brand Names, Logos
Technology	Process Patents , Patent Applications, Technical Documentation, Technical know-how
Artistic	Copyrights, Literary work, Musical Compositions, Maps, Engravings
Data Processing	Software Copyrights, Proprietary software, Automated databases, Integrated circuit Masks & Masters
Engineering	Industrial Design, Product Patent, Trade Secrets, Engineering Drawings, Blueprints, Proprietary Documentation
Customer	Customer Lists, Customer Contracts, Customer Relationship, Open Purchase Orders

Definition of Intangible Clarified (contd.)

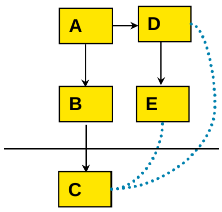
Contract	Favourable Supplier Contracts, License agreements , Franchise agreements , non-compete agreements
Human Capital	Trained & Organised work force , Employment agreements, Union Contracts
Location	Leasehold interest, Mineral exploitation rights, Easements, Air rights, Water rights
Goodwill	Institutional / Professional Practice / Celebrity goodwill , Personal goodwill of professional, General business going concern value
Similar	Similar Item deriving its value from its Intellectual content rather than its physical attributes
Others	Methods , Programmes , Systems, Procedures, Campaigns, Surveys, Studies, Forecasts, Estimates, Customer Lists or Technical data

Meaning of Associated enterprises (Sec 92A)



Both A and B are associated enterprises of C

Direct or indirect participation (through one or more intermediaries) in management, control or capital

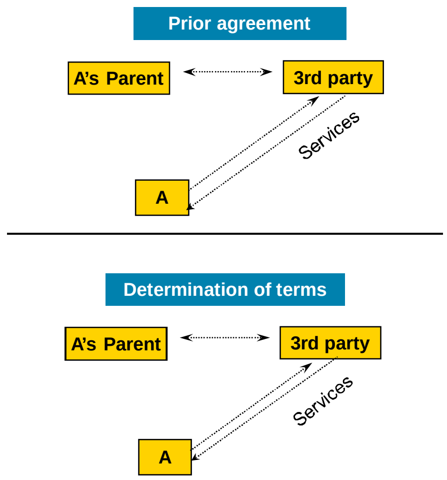


D and E are also associated enterprises of C since they have a common ultimate parent (A)

Deemed Associated enterprises (Sec 92A(2))

Holding	Management	Activities	Control
1. >= 26% direct / indirect holding by enterprise OR 2. By same person in each enterprise 3. Loan >= 51% of Total Assets 4. Guarantees > = 10% of debt 5. > 10% interest in Firm / AOP / BOI	6. Appointment > 50% of Directors / one or more Executive Director by an enterprise OR 7. Appointment by same person in each enterprise	8. 100% dependence on use of intangibles for manufacture / processing / business 9. Direct / indirect supply of > = 90% Raw Materials under influenced prices and conditions 10. Sale under influenced prices and conditions	11. One enterprise controlled by an individual and the other by himself or his relative or jointly 12. One enterprise controlled by HUF and the other by - a member of HUF - his relative or - Jointly by member and relative

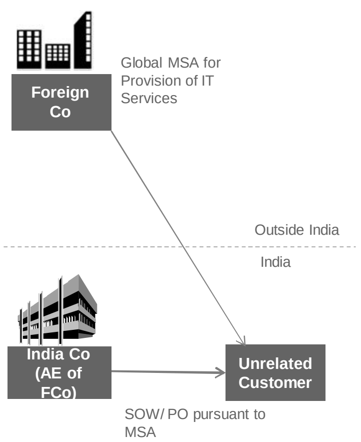
Deemed International Transaction
Overview



An transaction with an unrelated company (3rd party) is deemed to be an international transaction and subject to transfer pricing regulations if:

- a **prior agreement** exists between A's AE and 3rd party in relation to services rendered by A to the 3rd party; or
- **terms of transaction** are determined in substance by A's AE and 3rd party

Deemed International Transaction
Recent amendment



- Foreign Co is a US based global IT Services Co. FCo and its affiliates (including India Co) enters into Global MSAs with potential customers for provision of IT services. MSA provides the broad terms and conditions under which customers and FCo's affiliates may enter into local SOWs
- In case customer entity in India requires IT services in India, a separate SOW is entered into with India Co with price and service level separately agreed. Terms of the SOW are substantially determined based on the MSA
- Such transaction would be covered under the amended provision

Clarification provided by Finance Act 2014 that deemed international transactions would also cover cases where both the contracting parties are residents

Specified Domestic Transaction – Sec 92(2A)

- Scope of TP provisions expended w.e.f. AY 2013-14 by including "SDT" if aggregate value of such transaction exceeds INR 50 Million (INR 5 Crores) *[Finance Bill 2015 has increased this threshold to INR 20 Crores]*

- Applicability of TP regulations (including procedural and penalty provisions) to specified transactions between domestic related parties and payments made to related parties.

