Water & Shark

BASIC OVERVIEW OF INDIAN TRANSFER PRICING

BY: KINJAL SHAH
INTERNATIONAL TAX

Table Of Content

Water & Shark

Water & Shark

BACKGROUND

1990 — INTRODUCTION OF FDI AND INTREST FROM MNCs

1991 — STANDING COMMITTEE SET UP FOR DISCUSSIONS ON TP

1999 — CBDT EXPERTS RECOMMENDED OVERHAUL OF THE OLDER TP PROVISIONS

2001 — INTRODUCTION OF INDIAN TRANSFER PRICING REGULATIONS (TPR)

2002 — AMENDMENTS TO BRING IN LINE WITH OECD GUIDLINES ON TP

WHAT IS TRANSFER PRICING?

Water & Shark

Prices that one division in a company charges another division for goods and services provided especially when one such devision is from another tax nation

TPR help in keeping a check on possible tax leakages in cross border intra-group transactions.

In short, by charging above or below the market price, companies can use transfer pricing to transfer profits and costs to other divisions internally to reduce their tax burden.

EFFECTS OF TRANSFER PRICING

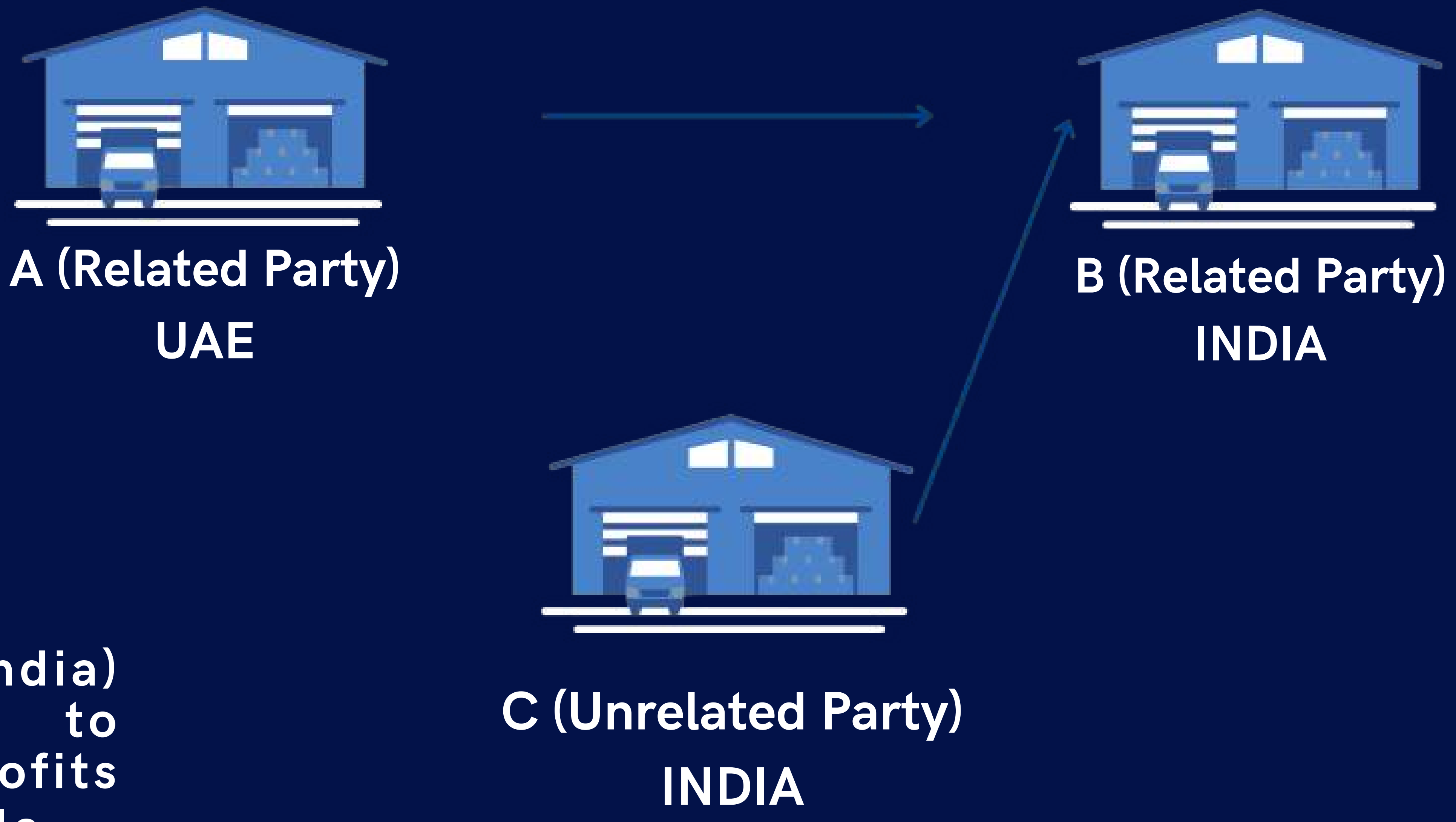
Water & Shark

The effect is such that parent company or a specific subsidiary tends to produce insufficient taxable income or excessive loss on a transaction within the group.

