



CTC

Recent Developments in Transfer Pricing

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14 February 2015

Transfer Pricing Developments



- ✦ Introduction of Rollback provisions to the Advance Pricing Agreements (APA) regime - the conditions, procedure and manner of covering the APA results for the prior periods under the roll-back mechanism are yet to be prescribed
- ✦ Strengthening the administrative set up of APA to expedite processing of applicants
- ✦ Changes to the definition of the term deemed international transaction
- ✦ Empowering of the Transfer Pricing Officer (TPO) to levy penalties
- ✦ Introduction of Range concept - Determination of arm's length price (ALP) when more than one price is determined by most appropriate method (MAM) - effective from April 1, 2015
- ✦ 1%/3% arm's length range retained, 'Wholesale Trading' defined
- ✦ Amendment in Rule 10D and Safe Harbour Rules for Specified Domestic Transactions notified



Definition of Deemed International Transaction



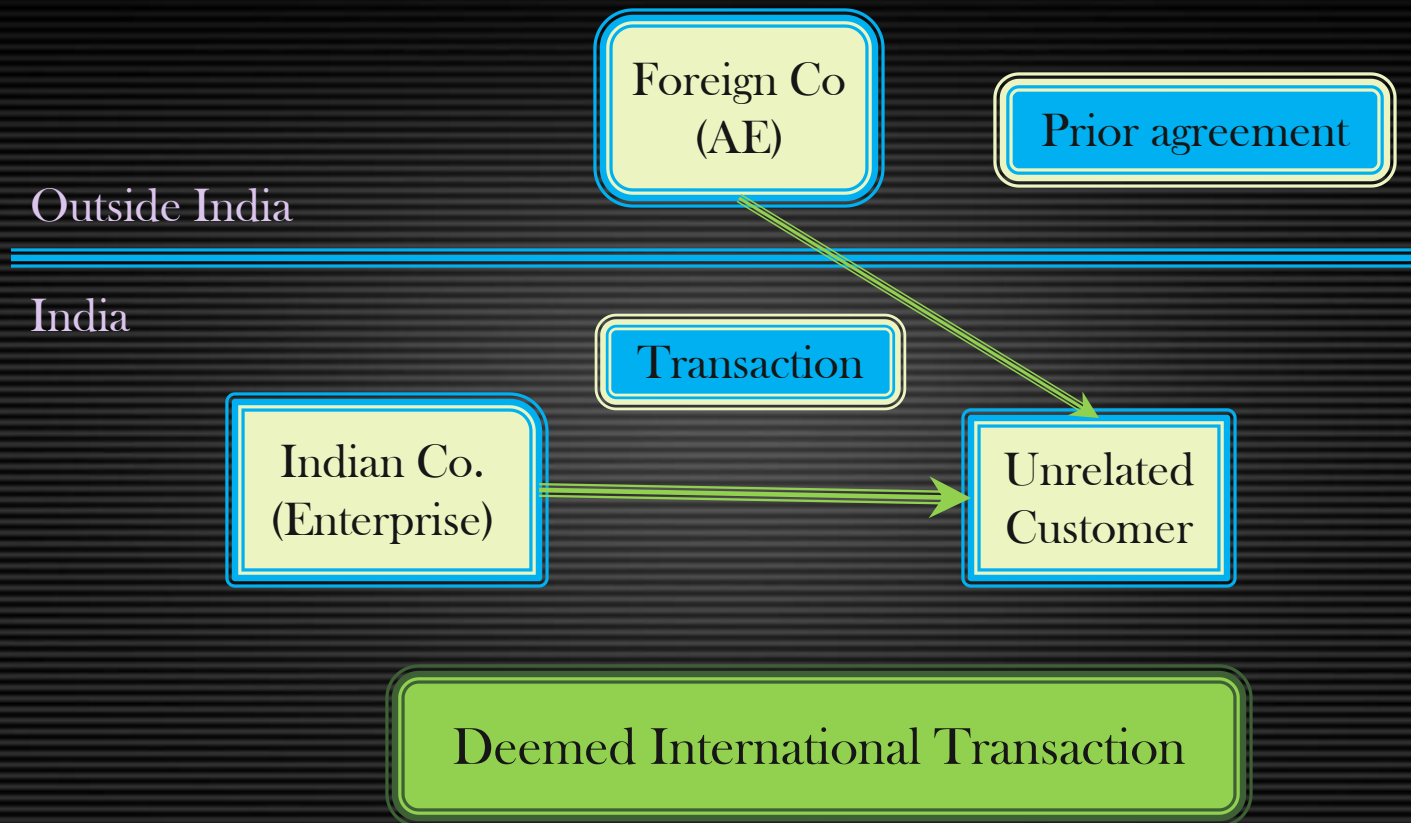
- ✦ The definition of “deemed international transaction” provides that a transaction of an enterprise with a third party shall be deemed to be an international transaction with the AE if there exists a prior agreement in relation to the said transaction or the terms of the said transaction are determined in substance between the AE and the third party
- ✦ There had been an uncertainty - whether 'deemed international transactions' would cover a case where both the contracting entities are Indian residents
- ✦ The Finance Act 2014, has broadened the scope of international transaction. Further, the amendment is effective from 1 April 2015

