

Overview of Transfer pricing regulations



BCA

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Transfer Pricing – An Introduction

- ◆ Evaluation of the price charged by one related party to an other related party for goods, services, etc.
- ◆ Objective of the Revenue is to check erosion of the tax base and plug the leakage of the revenue;
- ◆ Foundation of the Transfer Pricing Regulations are embedded in the Double Taxation Avoidance Agreements - Article 9 of the OECD Model Convention
- ◆ The OECD Report on Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration (OECD TP Guidelines) are the foundation for transfer pricing regulations in India



Evolution of Transfer Pricing



- ◇ It is estimated that, more than 60% of international trade is carried on between related or Associated Enterprises (AEs)
- ◇ To counter the effect of transfer of profits using favourable transfer prices among AEs, many developing and developed countries introduced TPR
- ◇ The TPR have increased the burden of proof on taxpayers, to demonstrate arm's length price of controlled transaction



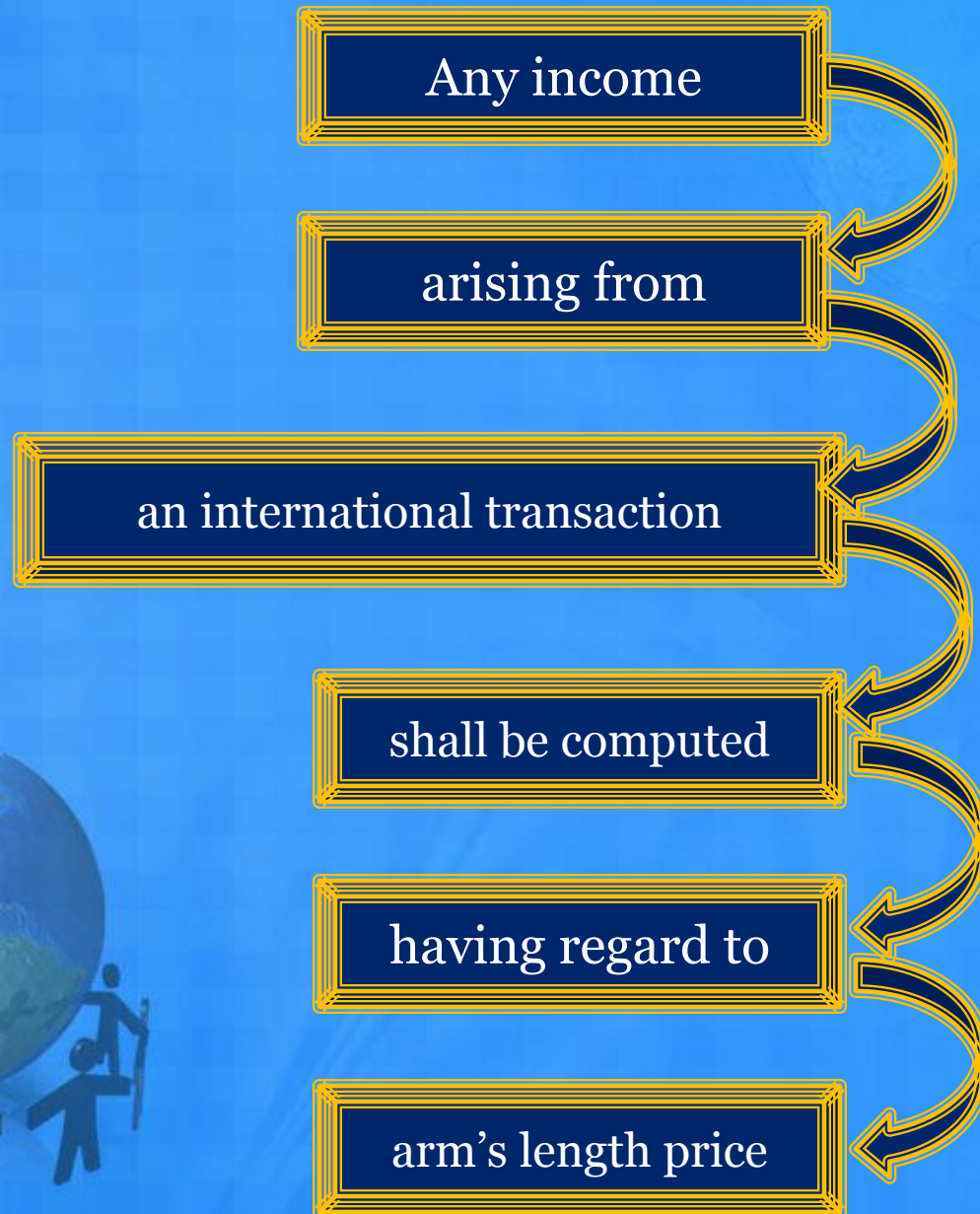
Origin of Arm's Length Standard

Year	Introduction of concept
1934	The arm's length standard (ALS) was initially stated in the earliest U.S regulations under Section 482 of Internal Revenue Code (the code) issued
1963	The United States was prime promoter of adoption of the standard in OECD Model Tax Convention released
1979	The 1979 OECD Report focused on arm's length standard and set forth the appropriate methodologies to be used to achieve arm's length result
1995 / 2010	The OECD Transfer Pricing Guidelines for Multinational Enterprises (MNEs) and Tax Administrations (OECD TP Guidelines) reaffirmed the status of arm's length standard "as the international standard"
2014	OECD introduced Base Erosion and Profit Shifting (BEPS) Action Plan (Action 8-10 and Action 13)
2016	Amendments in Budget 2016, providing specific regime in respect of Country by Country reporting and Master File
2017	OECD updated its TP Guidelines to give effect to the changes resulting from BEPS Project