- Section 92BA - "**Specified Domestic Transactions**" in case of an Assessee means any of the following transactions, not being an international transaction, namely -
  - i. Any expenditure in respect of which payment is made or to be made to a person u/s 40A(2)(b);
  - ii. Any transaction referred u/s 80A;
  - iii. Any transfer of goods/services u/s 80-IA;
  - iv. Any business transaction u/s 80-IA(10);
  - v. Any transaction under Chapter VI-A or u/s 10AA – to which provisions of Sec 80-IA (8) or (10) applies; or
  - vi. Any other transaction as may be prescribed.

Specified Domestic Transaction – Sec 92(2A) (contd.)

- Meaning of related party of domestic transaction u/s 40A(2)(b) to include companies having same holding company.

- All provisions applicable for determination of ALP for international transactions would apply in case of SDT also. Also penal provisions applicable to international transactions would apply to SDT

- Remuneration to Key Managerial Personnel also covered under SDT

Arm's length price

Price applied or proposed to be applied in a transaction between persons other than AEs, in uncontrolled conditions

Determination of arm's length prices using one of the Prescribed methods

Whether you arrive at a single price ?

Yes

The price thus determined is the arm's length price

No

Earlier: The arithmetic mean of such prices, read with sec 92C(2)

+1% (upper ceiling) for wholesale traders; and
+ 3% (upper ceiling) in all other cases

**To be replaced in current finance Act with a range (to be defined) and mean to apply only in case of inadequate comparables*

Other countries: Interquartile range

Prescribed Transfer Pricing methods

Prescribed Transfer Pricing methods

Traditional Transaction Methods
- Comparable Uncontrolled Price
- Resale Price Method
- Cost Plus Method

Transactional Profit Methods
- Profit Split Method
- Transactional Net Margin Method

Other Methods
- Any other method as provided in Rule 10AB

- ► Tax payer may apply any of the above methods that is considered most appropriate for a transaction

Sixth method has been introduced w.r.e.f 1 April 2012 in the Indian transfer pricing regulations vide Rule 10AB which provides use of any method which ***takes into account the price which has been charged or paid***, *or* ***would have been charged or paid****, for the same or similar uncontrolled transaction*

Comparable Uncontrolled Price Method Rule 10B(1)(a)

- ► Considered the most preferred method, for all transactions, if information is available
- ► Compares the price charged in a controlled transaction with the price in an uncontrolled transaction
- ► Comparable can be **'Internal'** or **'External'**
- ► Requires strict comparability in products, contractual terms, economic terms, timing of transaction, geographical location, size/ level of market and intangible property associated with sale (eg brand, know-how)
- ► Most direct and accurate method

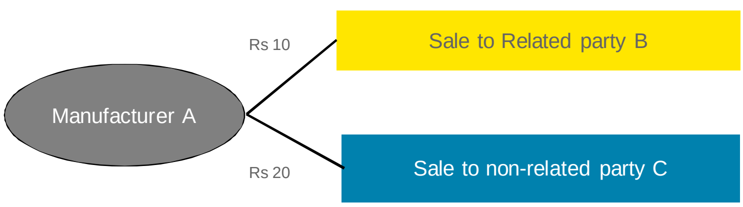
Applicability
- ► Transfer of tangibles i.e. standard products/ goods
- ► Use in case of strong similarity of products

Comparable Uncontrolled Price Method

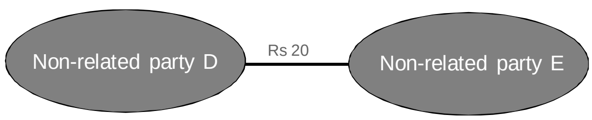
- Identification of price charged or paid in comparable transaction(s)
- Such price adjusted to account for differences if any between international transaction and uncontrolled transaction(s)
- Adjusted price arrived above taken to be arm's length price

Comparable Uncontrolled Price Method

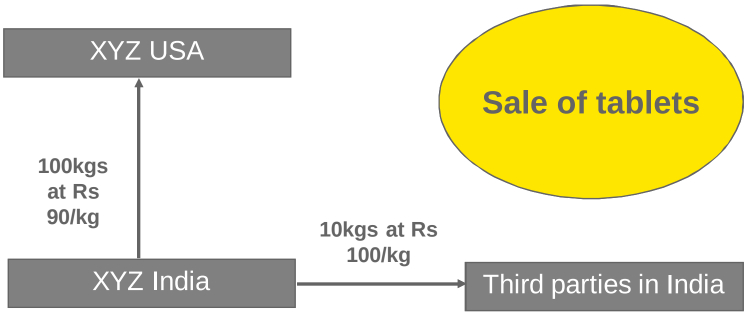
- Internal CUP



- External CUP

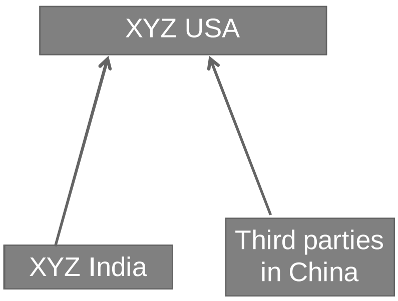


Case study - I



Which method applies to this transaction and why?