Transfer pricing acts to distribute earnings throughout an organization but is primarily used to skirt tax laws and reduce tax burdens by multinational companies.

Transfer pricing provisions are governed by section 92A-F of the Income Tax Act and Rule 10A-E of the Income Tax Rules, 1962.

EXAMPLE



- Entity A sells at higher value to Entity B
- Costs for Entity B in higher tax jurisdiction (India) are shown higher, triggering the profits to decrease, in the end leading to the taxable profits to reduce and tax savings of the MNC as a whole.

IMPORTANT SECTIONS

Water & Shark

92A

ASSOCIATED ENTERPRISES

One of them participates in the management, control, or capital of another;
There is common management, control, or capital exercised by some persons.

92B

INTERNATIONAL TRANSACTIONS

Transaction between two or more associated enterprises (AEs) and either or both of them are non-residents.

92C

COMPUTATION OF ALP

A price that is applied to transactions between persons other than AEs in uncontrolled conditions.

IMPORTANT SECTIONS

Water & Shark

92D

DOCUMENTATION

Rule 10B lists the documents to be maintained.

92E

ACCOUNTANT'S REPORT

Audit report with all the details and the form 3CEB shall be filed

92F

OTHER DEFINITIONS

This section contains certain definitions relevant to computation of arm's-length price

ECONOMIC ANALYSIS

Water & Shark

A. SELECTION OF TESTED PARTY

When the tested party is a foreign AE, the foreign comparables are used for benchmarking

There is no specific prohibition in the TP Regulations regarding use of foreign comparables.

The difference in Indian GAAP vis-à-vis accounting principles and practices of other countries are usually major reason why tax authorities reject foreign comparables

Tax authorities have held that if a taxpayer wishes to consider a foreign AE as the tested party, then relevant data for comparison should be available in the public domain or should be furnished to the tax administration

ECONOMIC ANALYSIS

Water & Shark

B. METHODS OF ALP COMPUTATION

- Comparable Uncontrolled Price ('CUP') method
- Resale Price Method or Resale Minus Method ('RPM')
- Transactional net margin method (TNMM)
- Cost Plus Method ('CPM')
- Profit Split Method ('PSM')

ECONOMIC ANALYSIS

Water & Shark

C. SELECTION OF PROFIT LEVEL INDICATOR (PLI)

Selection of appropriately PLI depends on:

Nature of the activities of the tested party

The reliability of the available data with respect to comparable uncontrolled taxpayers

The extent to which a particular profit level indicator is likely to produce a reasonable determination of the income that the tested party would have earned had it dealt with the controlled taxpayer at arm’s length

Economic Analysis

Water & Shark

PLI	REMARKS
Gross Profit/ Sales	Appropriate for trading activity
Net Profit/ Operating Costs	Appropriate for indenting activity
Net Profit/ Operating Assets	Appropriate for capital intensive industry
Cash Profit Ratio	New Business with Heavy Investment
Return on Capital Employed	Capital Intensive Business
Return on Shareholder’s Funds	Highly Geared Companies
Revenue per Employee	Human Capital Based Based

ECONOMIC ANALYSIS

Water & Shark

C. Search Process

Step 1. Identification of companies engaged in activities that are potentially comparable to the activities of tested party

Step 2. Quantitative analysis – application of filters : –Data availability filter –Turnover filter –Net worth filter –Trading / Manufacturing / Service Income to total Income filter –Related party transaction filter

Step 3. Qualitative analysis - analysis of the information contained in the databases and/or annual reports

Step 4. Final validation of the potential comparable companies through additional research and a close scrutiny

ECONOMIC ANALYSIS

Water & Shark

C. Search Process

Step 5. Selecetion of PLI

Step 6: Margin of the comparable – range/weighted average

Step 7: Margin of Comparable v/s tested party

TAX AUDIT PROCEDURE

A fixed amount of tax returns are selected on the detailed audit.
6 months notice period is sent from the financial year end in which returns were filed

- AO refers case to TPO with prior approval from IT Commisioner if value of transaction >50 million INR
- TPO sends notice to taxpayer for more evidence to support the claim of ALP
- Reply within 30 days and in some case maximum upto 60 days
- Scrutiny assessment takes place with maximum upper limit of 36 months to 48 months
- Order passed by TPO and copy sent to AO for computation of taxable income
- Order passed by AO and scrutiny assessment reaches completion

Water & Shark

DOCUMENTATION

Water & Shark

The provision in Section 92D contained in the TPR are exhaustive as far as maintenance of documentation is concerned

Back ground information like nature of transaction, analysis carried out to select the most appropriate method and to identify comparable transaction and the actual working out of the ALP and whether they are calculated as per the TPR

This includes report of an accountant certifying that the ALP has been determined in accordance with TPR

DOCUMENTATION

Water & Shark

The prescribed documentation shall be maintained and retained for 8 years

The primary responsibility is on the taxpayer to determine an ALP in accordance with the TPR and to substantiate the same with the prescribed documentation.