Transfer Pricing (TP) – Indian Perspective



TP Regulations in India – Section 92

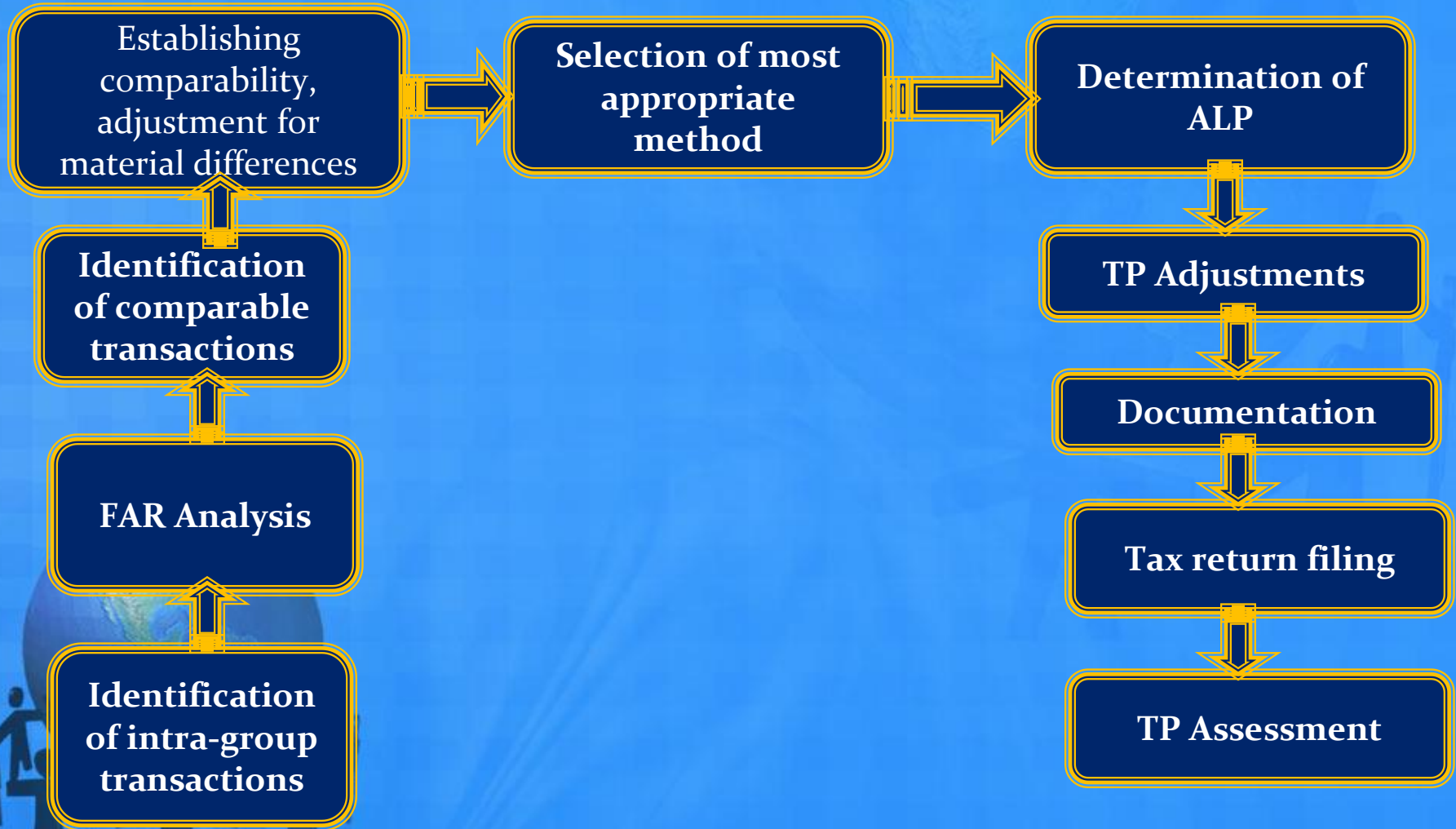


Overview of Transfer Pricing in India

- ◈ Income under any head is covered under the ambit of TPR
- ◈ Section 4 – Income must be chargeable to tax
- ◈ Preconditions:
 - Two or more associated enterprises
 - Enter into an international transaction
 - Specified Domestic Transaction (w.e.f. AY 2013-14)
- ◈ Consequence:
 - Income/ Expenditure to be computed having regard to the arm's length price



Transfer Pricing Process



Associated Enterprises [Section 92A]

- ◇ Means direct or indirect participation in management
 - ◇ control or capital:
 - ◇ by one enterprise into another enterprise; or
 - ◇ by the same person in both the enterprises
- ◇ Equity holding, Control of Board of Directors / Appointment of one or more Executive Director, mutual interest will also constitute Associated Enterprise
- ◇ Either or both of Associated Enterprises should be a non-resident
- ◇ “Deemed Associated Enterprises” includes:
 - ◇ Purchase of 90% or more of raw materials and consumables,
 - ◇ Sale of goods - influence on price and conditions of supply by buyer,
 - ◇ Dependence on intangible assets, financial transaction, guarantee,
 - ◇ Control by individual or his relative, etc.



International transaction [Section 92B]

- ◆ Means a “transaction” between two or more Associated Enterprises:
 - ◆ Transaction between two or more associated enterprises (at least one of which will be non-resident) of purchase, sale or lease of tangible and intangible property, provision of services, financing, cost sharing / cost contribution arrangements
- OR
- ◆ Any other transactions affecting profits, losses, income, assets or liability of the enterprise
- ◆ The expression “International Transaction” was amended by Finance Act, 2012 w.e.f 1.04.2002 to specifically include:
 - ◆ Inter-company Guarantees,
 - ◆ Advance payments, deferred payments, receivables,
 - ◆ Capital Financing/ Business restructuring / reorganization,
 - ◆ Purchase / sale/ use of intangibles such as customer lists, customer contracts, customer relationships,
 - ◆ Transfer / secondment of trained employees, etc.



Definition of Deemed International Transaction (Amendments by Finance Act, 2014)

- ◇ The Finance Act 2014, has broadened the scope of international transaction. Further, the amendment is effective from 1 April 2015
- ◇ Where a transaction is entered into by an enterprise with a person other than an AE and
 - ◇ There exists a prior agreement in relation to the relevant transaction between such other person and the AE or,
 - ◇ Terms of the relevant transaction are determined in substance between such other person and the AE, and
 - ◇ Either the enterprise or the AE or both of them are non-resident whether or not such other person is a non-resident
 - ◇ Such transaction will be deemed to be an international transaction



Specified Domestic Transactions

- ◇ The Finance Act, 2012 has introduced TPR for specified domestic transactions under section 92BA
- ◇ Specified Domestic Transactions* to include :
 - ◇ Transfer of goods or services between two units, undertakings or companies which are related and one of them is eligible to avail deduction under Chapter VI-A, 80IA
 - ◇ Any transaction in Chapter VI-A or section 10AA to which the transfer pricing clause under section 80IA are specifically made applicable
 - ◇ *any business transacted between the persons referred to in section 115BAB(4);*
(inserted by the Taxation Laws (Amendment) Act, 2019, w.e.f. 1-4-2020)
 - ◇ Any other transaction as may be prescribed

* Omitted w.e.f. 1 April 2017 - any expenditure in respect of which payment has been made or is to be made to a person referred to in clause (b) of sub-section (2) of section 40A



Recent Rulings

- ◇ The Karnataka High Court (HC) has, in the case of **Texport Overseas Pvt Ltd** [ITA No.392/2018 and ITA No.170/2019] reaffirmed the order of the ITAT quashing the reference made by AO to TPO u/s 92CA and the consequential orders passed by TPO/DRP making/upholding adjustments on remuneration paid to directors as *unsustainable in the eyes of law*
- ◇ The HC stated that :
“..when clause (i) of Sec.92BA having been omitted by Finance Act, 2017, w.e.f 1.7.2017 from the Statute, the resultant effect is that it had never been passed and to be considered as a law never been existed”



Most Appropriate Method (MAM)



◆ The Act prescribes selection of the MAM from the six specified methods; having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe

◆ The Six methods:

◆ Comparable Uncontrolled Price Method (CUP)

◆ Resale Price Method (RPM)

◆ Cost Plus Method (CPM)

◆ Profit Split Method (PSM)

◆ Transaction Net Margin Method (TNMM)

◆ Rule 10AB - Any other method prescribed by CBDT



Multiple year data and Range Concept

◆ Multiple Year Data

- ◆ Data pertaining to the current year and immediately preceding two years is considered while computing the ALP in case of RPM, CPM and TNMM

◆ Range Concept

- ◆ Use of the Range concept has been permitted if the results are 6 or more in case of certain methods namely RPM, CPM and TNMM



The image displays three calendar grids for the years 2018, 2019, and 2020. Each grid is a 12x7 table showing months and days. The 2018 grid is on the left, 2019 in the middle, and 2020 on the right. Each grid includes a header for the year and a footer with additional information like 'Federal holidays 2018'.



Transfer Pricing Adjustment

- ❖ Absence of arm's length price in international transaction, or failure to maintain the prescribed documentation, or use of unreliable data can lead to adjustment
- ❖ Use of the Range concept has been permitted if the results are 6 or more
- ❖ Tax exemption will not be available for the amount of adjustment (10A, 10B, Chapter VI A)



Transfer Pricing Assessments -TPA

- ◆ The revenue authorities across the globe in their wanting to safeguard their country's tax base, require strict compliance from the taxpayers to the TP rules and regulations



Transfer Pricing Assessment

- ◆ Documentation is the key to demonstrate adherence to the Arm's Length Standard



Documentation....Seven steps Approach



- ◇ Understanding the Business Model of the Corporate Body
- ◇ Analyzing the Transaction(s)
- ◇ Functional & Economic analysis
- ◇ Assessment of comparables
- ◇ Selection and application of methodology
- ◇ Benchmarking the transaction
- ◇ Reviewing the process



Documentation Requirements - Rule 10D(1)

◈ This is the mandatory documentation required by law

- a. Description of Ownership Structure (Step I)
- b. Profile of Multinational Group (Step I)
- c. Description of Business (Step I)
- d. Nature & Terms of Transactions (Step II)
- e. Description of Functions, Risks & Assets (Step III)
- f. Record of Economic & Market Analyses, if any (Step III & IV)