Case study - II



- XYZ India sells wipers to XYZ USA. Similar wipers are purchased by XYZ USA from third parties in China
- CUP method applied by XYZ India
- Transfer Pricing Officer disregarded CUP on the basis that conditions prevailing in the market are not similar
- How would you defend the case?

Resale Price Method- Rule 10B(1)(b)

- To be used when purchase from AE for resale purposes
- Compares the resale gross margin earned by an associated enterprise with the resale gross margin earned by comparable independent distributors
- An arms' length gross margin should be sufficient for a reseller to cover its operating expenses and make an appropriate operating profit (in light of its functions and risks)
- Preferred method for a distributor buying purely finished goods from a group company without any value addition (if no CUP available)

Application of RPM Method

Identification of resale price by tested party

Resale price reduced by normal gross profit with reference to uncontrolled transaction(s)

Such price reduced by expenses incurred (customs duty etc.) in purchase of the product/ services.

This price may be adjusted to account for functional and other differences, if any. Adjusted price arrived above taken to be arm's length price

RPM - Example

Transaction: Import of goods from associated enterprises for resale to unrelated parties

Particulars	Amount
Actual resale price earned by XYZ India from sale of group company products to unrelated enterprises	100
Less: Comparable gross profit margin	(10)
Cost of Sales	90
ALP for products procured from group companies during the year	90

Hence, XYZ can pay a maximum of Rs 90 to its A

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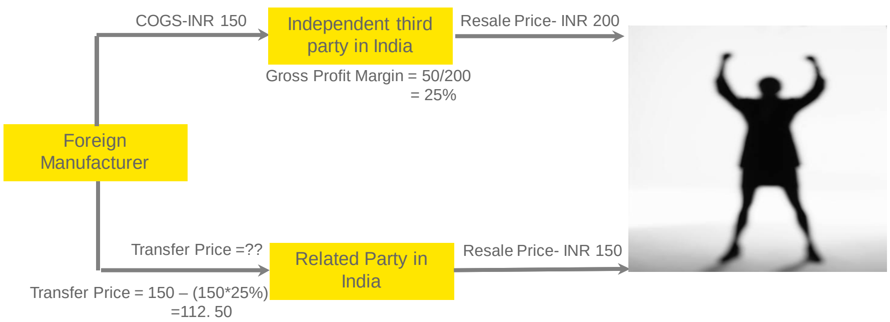
RPM - Example



Particulars	Amount
Gross Profit	50 i.e. (200-150)
Gross Margin	25% i.e. (50/200)
Arm's Length Purchase Cost	112.50 i.e. [150 – (25% 0f 150)]

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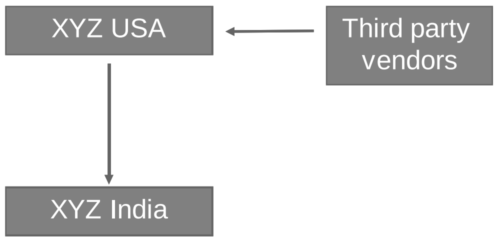
Case study

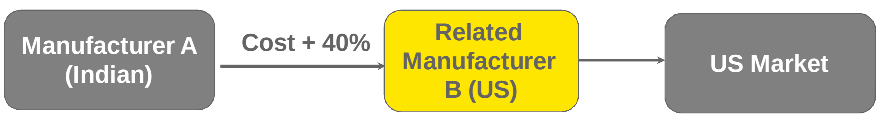


- XYZ USA purchases raw material from third party vendors and sells the same to XYZ India
- XYZ USA has directly sold the goods procured to XYZ India without any value addition

Can RPM method be applied to benchmark the international transaction of import of raw material by XYZ India taking XYZ USA as tested party?