Definition of Deemed International Transaction



- ★ 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*

Definition of Deemed International Transaction...



Definition of Deemed International Transaction



- ★ The Hyderabad Tribunal in the case of Swarnandhra IJMII Integrated Township Development Co. P. Ltd vs. DCIT [2013-TII-152-ITAT-HYD-TP] held that deeming fiction does not cover transactions between two Indian entities
- ★ Similar position taken in Kodak India Pvt Ltd (155 TTJ 69) (Mum ITAT) and Vodafone India Services Pvt Ltd (Bom HC) (262 CTR 153)

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



1%/3% arm's length range retained

“Wholesale Trading” defined



★ The CBDT via Notification No.45/2014/F.No.500/1/2014-APA-II dated 23rd September 2014:

★ retained transfer pricing variation range, i.e.

★ 1% in case of wholesale trading and

★ 3% in other cases

from the transaction price for international transactions and/or specified domestic transactions entered during financial year 2013-14 as well;

★ Also defined the term ‘wholesale trading’ i.e.

★ Purchase cost of finished goods is eighty percent or more of the total cost pertaining to such trading activities; and,

★ Average monthly closing inventory of such goods is ten percent or less of sales pertaining to such trading activities

Whether ‘Purchase cost’ shall mean price paid or it shall also include other incidental charges like custom duty or freight inwards etc.?

Whether ‘Total cost pertaining to such trading activities’ shall only be a sum of all operating costs or it shall also include financial costs pertaining to trading activity?

CBDT notifies amendment in Rule 10D and Safe Harbour Rules for Specified Domestic Transactions



✦ The CBDT via Notification No.11/2015/F.No.142/7/2014-TPL]dated 3rd February 2015:

✦ Eligible assessee -

- ✦ A person who has exercised a valid option for application of safe harbour rules in accordance with the provisions of rule 10 THC, and
- ✦ Is a Government company engaged in the business of generation, transmission or distribution of electricity

✦ Eligible specified domestic transaction (SDT)-

- ✦ Means a SDT undertaken by an eligible assessee and comprises of :-
 1. Supply of electricity by a generating company; or
 2. Transmission of electricity; or
 3. Wheeling of electricity

CBDT notifies amendment in Rule 10D and Safe Harbour Rules for Specified Domestic Transactions



* Safe Harbour Rule -

The tariff as determined by the Appropriate Commission in accordance with the provisions of the Electricity Act, 2003 (36 of 2003)

* Appropriate Commission - Section 2(4) of the Electricity Act, 2003 (36 of 2003)

An appropriate commission shall be a Commission to be known as the Central Electricity Regulatory Commission to exercise the powers conferred on, and discharge the functions assigned to it under the Electricity Act

* Government company - Section 2(45) of the Companies Act, 2013 (18 of 2013)