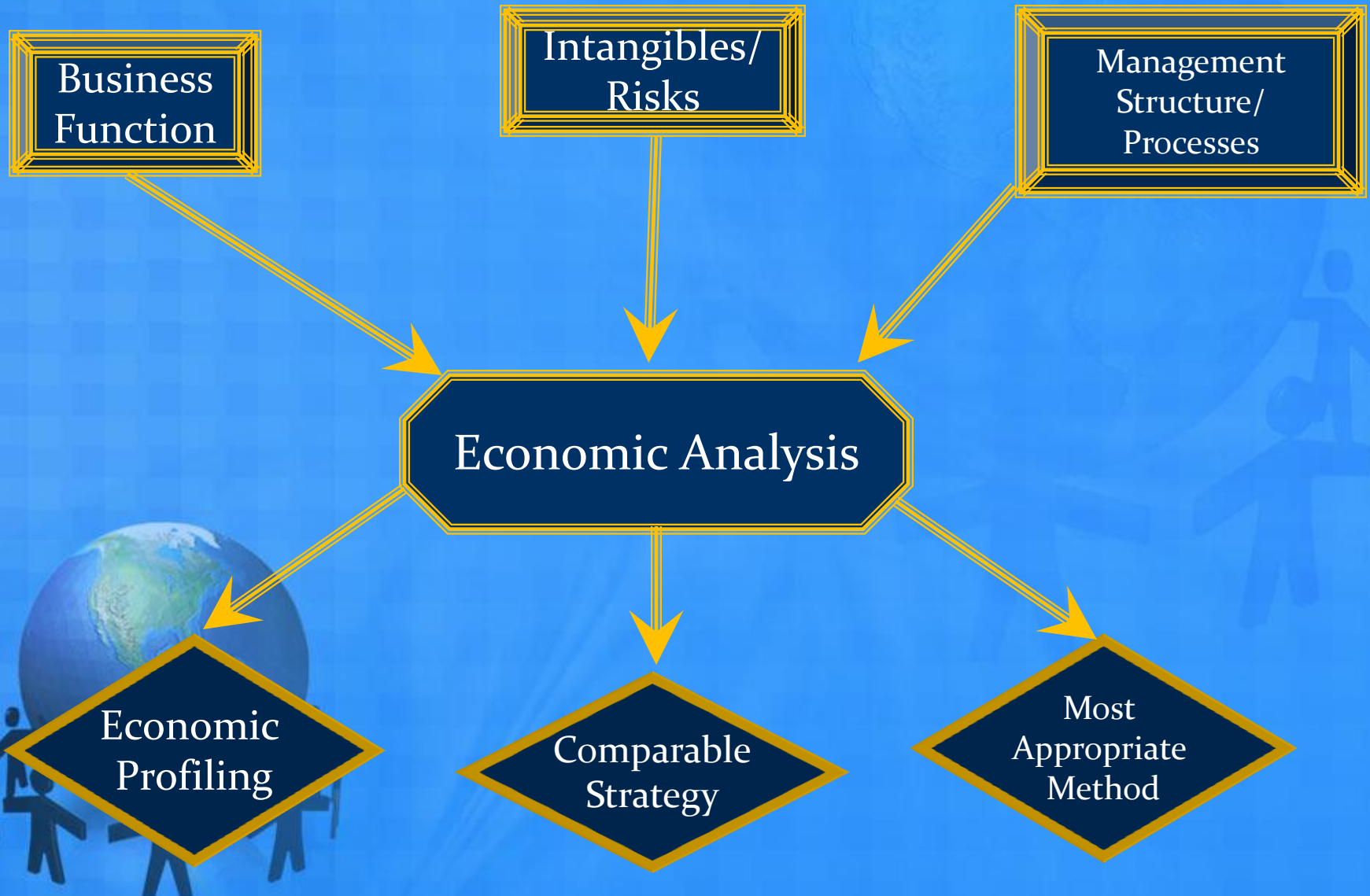


Documentation Requirements.....

- a) Comparability Analysis (Step IV)
- b) Record of Uncontrolled Transactions (Step VI)
- c) Description of Methods considered (Step V)
- d) Record of Actual working (Step VI)
- e) Assumptions, policies, price negotiations, if any (Step II & III)
- f) details of the adjustments, if any, made to transfer prices to align them with ALP
- g) Any other information, data or document (Company Specific information, if any)



Economic Analysis ?



Case Study 1

Aggregation v. Segregation



Facts of the Case

France

A Co

100% subsidiary

India

B Co



Facts of the case

France

India

A Co

Services
agreement

Software
Distribution
License
agreement

B Co.

**End
Customer**

Pre sale, Marketing,
post sale services,
 sublicensing



Facts of the case

◆ A Co., is a France resident Co., has 100% subsidiary in India B Co India

◆ A Co. develops software entirely in France and hence also retains IP of the software

◆ A Co. (AE) enters into software distribution licensing agreement with B Co. whereby it grants B Co. a license to sublicense its software in India. For this B. Co. would pay annual license fee to AE



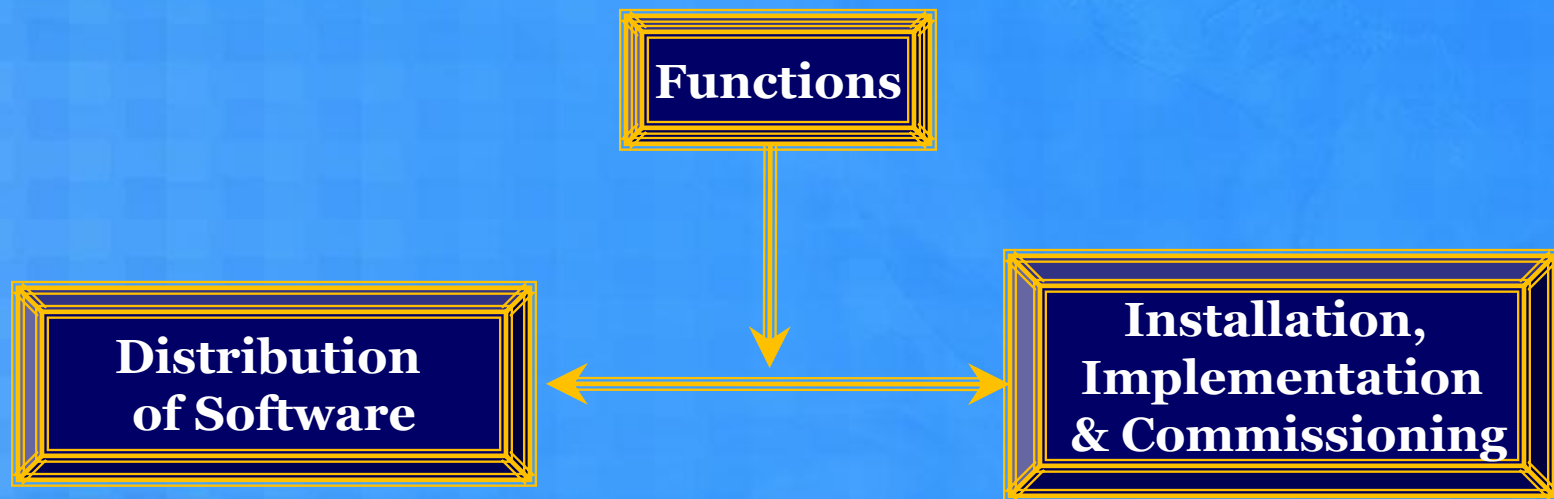
Facts of the Case

- ◆ B Co. also performs pre sale marketing and post sale client support and maintenance services.
- ◆ B Co then enters into service agreement with AE whereby AE 's employees fly down to India for installation, implementation and commissioning of software at B Co's client place
- ◆ AE charges 'Employee Cost + 20%' on installation services performed as per service agreement



Benchmarking

Benchmarking is to be done by segregating activities performed



This is done by working-out separate profit & loss Account for each of the functions based on appropriate cost- allocations



Benchmarking

- ◆ Assessee segregated functions of distribution of licensed software and Installation & commissioning of software to benchmark the international transactions with AE
- ◆ Assessee proposed to apply Resale Price Method (RPM) to benchmark the distribution of licensed software
- ◆ To benchmark the transaction of commissioning and installation of software, Cost Plus Method (CPM) was proposed to be applied



P&L Account of Software Distribution function (RPM)

Particulars	Debit (Amt)	Particulars	Credit (Amt)
Distribution License Cost to AE	800	Sale of Software License	1600
Gross Margin	800		
% Gross Profit on Cost	100 %		

P&L Account of Software Installation & Commissioning (CPM)

Particulars	Debit (Amt)	Particulars	Credit (Amt)
Cost to be paid to employees of AE	200	Installation Fee	200
Employee Cost (Commissioning & Installation support)	150		
Gross Loss	(150)		
% Gross Loss on Cost	(42.85%)		

Benchmarking

- ◆ Results of Benchmarking due to Segregation of functions :
 - ◆ Huge Profits in Software Distribution Function
 - ◆ Huge Losses in Software Installation & Commissioning function
- ◆ This is because the price to end customer is function of market dynamics