Cost Plus Method Rule 10B(1)(c)

- Applicable when an enterprise is engaged in manufacturing activity or provision of services, sells such goods or renders such services to AEs
- Direct and indirect cost of production of property transferred or service provided is determined
- Compares the gross profit on costs the associated enterprise earns with the gross profit on costs earned by comparable independent companies
- Preferred method for:
  - Manufacturer supplying semi-finished goods
  - company providing services



Application of Cost Plus Method

- Identification of direct and indirect costs of production incurred in tested party transactions
- Identification of normal gross profit with reference to uncontrolled transaction(s)
- Normal gross profit adjusted to account for functional and other differences if any
- Adjusted gross profit added to total costs identified in step 1. Sum arrived above is taken to be arm's length price

Cost Plus Method - Example

- Transaction: Export of raw material and electronic components by XYZ India to associated enterprises

Particulars	
Direct and Indirect cost of production incurred by XYZ India	A
Add: Comparable gross profit margin	B
ALP for products sold to AEs during the year (A+B)	C

Profit Split Method- Rule 10B(1)(d)

- Appropriate for transactions which are not capable of being evaluated separately
- Calculates the combined operating profit resulting from a whole inter-company transaction based on the relative value of each associated enterprise's contribution to the operating profit
- The contribution made by each party is determined on the basis of a division of functions performed, valued, if possible using external comparable data
- Applicable for analysing tangible, intangible or services issues

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Profit Split Method

Determination of combined net profit of the associated enterprises arising out of international transaction

Evaluation of relative contributions by each enterprise on the basis of functions performed, risks assumed and assets employed

Splitting of combined net profit amongst enterprises in proportion to their relative contributions

Profit thus apportioned to the tested party is used to arrive at the arm’s length price

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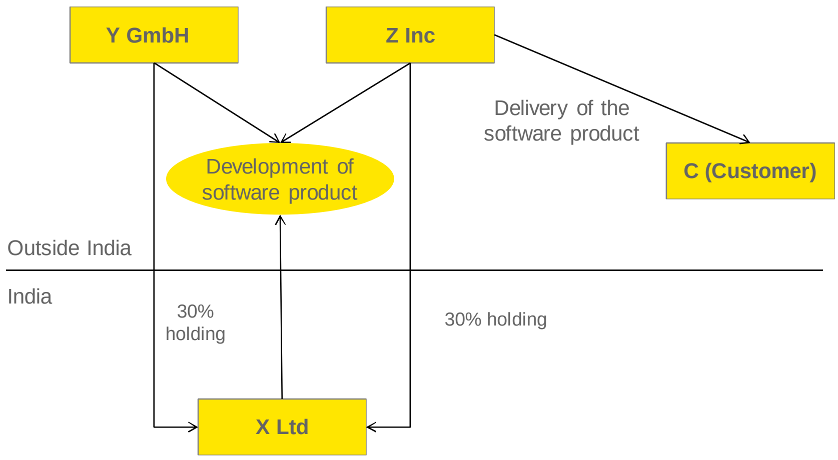
Profit Split Method - Example



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Profit Split Method - Example

- X Ltd, an Indian company is mainly engaged in software development and does both onsite and offsite consultancy
- Y GmbH and Z Inc hold 30% shares each in X Ltd
- Z Inc received an order from C Inc, customer for developing a software product for which X Ltd, Y GmbH and Z Inc contributed integrally
- Z Inc finally delivered the software product to C Inc and received a consideration of USD 50,000 out of which Z Inc paid USD 12,000 to X Ltd, USD 10,000 to Y GmbH and retained the balance for itself
- In the entire transaction a profit of USD 10,000 was earned
- X Ltd, Y GmbH and Z Inc incurred total cost of USD 9,500, USD 8,500 and USD 22,000 respectively in executing their functions

Key Assumptions:

- On the basis of functions performed, risks assumed and assets employed, relative contribution is taken at 50%, 20% and 30% for X Ltd, Y GmbH and Z Inc, respectively

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Profit Split Method - Example

Determination of arm's length price using Relative Contribution method:

Particulars	X Ltd	Y GmbH	Z Inc	Total
Revenue (Transfer price) (A)	12,000	10,000	28,000	50,000
Cost incurred (B)	9,500	8,500	22,000	40,000
Profits earned	2,500	1,500	6,000	10,000
Return based on relative contribution (C)	5,000 (50%)	2,000 (20%)	3,000 (30%)	
Income based on relative contribution (arm's length price) (D=B+C)	14,500	10,500	25,000	
Increased/ (decreased) income (D-A)	2,500	500	(3,000)	

- Associated enterprises of X Ltd - Y GmbH and Z Inc
- Ultimate delivery of the product done by Z Inc to C Inc
- International transaction – Payment by Z Inc to X Ltd

Transactional Net Margin Method- Rule 10B(1)(e)

- Examines net operating profit from transactions as a percentage of a certain base (can use different bases i.e. costs, turnover, etc) in respect of similar parties - Ideally, operating margin should be compared to operating margin earned by same enterprise on uncontrolled transaction
- Can compare to "comparable transactions" between independent parties
- Applicable for any type of transaction and often used to supplement analysis under other methods
- Most frequently used method in India, due to lack of availability of comparable uncontrolled prices and gross margin data required for application of the comparable uncontrolled price method/ cost plus method/ resale price method
- TNMM can be internal or external. Internal TNMM - transaction between AEs and unrelated parties, External TNMM - transactions between third parties. Internal TNMM is preferred over External TNMM as it provides more reliable and accurate data for comparison