The details shall include a detailed description of the ownership, profile of the MNC,

SECTION 92D read with RULE 10D

10D(1)(a)	Description of ownership structure	10D(1)(h)	Record of analysis for finding comparability
10D(1)(b)	Profile of MNC- name,address,tax country of all AE	10D(1)(i)	Description of method considered for computation of ALP
10D(1)(c)	Business description	10D(1)(j)	Record of analysis for finding comparability
10D(1)(d)	Terms of international transactions	10D(1)(k)	Assumptions and policies which affected determination of ALP
10D(1)(e)	FAR analysis description	10D(1)(l)	Details of adjustments relevant for computation of ALP
10D(1)(g)	Record of uncontrolled transactions and comparables	10D(1)(m)	Any other information relevant for ALP

BEST TP DOCUMENTATION PRACTISE

- Robust and detailed FAR and Economic Analysis
- Transfer pricing assessment experience
- Comprehensive and detailed
- Cognizance of Indian & overseas judicial rulings
- Application of OECD principles and guidelines
- Consistent with Master File

Water & Shark

OECD BEPS ACTION PLAN

Water & Shark

India has introduced the concept of three tier TP documentation in the year 2016 to be in line with the OECD guidelines. An entity which is part of a multinational enterprise (MNE) group is required to maintain the following group information by way of three files:

- Local File (Section 92D)
- Master File- Form 3CEAA
- Country by country reporting (CBCR)- Form 3CEAA

Emphasised in BEPS Action Plan 13 wherein the constituent entities are required to maintain a Master plan and Country-by-Country Report as per transfer pricing provisions Form 3CEAA.

MASTER FILE

PART A OF FORM 3CEAA	PART B OF FORM 3CEAA
Basic information like the name of the international group, entities involved in that group, their details like PAN and permanent address, etc. It shall be filed by every entity that has entered into any international transaction, irrespective of any limits or threshold of the value.	**Part B of the Form 3CEAA does not apply to everyone. It is to provide in-depth details** Has to filed if 2 conditions are followed: 1. Consolidated group revenue for PFY exceeds Rs. 500 crore 2. Total value of the international transactions has exceeded Rs. 50 crore and Rs. 10 crore if transaction involves Intangible property.

Water & Shark

Country-by-Country Report (CbCR) is required to be electronically filed in India where

1. The Ultimate Parent Entity (UPE) of the Multinational group (MNE) is resident in India or
2. Where the MNE has designated an alternate reporting entity for the purposes of filing CbCR in India.

CBCR

ELIGIBILITY	DUE DATE AND FORM
Where the annual consolidated group revenue as per the consolidated financial statements of the MNE group in the immediately preceding accounting year relevant to the Indian financial year, is more than INR 64 billion.	**The due date for filing CbCR is in the prescribed Form no. 3CEAD in India is 12 months from the end of reporting accounting year of the UPE preparing consolidated financial statements.**

SAFE HARBOUR RULES

The circumstances in which the income-tax authorities shall accept the transfer price declared by the assessee. It substitutes simpler obligations for those under the general TP regime.

For those who are engaged in

1. Providing software development services information technology-enabled services or KPO services, etc with insignificant risk, to a non-resident associated enterprises.

2. Intra group loan, corporate guarantee, providing contract research and development services wholly or partly relating to software development, etc with insignificant risk, to a foreign principal.

Advance Pricing Agreement

Water & Shark

Transfer prices are negotiated in advance with the tax authorities

Unilateral, bilateral or multilateral

For any tax payer with an international transaction

Validity upto 5 years

APA filing fees w.r.t value of transactions

<INR 100 Crores = INR 10 lakhs

>INR 100 crores but < INR 200 crore =INR 15 lakhs

>INR 200 crores = INR 20 lakhs

APA PROCESS

- Pre-filing consultation
- Formal APA application
- Negotiation
- Finalisation

PENALTIES

Water & Shark

Sections	Nature of Penaties	Quantum of Penalty
Section 270A	Penalty of under-reporting of income as a consequence of failure to report international transactions,	50% of the amount of tax payable in case of underreporting and a penalty of 200% of the amount of tax payable in case of misreporting
Section 271AA	Penalty for failure to maintain documents, report a transaction, or maintaining or furnishing incorrect information under Section 92D	2% of the value of international transaction
Section 271G	Penalty for failure to furnish documentation prescribed under Section 92D(3) of the Act	2% of the value of international transaction
Section 271BA	Penalty for failure to furnish Accountant's Report in Form 3CEB as required under Section 92E	1,00,000 INR

Water & Shark

Thank You

Disclaimer: Water and Shark refers to global organization, and may refer to one or more member firm of Water and Shark International Inc. (WASII). The views or opinions represented in this presentation belong to the individuals only, these do not reflect the views of the firm. The views and opinions expressed in the presentation should not be construed as a professional advice unless explicitly stated.