B Co

**Identifying
Consumer base**

**Marketing &
Advertising of
Software**

Site Inspection

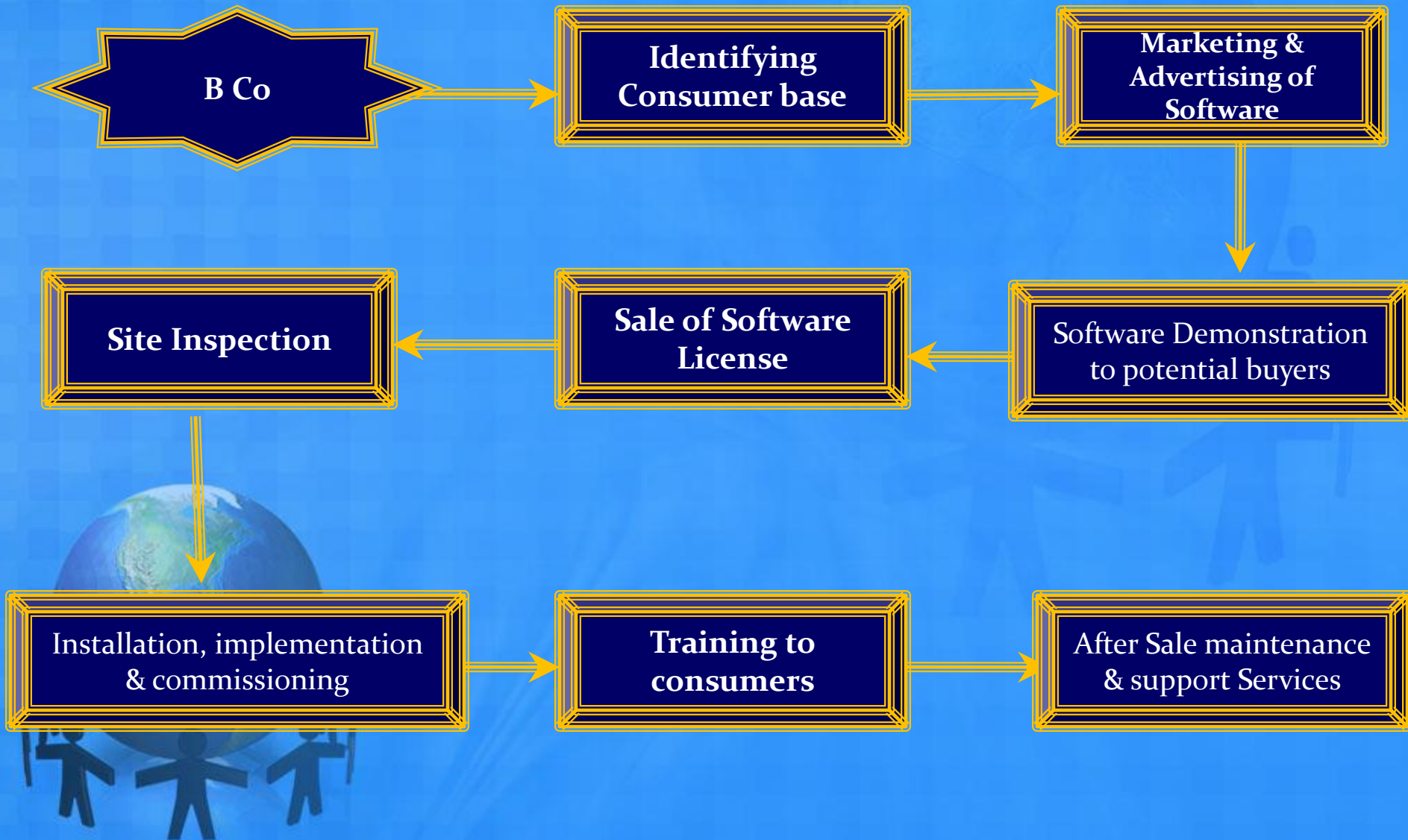
**Sale of Software
License**

**Software Demonstration
to potential buyers**

**Installation, implementation
& commissioning**

**Training to
consumers**

**After Sale maintenance
& support Services**



The Way Forward

- ❖ The functions of distributing the software licenses and installing & commissioning the same are integrated & intertwined
- ❖ Hence, it would be necessary to adopt “Whole Entity Approach” to benchmark these integrated functions
- ❖ The functions are to be aggregated and benchmarked by using TNMM on whole entity basis



Pricing Method Selection

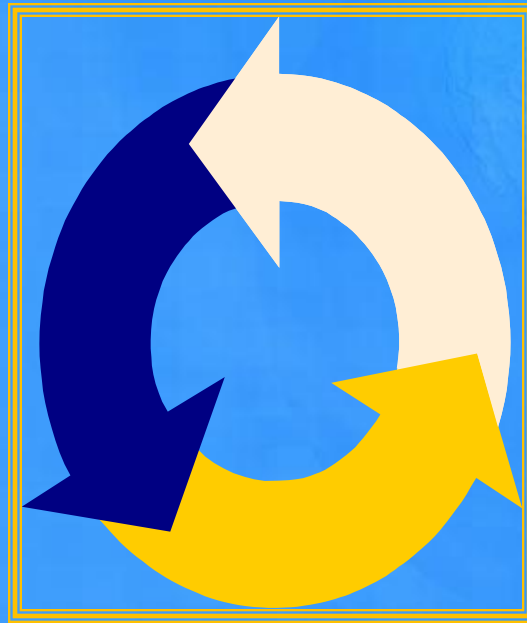
- ◇ Transaction Based Methods
- ◇ Comparable Uncontrolled Price (CUP)
- ◇ Resale Price
- ◇ Cost Plus
- ◇ Other method as per Rule 10AB

- ◇ Profit Based Methods
- ◇ TNMM
- ◇ Profit Split
 - Comparable
 - Residual



CUP Method

Product/Service



Economic
Conditions

Contractual terms

- ◇ Compares the prices charged for property or services
- ◇ Price under 'controlled transaction' is compared with 'uncontrolled transaction'
- ◇ It requires close similarity in products, property or services that are involved



Resale Price Method

RPM computes purchase price paid to related party based on its resale price to unrelated party

- 1 Determine the gross profit (GP) margin earned in comparable uncontrolled transactions