Transactional Net Margin Method

- Computation of net profit as a percentage of a certain base realised from the international transaction.
- Computation of net profit realized by the tested party or an unrelated enterprise in a comparable uncontrolled transaction
- Net profit from uncontrolled transaction adjusted to account for differences if any
- The net profit thus established is taken into account to arrive at an arm's length price for the international transaction

TNMM - Example

- X Co renders software development & maintenance services to its AEs and earns an OPM (on cost) of 20%
- TNMM used and following are considered as comparable companies:

Company	OPM on Cost (Scenario I)	OPM on Cost (Scenario II)
A	-5%	30%
B	30%	40%
C	5%	20%
D	15%	10%
E	35%	25%
Arithmetic mean	16%	25%

- +/- 3% of Rs 120 (Transfer price of XCo) = Rs 116.4 to Rs 123.6
- Hence, arm's length range: 16.4% to 23.6%

Are the transactions between XCo and its AE at arm's length under TNMM?

Sixth Method - Rule 10AB

"Rule 10AB - For the purposes of clause (f) of sub-section (1) of section 92C, the other method for Determination of the arms' length price in relation to an international transaction shall be ***<u>any method</u>*** *which* ***<u>takes into account the price</u>*** *which has been* ***<u>charged or paid</u>****, or* ***<u>would have been charged or paid</u>****, for the same or similar uncontrolled transaction, with or between non associated enterprises, under similar circumstances, considering all the relevant facts."*

- Operative from 1 April 2012 and applicable for Assessment Year ('AY') 2012-13
- No further clarity or guidance provided in terms of the manner of benchmarking a transaction under this method

Sixth Method - Rule 10AB

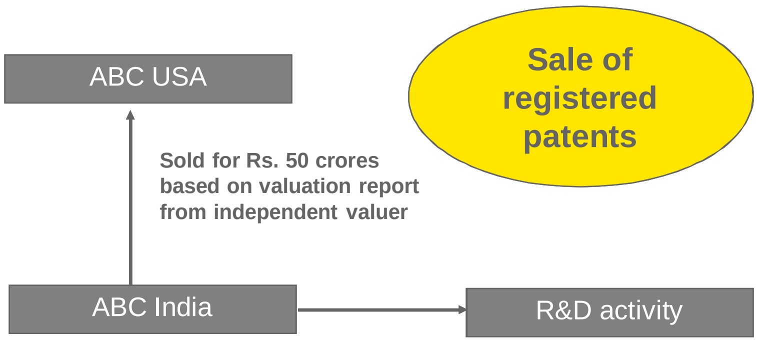
<u>Applicability</u>

- Where the application of the five specific methods is not possible due to difficulties in obtaining comparable data or due to uniqueness of transactions
- Intangibles or business transfers, transfer of unlisted shares, sale of fixed assets, revenue allocation/splitting, guarantees provided and received, etc.

<u>Possible methods</u>

- Third party quotations
- Valuation reports
- Commercial & economic models

Case study



Which method applies to this transaction and why?

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Comparable search process

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General Guidelines
Tested party

- Every international transaction has at least two parties to it. The point of reference for an economic analysis is the 'tested party';
- Choice of tested party;
  - Least complex of all entities involved in the controlled transaction
  - Entity whose profit attributable to controlled transaction can be verified using the most reliable data
  - Entity for which the benchmarking analysis will require the fewest and most reliable adjustments
  - Entity for which the most reliable data regarding uncontrolled comparables can be located

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Search Process
Database

- Most searches are undertaken using Prowess and Capitaline database;
- A separate search is done on each of the databases to generate separate list of companies from each database;
  - Searches can be conducted using industry classification or keyword search;
  - Keywords can be product name, NIC code, NIC activity, segment name, etc.

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Search Process
Quantitative filters

- On the final list of companies, following quantitative filters can be applied:
  - Insufficient financial data – No data for even one relevant year;
  - No operations – The sales figures for all relevant years, for which data is available, is ‘zero’;
  - Sick Company – The net worth for all relevant years, for which data is available, is negative;

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Search Process
Qualitative filters

- After the application of the quantitative filters, companies can be evaluated on the basis of qualitative criteria, such as
  - Insufficient Descriptive Information
  - Sick Company
  - Product Comparability
  - Functional Comparability
  - Insufficient Segmental Information
  - Significant Related Party Transactions
  - Persistent Operating Loss
  - Exceptional Year of Operations
  - Other filters e.g. Turnover, Employee Cost, Foreign Exchange Earnings, etc.

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Economic Adjustments
Rationale

- **Rule 10B** provides that an uncontrolled transaction shall be comparable to an international transaction if –
  - None of the difference, if any, between the transaction being compared, or 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
  - **Reasonable accurate adjustments can be made to eliminate the material effects of such difference.**

- **Para 1.16 of the OECD guidelines** state that "…. **adjustment must be made to account for difference between controlled and uncontrolled transactions** that would significantly effect the price charged or return required by independent enterprises."