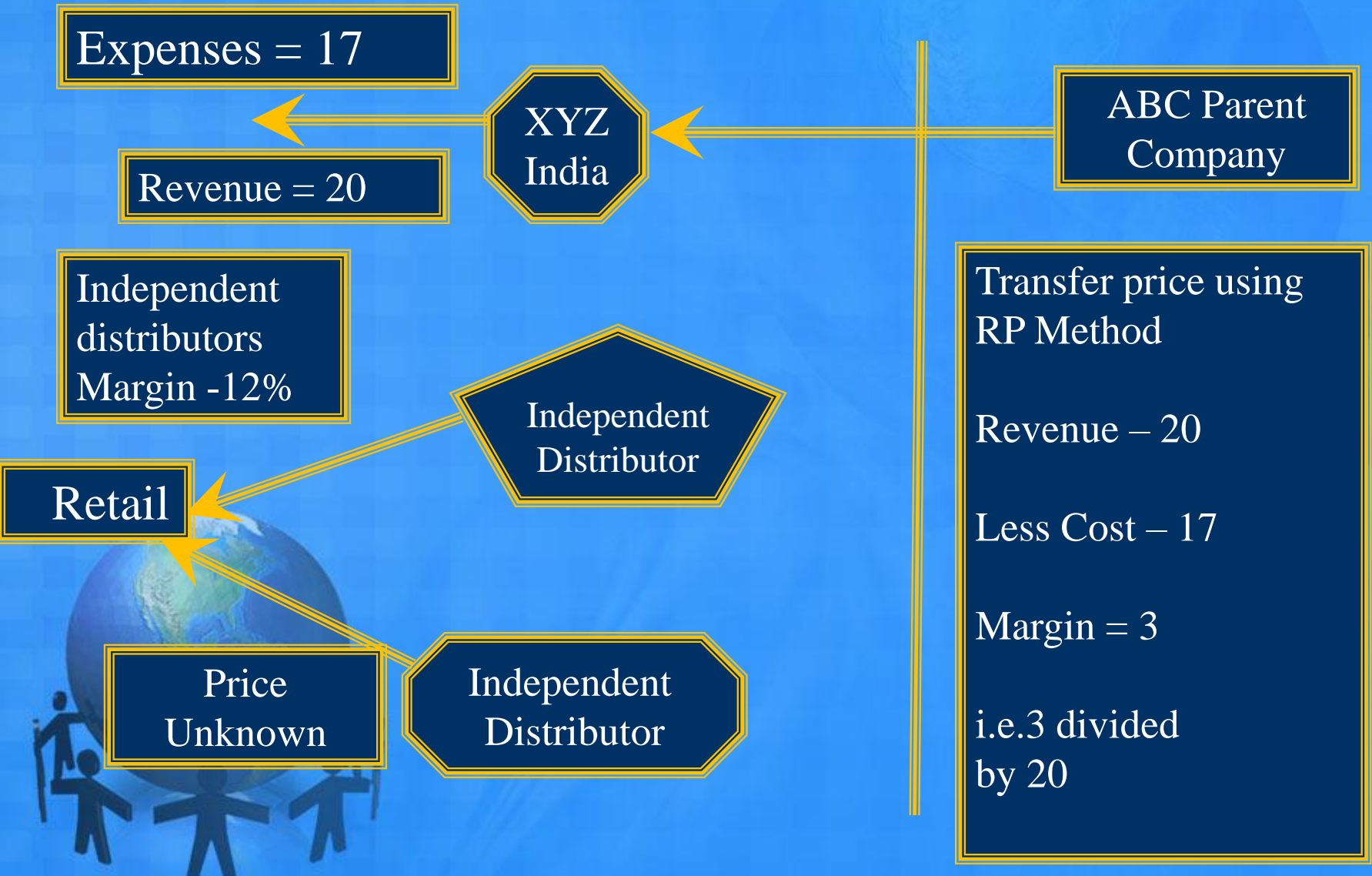
Steps

- 2 Subtract the appropriate gross margin from the applicable resale price

- 3 The remainder will be the arm's length price with the controlled entity



Resale Price Method - Trading



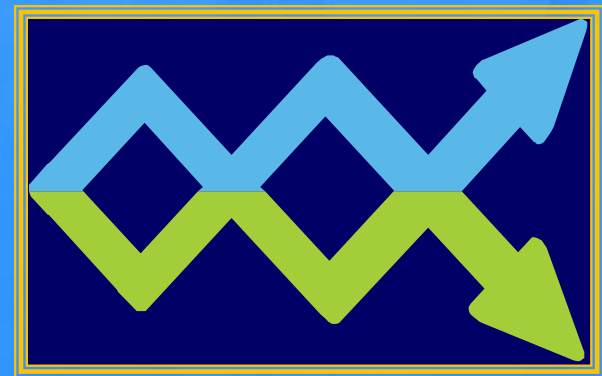
Cost Plus Method (CPM)

- ❖ The Cost Plus Method is a traditional transaction method.
- ❖ CPM determines ALP by adding Gross Profit Margin (mark-up) earned in comparable transaction(s) / by comparable companies to the cost incurred by Tested Party under controlled transaction
- ❖ The Cost Plus Method is often applied to low-risk routine-like activities such as manufacturing. Compared to the CUP method, there is less requirement of exact comparability of products in CPM



Profit Split Method

- ◈ Compares allocation of profit / loss to allocation between uncontrolled parties in similar activities
- ◈ Applicability
 - Transfer of unique intangibles
 - Multiple interrelated International Transactions
- ◈ Relies on market data
- ◈ Few taxpayers qualify for this method - difficult to get a comparable
- ◈ PSM determines arm's length profit based on combined profits derived by related parties



TNMM

- ◆ Determine arm's length price by comparing financial results of tested party and selected uncontrolled comparable instances
- ◆ TNMM tests the net margins of the tested party as oppose to gross margins in case of RPM or CPM
- ◆ Apply Profit Level Indicators (PLIs)



TNMM

Cost
Structures

Comparability
Factors

Resources

Risks



TNMM

TNMM – For Marketing of software services

Profit level Indicator: Operating Margin (OM)

$$OM = \frac{EBI}{\text{Total Cost}}$$



Any other method prescribed (Rule 10AB) [w.e.f. AY 2012-13]

- ◆ Rule 10AB – Other Method shall be 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 with or between unrelated parties, under similar circumstances, considering all the relevant facts



Any other method prescribed (Rule 10AB) [w.e.f. AY 2012-13]

- ◈ Any other method is applicable for transactions which are carried out on the basis of proposals, rates quoted on exchanges, prices/rates quoted in industry reports, etc



Transfer Pricing Regulations (TPR) in India – certain specific aspects



Advance Pricing Agreement & Revised Safe Harbour Rules



Advance Pricing Agreements (APA)

- ◆ The Finance Act, 2012 introduced 'APA Mechanism'
- ◆ Salient Features –
 - ◆ Seeks to provide assurance of certainty and unanimity in transfer pricing approach followed by the tax authorities and taxpayers
 - ◆ Validity: Upto subsequent five years and four previous years (Rollback proposed vide the Finance Act, 2014)
 - ◆ Binding on tax authorities as well as taxpayers unless there is a change in the law or facts of the case
 - ◆ Pre – Consultation process (with anonymous application option)



APA...

- ◆ Following are important points to be considered:
 - ◆ Each year Annual Compliance Report in Form No. 3CEF needs to be filed before DGIT (IT)
 - ◆ The APA can be cancelled/revised if critical assumptions are violated or conditions are not met, subject to which the agreement has been entered into
 - ◆ If the Compliance Audit results in a finding that the assessee has failed to comply with the terms of the agreement, the agreement can be cancelled
 - ◆ Non filing of Compliance Report or the report contains material errors, it may result in cancellation of the agreement



Recent Developments

- ◆ As per CBDT's third annual APA Report for 2018-19, The total number of applications filed on an annual basis (till 31 March, 2019) is shown below :

Financial Year (F.Y)	Unilateral APA Applications	Bilateral APA Applications	Total
2012-13	117	29	146
2013-14	206	26	232
2014-15	192	14	206
2015-16	113	19	132
2016-17	78	23	101
2017-18	115	53	168
2018-19	123	47	170
Total	944	211	1155



Recent Developments

F.Y	(A) No. of Applications Filed	(B) No. of Agreements Signed out of (A)	(C) No. of Applications disposed of out of (A) due to other reasons	(D) No. of Applications Under Processing out of (A) [(A) – (B+C)]
2012-13	146	92	20	34
2013-14	232	108	40	84
2014-15	206	51	19	136
2015-16	132	15	3	114
2016-17	101	3	0	98
2017-18	168	2	0	166
2018-19	170	0	0	170
Total	1155	271	82	802

Source : CBDT third annual APA Report for 2018-19

Safe Harbour Rules



- ❖ Safe Harbour provisions were introduced in the Finance Act, 2009 in order to reduce transfer pricing disputes, however, no rules were prescribed to the effect
- ❖ CBDT released Safe Harbour Rules on 8th June 2017, for assessment years 2017-18 to 2019-20 as regards various financial parameters for the prescribed sectors/activities performed by an eligible assessee
- ❖ Eligible assessee has the right to exercise the option under either sub-rule (2) or sub-rule (2A) of Rule 10TD, whichever is beneficial



Summary of Safe Harbour Rules

Eligible International Transaction (EIT)	Safe Harbour Rules		
	Old [Rule 10TD (2)]	Revised [Rule 10TD (2A)]	
Provision of software development services (other than contract R&D) and ITES	20 % or more (EIT ≤ INR 500 crores)	17 % or more of OE (EIT ≤ INR 100 crores)	
	22 % or more (EIT > INR 500 crores)	18 % or more of OE (EIT > INR 100 crores)	
Provision of knowledge process outsourcing services	25 % or more (No Threshold)	(EIT ≤ INR 200 crores)	
		Employee Cost to Operating Cost	OP to OC %
		< 40 %	18 % or more
		≥ 40 % and < 60 %	21 % or more
		≥ 60 %	24 % or more

Safe Harbour Rules (Contd...)

Eligible International Transaction (EIT)	Safe Harbour Rules	
	Old [Rule 10TD (2)]	Revised [Rule 10TD (2A)]
Provision of contract R&D services wholly or partly relating to software development and generic pharmaceutical drugs	30 % or more (software development)	24 % or more (EIT ≤ INR 200 crores)
	29 % or more (generic pharmaceutical drugs)	
Manufacture and export of core and non-core auto components	12 % or more (core auto components)	
	8.5 % or more (non-core auto components)	
Providing corporate guarantee (other than comfort letter, performance guarantee, etc.)	2 % p.a. or more (EIT ≤ INR 100 crores)	1 % p.a. or more (No Threshold)
	1.75 % p.a. or more (EIT > INR 100 crores)	

Safe Harbour Rules (Contd...)

Eligible international transaction	Safe Harbour Rules	
	Old [Rule 10TD (2)]	Revised [Rule 10TD (2A)]
Interest on advancing of intra-group loans	SBI base rate + 150 bps (INR Loan \leq 50 crores)	1 year SBI MCLR + basis points as shown below in (A) (INR Loan)
	SBI base rate + 300 bps (INR Loan > 50 crores)	6 month LIBOR + basis points as shown below in (B) (foreign currency Loan)

CRISIL credit rating of associated enterprise (AE)	(A)	(B)
	Basis points	Basis points
AAA to A or equivalent	175	150
BBB-, BBB or BBB+ or equivalent	325	300
BB to B or equivalent	475	450
C to D or equivalent	625	600
Credit rating not available and total loan in INR provided to all AEs do not exceed INR 100 crores as on 31 March of the relevant previous year	425	NA
Credit rating not available and total loan provided to all AEs do not exceed equivalent to INR 100 crores as on 31 March of the relevant previous year	NA	400

Safe Harbour Rules (Contd...)

Eligible International Transaction (EIT)	Safe Harbour Rules	
	Old [Rule 10TD (2)]	Revised [Rule 10TD (2A)]
<p>Receipt of low value adding intra group Services</p> <p>(This concept was introduced in the BEPS Action Plan 13, wherein it has been stated that these services are activities which are not the principal business activities of the group entity providing such services)</p>	Absent	<p>Value of EIT including a markup on cost upto $5\% \leq$ INR 10 crores *</p>
<p>* The following shall be required to be certified by an accountant:</p> <ol style="list-style-type: none"> 1. Method of cost pooling 2. Exclusion of shareholder costs duplicate cost from the cost pool 3. Reasonableness of the allocation key used by overseas AE for allocation of cost to the Assessee 		

Summary of Safe Harbour Rules

◆ Procedural Aspects

- ◆ Eligible taxpayers must furnish a self-attested form i.e. Form No. 3CEFA, containing various details of the eligible transactions on or before the due date for filing the income tax return
- ◆ The Assessing Officer may make a reference to the Transfer Pricing Officer to verify the validity of option exercised by the taxpayer
- ◆ Various other procedural aspects have been provided by the relevant Rules



Secondary Adjustment (Section 92CE)



Secondary Adjustment

- ◇ Introduced by Finance Act 2017, applicable from AY 2018-19

- ◇ “Secondary adjustment” is an adjustment that arises from imposing tax on a deemed basis by considering previous period’s transfer pricing adjustment itself as a separate international transaction

- ◇ Applicable to primary adjustments exceeding one crore rupees made in respect of the AY 2017-18 and onwards

- ◇ Whether primary adjustment made to the international transaction determines additional benefit transferred to the associated enterprise on a deemed basis?



Secondary Adjustment

Conditions	Time Limit for repatriation of excess money
If primary adjustment to transfer price has been made suo-moto by assessee in his return of income	Within 90 days from due date of filing return of income u/s. 139(1) i.e. 30th November
In case APA entered into by the assessee u/s. 92CD	
In case option exercised by the assessee as per Safe Harbour rules u/s 92CB	
In case of an advance pricing agreement entered into by the assessee under section 92CC, on or after the 1st day of April, 2017 (Inserted by the Finance Act (No. 2) of 2019 w.r.e.f. 1-4-2018.)	
In case assessee has entered into a Mutual Agreement Procedure under DTAA u/s. 90 or 90A	
In case the primary adjustment made as per the order of Assessing Officer (AO) / Appellate Authority has been accepted by the assessee	From the date of order of AO/ appellate authority

Recent amendments as per the Finance (No. 2) Act, 2019

- ◆ The proviso Clause (iii) of section 92CE(1) is amended to provide exemption in cases:
 - ◆ where the amount of primary adjustment made in any previous year does not exceed the threshold limit of INR one crore; or
 - ◆ the primary adjustment is made in respect of an assessment year commencing on or before 1 April 2016
- ◆ A proviso is inserted to section 92CE(1) so as to provide that no refund of any taxes already paid till date, under the pre-amended section shall be claimed and allowed



Recent amendments as per the Finance (No. 2) Act, 2019

- ◆ Section 92CE(2) provides that the excess money available to the associated enterprise (AE) shall be repatriated to India from such AE within prescribed time and in case of non-repatriation, interest thereon is to be computed deeming the same as advance to such AE
- ◆ Interest shall be computed on the excess money or part thereof
- ◆ The excess money can be repatriated from any of the AEs of the assessee, which is not resident in India, apart from the AE with which the excess money is available
- ◆ The amendments in section 92CE(1) and section 92CE(2) will take effect retrospectively from 1 April 2018



Recent amendments as per the Finance (No. 2) Act, 2019

- ◆ New sub-sections 92CE(2A), 92CE(2B), 92CE(2C) and 92CE(2D) have also been inserted:
- ◆ Section 92CE(2A): The provisions of this section are applicable without prejudice to the provisions of section 92CE(2) of the Act
 - ◆ In a case where the excess money or part thereof has not been repatriated in time, the assessee will have the option to pay additional income-tax at the rate of eighteen per cent on such excess money or part thereof in addition to the existing requirement of calculation of interest till the date of payment of this additional tax
 - ◆ The additional tax is proposed to be increased by a surcharge of twelve per cent



Recent amendments as per the Finance (No. 2) Act, 2019

- ◆ Section 92CE(2B): The tax so paid under section 92CE(2A) shall be the final payment of tax and no further credit shall be claimed by the assessee or any other person in respect of the amount of tax so paid
- ◆ Section 92CE(2C): No deduction under any other provisions of the Act shall be allowed to the assessee in respect of the amount on which such tax has been paid under section 92CE(2A)
- ◆ Section 92CE(2D): If the assessee pays the additional income-tax under section 92CE(2A), he shall not be required to make secondary adjustment under section 92CE(1) or compute interest under section 92CE(2), from the date of payment of such tax



Imputation of interest income on excess money not repatriated within time limit

Currency denomination of international transaction	Rate of imputation of interest income per annum
INR	1-year marginal cost of lending rate (MCLR) of SBI as on 1 st April of relevant previous year + 325 basis points
Foreign currency	6-month LIBOR as on 30 th September of relevant previous year + 300 basis points

Whether suo-motu payment of taxes on the primary transfer pricing adjustment is not a sufficient parameter for the revenue authorities?

Can income-tax department force a company to bring money into India or its role is restricted to collection of taxes on the money?

An Illustration

Overseas Ltd. (AE of India Ltd.)

Revenue from software development services

India Ltd.

Initial Year

- PLI of India Ltd. = 18%
- Comparable uncontrolled transactions = 24%
- TPO made an adjustment for the difference between the profit margin on sales of INR 100 crores

Later Year

- TP adjustment continues
- Overseas Ltd. does not pay the amount of TP adjustment to India Ltd.
- TPO makes a secondary TP adjustment

Preliminary Issues on Secondary Adjustment

- ◈ Whether laws of other countries may allow free repatriation of money? i.e. Effect under FEMA
- ◈ Would lead to double taxation
- ◈ Effect of treatment under MAT / in the books of accounts maintained in India prepared as per Companies Act, 2013
- ◈ Whether interest income is a one time levy or will apply on a year to year basis until the amount related to the primary adjustment is brought into India?
- ◈ Is there a contradiction for agreements between competent authorities in the case of Bilateral APAs or MAPs
- ◈ In case assessee goes for appeal before ITAT / High court / Supreme court, at what stage secondary adjustment to be made?
- ◈ Whether secondary adjustment leads to discrimination under DTAA?