It is important to understand the functional, asset and risk analysis of the tested party vis-à-vis comparables and also **analyse the business/ commercial rationale** to carry out any economic adjustments

Economic Adjustments
Key adjustments

- Following are the some of the economic adjustments which could be considered while applying TNMM as the most appropriate method:
  - Working capital adjustment
  - Capacity Utilisation adjustment
  - Depreciation adjustment

Transfer Pricing Documentation & Penalties

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Transfer Pricing Documentation

- A detailed list of mandatory documents are given in Rule 10D(1) of the Rules.

Entity Related
- Ownership Structure
- Profile of multinational group
- Business description/ Profile of industry

Price Related
- Nature and terms (including price) of international transactions
- Description of functions performed, risk assumed and assets employed (functional analysis)
- Records of economic and market analysis (economic analysis)
- Record of budgets, forecasts, financial estimates
- Any other record of analysis (if, any) to evaluate comparability of international transaction with uncontrolled transaction(s)
- Description of method considered with reasons of rejection of other methods
- Details of transfer pricing adjustment(s) made (if, any)

Transaction Related
- Any other information e.g. data, documents like invoices, agreements, price related correspondence etc.

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Transfer Pricing Documentation (contd.)

- Detailed documentation not required in case aggregate transaction value is less than INR 1 Crore
- List of supporting documents are also provided in the law
- Contemporaneous data requirements
- Need to obtain Accountant's report (under Form 3CEB) to be filed along with the return of income

Accountant's report (Form 3CEB) - Rule 10E

- Obtained by every tax payer filing a return in India and having international transaction or SDT
- To be filed by due date for filing return of income
- Essentially comments on the following:
  - whether the tax payer has maintained the transfer pricing documentation as required by the legislation,
  - whether as per the transfer pricing documentation the prices of international transactions are at arm's length, and
  - certifies the value of the international transactions as per the books of account and as per the transfer pricing documentation are "true and correct"

TP Penalties

Default	Penalty
Post-inquiry adjustment (deemed concealment of income) → u/s 271(1)(c)	100 - 300% of tax on the adjusted amount
Failure to maintain information or documents / Fails to report transactions / Maintains or furnishes an incorrect information or documents → u/s 271AA	2% of the transaction value
Failure to furnish information or documents → u/s 271G	2% of the transaction value
Failure to furnish accountants report → u/s 271BA	Rs 100,000

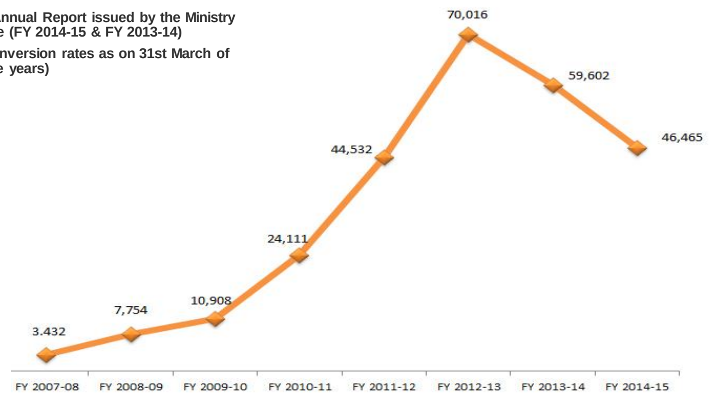
Empowering the TPO to levy penalty under section 271G

- The existing provisions of section 271G of the Act provide that if any person who has entered into an international transaction or specified domestic transaction fails to furnish any such document or information as required by sub-section (3) of section 92D, then such person shall be liable to a penalty up to 2% of the value of international transactions (or specified domestic transaction) which may be levied by the Assessing Officer or the Commissioner (Appeals).
- Given that determination of ALP in several cases is done by TPOs, TPOs are now empowered to levy penalty under section 271G for failure to furnish information/ documentation.
- The amendment came into effect from 1 October 2014.
- Need to be mindful of the 30 days time limit for submission of information/ documents during the course of transfer pricing audits

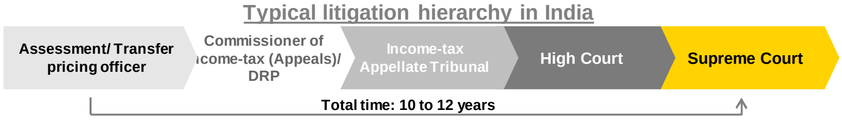
Recent trends in TP Assessment & Litigation

Transfer Pricing in India
The story so far…

Source: Annual Report issued by the Ministry of Finance (FY 2014-15 & FY 2013-14)
(Using conversion rates as on 31st March of respective years)