Background of BEPS



Background

- ❖ Increased integration of national economies and markets has put a strain on the international tax framework, which was designed more than a century ago
- ❖ The current rules have revealed weaknesses that create opportunities for Base Erosion and Profit Shifting (BEPS)
- ❖ G20 countries mandated the Organisation for Economic Co-operation and Development (OECD) to come out with recommendations to prevent BEPS. With the intention of :
 - ❖ Restoring the trust of ordinary people in the fairness of their tax systems;
 - ❖ Creating a level playing field among businesses; and
 - ❖ Providing governments with more efficient tools to ensure the effectiveness of their sovereign tax policies



Introduction to BEPS

◆ The OECD released the final BEPS package in October 2015 to

- ◆ Prevent double taxation
- ◆ Prevent no or low taxation by shifting of profits
- ◆ Ensure fair share of tax revenues
- ◆ Prevent treaty abuse

◆ What's in the BEPS Package?

- ◆ Minimum standards
- ◆ Reinforced international standards on tax treaties and transfer pricing
- ◆ Common approaches and best practices for domestic law measures
- ◆ Analytical reports with recommendations (digital economy and multilateral instrument)
- ◆ Detailed report on measuring BEPS



3 Options as per BEPS Action Plan to implement in Domestic laws and Introduction by India

3 Options as per BEPS Action Plan:

- ◆ A new nexus in the form of a significant economic presence,
- ◆ A withholding tax on certain types of digital transactions, and
- ◆ An equalisation levy subject to treaty obligations

Introduction by India:

- ◆ A new nexus in the form of a significant economic presence,
- ◆ An equalisation levy subject to treaty obligations



BEPS Action Plan 8-10

◇ BEPS Action Plan 8-10 focuses on creation of value, i.e., profit should be taxed where value is created and requires that the FAR analysis be focused on :

- i. significant people functions,
- ii. economic substance , and
- iii. intangibles

in arriving at the appropriate share of profits to be taxed in that market jurisdiction

◇ As per this Action plan, value creation happens in the country which houses the supply side (i.e. significant people functions, development, enhancement, maintenance, protection and exploitation [DEMPE], functions for intangibles) rather than the country that houses the demand side (i.e. the consumers)



Importance of Value Chain Analysis

- ◆ While evaluating the arm's length price of international transactions under the latest regulations governing Base Erosion and Profit Shifting (“BEPS”), value chain analysis is an important tool to determine where and how value is created in the business operations



- ◆ This will also ensure that the strategic and operating models of constituent entities of various multinational enterprises (“MNEs”) are aligned with that of the MNEs



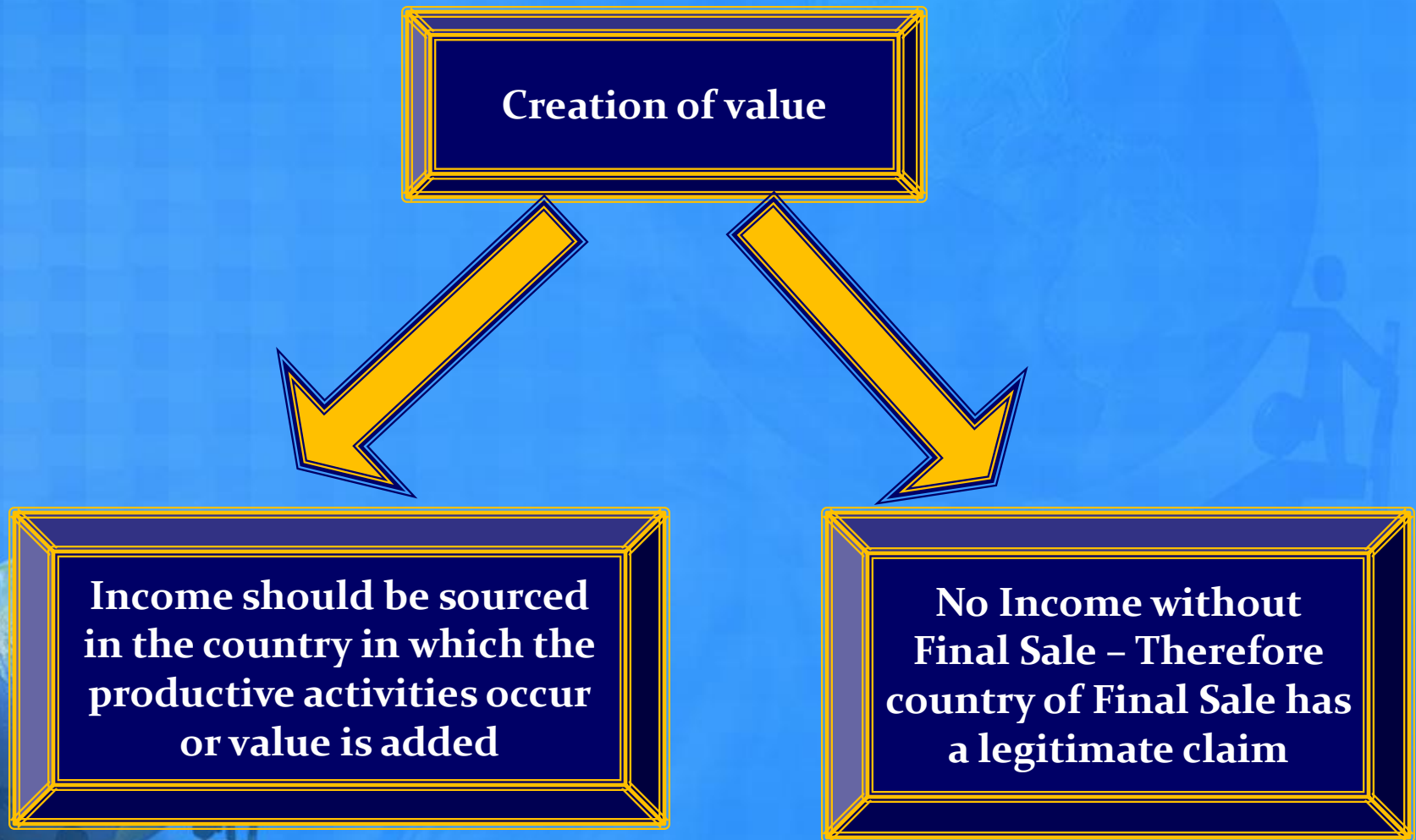
Traditional value chain models



Value chain analysis under new age business models




So where is value created?




Conflict in the attribution of value

◆ Organizations with Global Footprint

- ◆ View business as a continuous activity irrespective of geographies
 - ◆ Maximize profits through minimal tax outflow
- 
- ◆ Which impacts attribution of value to specific entities located in various geographies

◆ Revenue Authorities in every Country

- ◆ View organization entities on a standalone basis
 - ◆ Maximize tax base in the source country
- 
- ◆ which leads to attributing maximum value to entities functioning in their country / jurisdiction

Vs.



◆ Disputes are increasing

Benefits of value chain analysis in transfer pricing

◇ Value chain analysis will help in :

◇ consideration of the economically significant functions, assets and risks, which party or parties perform the functions, contribute the assets and assume the risks

◇ Reduction of probable disputes with tax authorities

◇ Demonstrates capturing of the correct profits attributable in accordance with value created, to the tax authorities



Where does Value Maximisation happen?

Strategically important processes create value for the organization



As a result of this merger, Walmart will also gain access to Flipkart's in-house eCommerce tool which it uses to engage its sellers in a B2B setup. This will create immense value in the Flipkart Data Platform that allows teams to consume data and process it in real-time.



Arm's length price (ALP) vs. ALP with Market base

- ◆ Transfer pricing has traditionally focused on functions, assets and risk (FAR) analysis for determining the arm's length price of international transactions
- ◆ However, in the context of digital economy, the attribution of profits needs to be expanded based on not just FAR analysis but by also considering the 'market' analysis, can also be referred as "FARM analysis"
- ◆ Under FAR analysis, adequate importance has not been given to 'market'
- ◆ FARM analysis, on the other hand, also considers those market jurisdictions that create 'value'



FAR vs. FARM (A case study)

Consider, an entity A which sells goods to entity B (a non-resident)



TURNOVER	INR 200 crores
OPERATING COSTS	INR 100 crores
NET PROFIT	INR 100 crores

Under FAR analysis, the entire INR 100 crores would be taxable in the hands of entity A

Under FARM analysis, an equal weight could be allocated to functions (25%), assets (25%), risks (25%) and market (25%)

FAR vs. FARM (A case study) Contd..