Typical litigation hierarchy in India



Synopsis of TP audits

Financial Year	Number of TP Audits Completed	Number of Adjustment Cases	% of Adjustment cases	Amount of Adjustment (in INR crore)
2006–07	1,768	471	27	3,432
2007–08	219	84	39	1,614
2008–09	1,726	670	39	6,140
2009–10	1,830	813	44	10,908
2010–11	2,301	1,138	49	23,237
2011–12	2,638	1,343	52	44,531
2012-13	3,171	1,686	53	70,016
2013-14	3,617	1,920	53	59,602
2014-15	4,290	2,353	55	46,465

Source: White Paper on Black Money, Ministry of Finance, GOI

Synopsis of Cases filed before DRP

Financial Year	Total cases filed during the cycle	Amount involved (in cr.)	Amount involved (in cr.) in confirmed /ascertainable cases
2009–10	1,154	37,595	34,849
2010–11	938	42,835	28,797
2011–12	1,041	68,977	40,578
2012–13	1,070	80,332	24,899
2013–14	1,015	98,565	33,665*
2014-15	1,103	123,800	Data NA

*This amount may increase as in some cases; Assessing Officers have to re-calculate the demand position.

Source: Annual Report 2015, Ministry of Finance (Budget Division)

Transfer Pricing Scenario in India

- Increase in Transfer Pricing teams Pan India
  - Increase in number of Transfer Pricing officers (TPO's) in all major locations
  - Current number of DITs – 13-15 and TPOs – 55-60
  - Current number of DRP Panels – 10 and CIT(A)-TP – 5-6*
  - Current number of benches in ITAT – 63*, specific benches for TP – 2* (Delhi & Mumbai)
- Strict enforcement of transfer pricing policy matters in India
- As per CBDT circular 6/2014, scrutiny compulsory where addition in an earlier AY is excess of 10 Crores or more or substantial question of law or fact exists
- Increasing focus on contribution of each entity in the value chain
- Interplay between related party transactions under Companies Act 2013 and clause 49

Soft Targets

Consistent loss makers	Low margin taxpayers	Royalty payments
Intra-group services	AMP expenditure	Corporate Guarantee
Captive developers / Contract manufacturer	Interest Payments / Receipts	Outstanding receivables

Increasing focus on contribution of each entity in the value chain

Share Issue Transaction – Controversy

Controversy	Jurisprudence
Issue of shares to overseas parent have been scrutinized terming it as an "international transaction'. TPO's have insisted on submitting a DCF valuation report Adjustments made in cases where value of shares derived from DCF valuation was more than price at which shares were issued.	The issue of share valuation was raised before the Mumbai High Court (HC) by way of writ filed by Vodafone and Shell India. Earlier the issue was remanded back to the DRP by the Mumbai HC on the question of jurisdiction. On 18 September 2014, the judgment in the Vodafone case was pronounced. The Mumbai HC held that neither capital receipts received on issue of equity shares nor shortfall between FV and issue price can be considered income within the meaning of the Act.

Royalty, technical know-how fees etc

- Issues relating to royalty/ technical know-how fee payouts
  - Perpetual royalty not appropriate
  - Commercial expediency challenged
  - Aggregation approach under TNMM challenged
  - Cost-benefit analysis
  - Documentary evidence / analysis
  - Whether approval under exchange control regulations sufficient
- If "Benefit Test" not satisfied – ALP determined is substantially low/ NIL

Contract development and location savings

Contract development	Location savings – Clinical trial/ contract manufacturing
▶ Nature of risk assumed by Indian development centers bearing contested – Center with significant risks not engaged in contract R&D activities ▶ TP adjustments - R&D centers should earn higher margins ▶ Evaluate whether the outcome of the R&D activities jointly belong to the Indian development centre and the AE. - In such case, Profit Split Method for the purpose of computation of arm's length price and attribute additional profits in India	▶ Net cost savings realized as a result of relocating business operations from a "high cost" to a "low cost" jurisdiction ▶ TP adjustments on clinical trial and exports based on location savings theory ▶ Attributed part of the savings to India ▶ Tribunal ruling – Watson Pharma

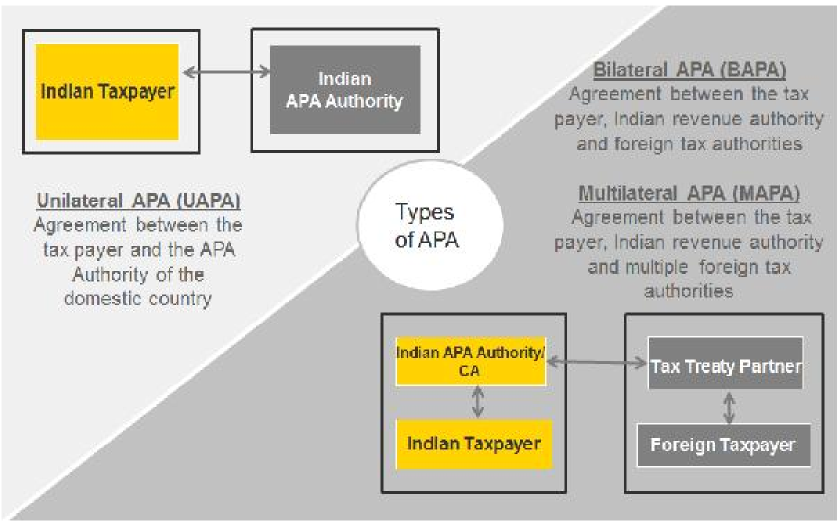
Advertising, Marketing and Promotion (AMP) Expenditure