- ◆ Consequently, as the market reflects a 25% weight, INR 25 crores will be attributed to entity B (a non-resident)
- ◆ This approach of weighted apportionment of profits to the market state of the non-resident is far less drastic than other apportionment techniques like 'formulary apportionment' in which the substantial portion of profit gets attributed to the market state



Convergence of OECD and UN Guidelines

- ◇ Over the years, there has been consensus among various countries to bring convergence between OECD and UN guidelines
- ◇ Indian law does not explicitly recognise the direct applicability of the **OECD** TP Guidelines or the UN TP manual. India has, however, framed its own rules and guidance on transfer pricing, which are broadly in line with the OECD TP Guidelines as well as the UN TP Manual.

OECD Guidelines	UN Manual
<ul style="list-style-type: none">▪ First edition—1979• Second edition—1995• The most recent edition—2017	<ul style="list-style-type: none">• First edition—2013• Second edition—2017• Draft updates to financial transactions and profit splits—2019



UN Manual Vis-à-Vis OECD TP guidelines

- ◆ The UN TP Manual's approach towards transfer pricing is more supportive of transfer pricing advisory, design and planning, whereas the OECD BEPS Project approaches regulations as a response to aggressive tax planning
- ◆ The UN TP Manual is more user friendly as it contains a more detailed recommendations for MNEs for establishing a new transfer pricing regime
- ◆ Both OECD and UN has adopted the three tier approach for documentation as suggested by BEPS Action Plan 13
- ◆ Both the standards promote the same five factors of comparability as well as the five core transfer pricing methods



UN Manual Vis-à-Vis OECD TP guidelines

- ◈ The UN Manual advocates a sixth transfer pricing method akin to the CUP method.
- ◈ With respect to intangibles, OECD states that Every member of the group having contribution in DEMPE must be compensated. The UN Manual adds an “A” to these OECD DEMPE functions

- ✓ Development
- ✓ Acquisition (of Intangibles)
- ✓ Enhancement
- ✓ Maintenance
- ✓ Protection
- ✓ Exploitation of intangibles



UN Manual Vis-à-Vis OECD TP guidelines

- ❖ The UN Manual has considered this and updated the UN Manual in April 2019 to try to manage consistency with the OECD Guidelines
- ❖ However, it stresses on the fact that “it cannot be automatically assumed that these international guidelines should be adopted wholesale in every developing country.”



Master file and Country-by-Country report



Master File and Country-by-Country Reporting (Indian Perspective)

- ◇ Introduction of Master File and CbCR in alignment with BEPS Action Plan 13 of the OECD

- ◇ Three-tier transfer pricing documentation structure with the introduction of the Finance Act, 2016:

- ◇ Local File [Transfer Pricing Documentation as per the Section 92D(1) of the Act]
- ◇ Master File [Master File as per the proviso to Section 92D(1) of the Act]
- ◇ Country-by-Country Report [CbC Report as per Section 286(3) of the Act]

- ◇ CBDT on 31 October, 2017 issued Final Rules in respect of keeping, maintaining and furnishing information and documents with respect to

- ◇ Master File - Rule 10DA;
- ◇ Country-by-Country Report - Rule 10DB



Master File and Country-by-Country Reporting (Indian Perspective)

- ◇ Rule 10DA - Thresholds for applicability, timelines, requirements and procedure in relation to Master File. The relevant information and intimation related to Master File is required to be filed in Form No. 3CEAA and 3CEAB
- ◇ Rule 10DB - The requisite details and procedures for CbC Report filing. The relevant information and intimations are required to be filed in Form No. 3CEAC, 3CEAD and 3CEAE
- ◇ Master File is an onerous documentation which depicts sensitive information and is supposed to provide a bird's eye view of the working of the group
- ◇ In line with the BEPS Action 13, India has become a signatory to the Multilateral Competent Authority Agreement (MCAA) for the automatic exchange of CBC Report with the other signatories of the Agreement on 12 May 2016 and notified on 28 July 2017



Master File



Amendments in section 92D (Finance Act (No. 2), 2019)

◆ The Finance Act (No. 2), 2019 amended section 92D(1), to provide the following :

Section 92D(1) before amendment	Section 92D(1) after amendment
<p>(1) Every person who has entered into an international transaction or specified domestic transaction shall keep and maintain such information and document in respect thereof, as may be prescribed :</p> <p><i>Provided that the person, being a constituent entity of an international group, shall also keep and maintain such information and document in respect of an international group as may be prescribed.</i></p>	<p>(1) Every person,—</p> <p>(i) who has entered into an international transaction or specified domestic transaction shall keep and maintain such information and document in respect thereof as may be prescribed;</p> <p>(ii) <i>being a constituent entity of an international group, shall keep and maintain such information and document in respect of an international group as may be prescribed.</i></p>

Country-by-Country Report (Rule 10DB)



CbCR in India

- ❖ India implemented the requirements set out under BEPS Action Plan 13, in section 286 of the Act vide Finance Act, 2016
- ❖ The objective of CbCR is to provide tax administrations with the information necessary to conduct a high-level and informed risk assessment analysis of the transfer pricing policies followed by MNEs



Country-by-Country Report (Rule 10DB)

- ◇ CbC report is applicable to an international group having total consolidated group revenue of more than INR 5,500 crore (approx. \$ 750mn) in the reporting accounting year preceding the financial year
 - ◇ For e.g., for FY 2018-19- the consolidated group revenue threshold should be tested for accounting year 2017-18
- ◇ Every parent entity or an alternate reporting entity, resident in India, would need to furnish CbC reporting prescribed under Form No. 3CEAD.
- ◇ Intimation under Form no. 3CEAC has to be filed by every constituent entity resident in India, of an international group, the parent entity of which is not resident in India



Filing CbCR in India

Section 286(4) of the Act requires constituent entities resident in India to file CbCR in India in the following situations:

- Where the parent entity is 'not obligated' to file CbCR in its home country (a)
- Where India does not have an agreement for exchange of CbCR with the jurisdiction in which the Ultimate Parent Entity or Alternate Reporting Entity is resident (aa)
- Where there has been a systemic failure in a country and this is intimated by the prescribed authority to the constituent entity (b)



Extension of Deadlines



- ❖ The CBDT, vide Notification No. 88/2018 dated 18 December 2018 prescribed timelines with respect to entities covered under section 286(4), providing that the period shall be twelve months from the end of the reporting accounting year
- ❖ **Implication :** For an entity having reporting accounting year ending 31 Dec 2017, due date for filing of CbCR would be 31 Dec, 2018 i.e. giving only 13 days to such entities.
- ❖ To remove such hardships, the CBDT, vide circular dated 26 December 2018 extended such due date to 31 March 2019 for all reporting accounting years ending up to 28 February 2018



Recent Developments

- ◆ The CBDT has, vide Notification No 03/2020, amended Rule 10DA to substitute the marginal heading to now read as *“Maintenance and furnishing of information and document by certain person under section 92D”*
- ◆ Rule 10DA(2) : the Master File to be furnished to the Joint Commissioner as the designated tax authority
- ◆ Rule 10DA(3) : the constituent entity shall furnish Part A of Form 3CEAA even if the conditions specified under Rule 10DA(1) are not satisfied



Recent Developments

- ◆ The CBDT amended Rule 10DA(4)/(5) to provide that where there are more than one constituent entities resident in India of an international group, Form 3CEAA may be furnished by any one constituent entity, if,
 - a) the international group has designated such entity for this purpose; and
 - b) the information has been conveyed in Form 3CEAB to the Joint Commissioner* 30 days before the due date of furnishing Form 3CEAA

** [as against DGIT (Risk Assessment) specified earlier]*



Recent Developments

- ❖ The CBDT has, vide Notification No 03/2020 also amended Rule 10DB(1) to clarify that income-tax authority for Sec 286 shall be the Joint Commissioner as may be designated by the Director General of Income-tax (Risk Assessment)
- ❖ Rule 10DB(2): the notification u/s 286(1) by constituent of an international group, the parent entity of which is not resident in India, shall be made in Form No. 3CEAC 2 months prior to the due date for furnishing Country-by-Country Report (CbCR)



Recent Developments

- ◆ Rule 10DB(3): every parent entity or the alternate reporting entity, as the case may be, resident in India, shall, for every reporting accounting year, furnish CbCR in Form 3CEAD
- ◆ Rule 10DB(5): the information required to be conveyed under proviso to Sec 286(4) regarding designated constituent entity shall be furnished in Form 3CEAE





Thank You

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