- Foreign company owns the brand
- Indian company manufactures/ distributes the products in India
- Indian company incurs significant AMP expenditure to promote the sale of these products in India

AMP Adjustment

Controversy	Jurisprudence
Use of bright line test for AMP adjustments and additions were being made using LG Electronics special bench ruling. While guidance put forth by the LG ruling on Non AMP i.e selling expenses, challenge on relief to be granted. Whether disallowance by separately benchmarking AMP expenditure is permissible when the overall net profit rate declared by the assessee was higher than other comparable cases ?	The SB of the ITAT in the case of LG Electronics while holding that AMP is an transaction, listed 14 parameters to assist in evaluating AMP issue. Selling expenses have been kept outside the purview of brand building exercise. The Delhi ITAT in the case of BMW India factually distinguished the case at hand from the SB ruling and held that the premium price of the product was in itself a compensation for the non-routine activities of the taxpayer. The HC in Sony held that AMP is an IT and TPO can segregate AMP expenses as an independent IT, but only after elucidating grounds for not accepting the bunching adopted by the assessee

APA
Introduction



APA
Process Flow

Pre-filing → APA request (Main application) → Hearings and Negotiation → **Execution and monitoring**

- APA valid for the periods specified in the APA (maximum period of 5 consecutive years)
- "Roll back" for previous 4 years immediately preceding the first year covered under the APA (subject to certain rules and procedure)

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APA Statistics

Financial Year	Unilateral APA Applications	Bilateral Application
2012–13	117	29
2013-14	205	27
2014-15*	7	1
Total	329	57

Note: One unilateral application filed in FY 2013-14 has been converted into Bilateral application during FY 2014-15

Source: Annual Report: FY 2014-15, Ministry of Finance, GOI

*[till 24.12.2014]. As per press reports, total number of applications in 3 years have crossed 580

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Safe Harbour Rules – Rules 10TA to 10TG

Meaning

- Safe Harbour Rules refers to determination of price margin which are acceptable to tax authorities to provide protection to taxpayers from TP scrutiny proceedings
- Prices established under such rules would be automatically accepted by the tax administrations that have expressly adopted such rules

Applicability

- Rules to be applicable for a maximum period of 5 years beginning AY 2013-14 or the period opted by the Assessee
- Does not apply where the AE is located in any country or territory notified under section 94A or in a no tax or low tax country or territory

Compliance

- The Assessee shall furnish a Form 3CEFA on or before 30 November of the first assessment year of the covered period for which it is seeking protection

Arbitration

- Objection to Commissioner within 15 days of receipt of TPO order
- Commissioner shall pass its order within 2 months from the end of the month in which the objection is received by him

Safe Harbour Rules – Rules 10TA to 10TG

Eligible international transactions	Circumstances
Provision of Software development services	If Transaction ≤ 500 crore, then Min. 20% If Transaction > 500 crore, then Min. 22%
Provision of ITES	If Transaction ≤ 500 crore, then Min. 20% If Transaction > 500 crore, then Min. 22%
Provision of KPO	Min. 25%
Advancing of Intra Group Loans	If Loan amount ≤ 50 crore, then Min. SBI base rate + 150 bps If Loan amount > 50 crore, then Min. SBI base rate + 300 bps
Provision of corporate guarantee	If Guaranteed amount ≤ 100 crore, then Min. 2% If Guaranteed amount > 100 crore and AE's credit rating (done by SEBI registered agency) is of highest safety, then Min.1.75%
Contract R &D	If relating to software development, then Min. 30% If relating to generic pharmaceutical drugs, then Min. 29%
Manufacture and export	Of core components, then Min. 12% Of non-core components, then Min. 8.5%

Range Concept applicability & Methodology

Method	Only under TNMM, RPM or CPM
Comparables	Minimum 9
Period	Weighted average of 3 year data of each company to construct the data set (In certain circumstances, data of 2 years could be used out of the 3 years)
PLI Computation	Numerator and denominator of the chosen PLI to be aggregated for all the years for every comparable
Range	Data Points lying within 40th and 60th percentile off the data set

If the transfer price of the tested party falls outside the range computed, the 'median' of the range would be taken as ALP and adjustment to transfer price shall be made.

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Thank You