Any company in which not less than fifty one per cent of the paid-up share capital is held by the Central or State Government partly or fully and includes a subsidiary company of such a Government company

* Procedural Aspects

* Eligible taxpayers must furnish a self-attested form i.e. Form No. 3CEFB, on or before the due date for filing the income tax return

* Various other procedural aspects have been provided by the relevant Rules

Key Challenges



- ✦ Undervaluation of shares
- ✦ Marketing intangibles
- ✦ Royalty pay-outs
- ✦ Management charges
- ✦ Single year data
- ✦ Arithmetic Mean / Concept of range
- ✦ IT/ ITES margins
- ✦ Loan and Guarantee fees





Recent Jurisprudence on Transfer Pricing



Vodafone India Services Limited (Writ Petition No. 871 of 2014) Bombay High Court...



★ Facts of the case:

- ★ Vodafone India issued 2,89,224 equity shares of the face value of INR 10/- each on a premium of INR 8,509/- per share to its holding company which was determined in accordance with the methodology prescribed by the Government of India under the Capital Issues (Control) Act, 1947
- ★ The AO and the TPO valued each equity share at INR 53,775/- and on that basis made an adjustment of INR 45,256 per share (amounting to INR 1308.91 crores), by treating the shortfall in premium as income
- ★ Further, as a consequence of the above, the AO/ TPO treated the same as deemed loan given by the assessee to its holding company and also contended that periodical interest of INR 88.35 crores had to be charged to tax as interest income

Vodafone India Services Limited...



- ✦ The assessee filed a Writ Petition (Vodafone-III) before the Hon'ble Bombay Court ('the HC') challenging the jurisdiction of the AO/ TPO to tax the above transaction of issue of shares considering that the same did not generate any income as defined under the Act
- ✦ The HC in Vodafone-III accepted the plea of the assessee and directed the Dispute Resolution Panel (DRP) to first decide only the preliminary jurisdictional issue raised by the assessee
- ✦ Consequent to these directions, the DRP considered the issue of jurisdiction and rejected the assessee's preliminary objection thereto
- ✦ Hence, the assessee filed a Writ Petition (present) before the HC, challenging the DRP's order which had held that the AO/TPO had jurisdiction to tax such shortfall in premium under Chapter X of the Act, as income arose in the above international transaction

Vodafone India Services Limited...



✧ Observations, Analysis and Decision:

- ✧ The word income as defined in Section 2(24) of the Act, though an inclusive definition, cannot include capital receipts unless specified, as in Section 2(24)(vi) of the Act
- ✧ Capital gains chargeable to tax under Section 45 of the Act are, defined to be income
- ✧ The amounts received on issue of share capital including the premium were undoubtedly on capital account
- ✧ Due to absent express legislation; no amount received, accrued or arising on capital account transaction can be subjected to tax as income

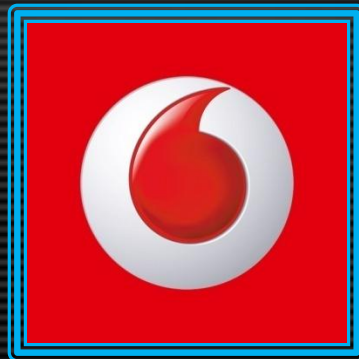
Reliance on the decision of :

Bombay High Court in Cadell Weaving Mill Co. vs. CIT 249 ITR 265, which was upheld by the Apex court in CIT v. D. P. Sandu Bros. Chember (P) Ltd. 273 ITR 1

Vodafone India Services Limited...



- ★ Chapter X of the Act is a machinery provision to arrive at the ALP of a transaction between associated enterprises (AEs)
- ★ The substantive charging provisions are found in Sections 4, 5 (Scope of income), 15 (Salaries), 22 (Income from house property), 28 (Profits and gains of business), 45 (Capital gain) and 56 (Income from other Sources) of the Act
- ★ An income arising from an international transaction between AE must satisfy the test of income under the Act and must find its home in one of the above heads i.e. charging provisions, as Chapter X is only a machinery provision to compute the chargeable income at ALP

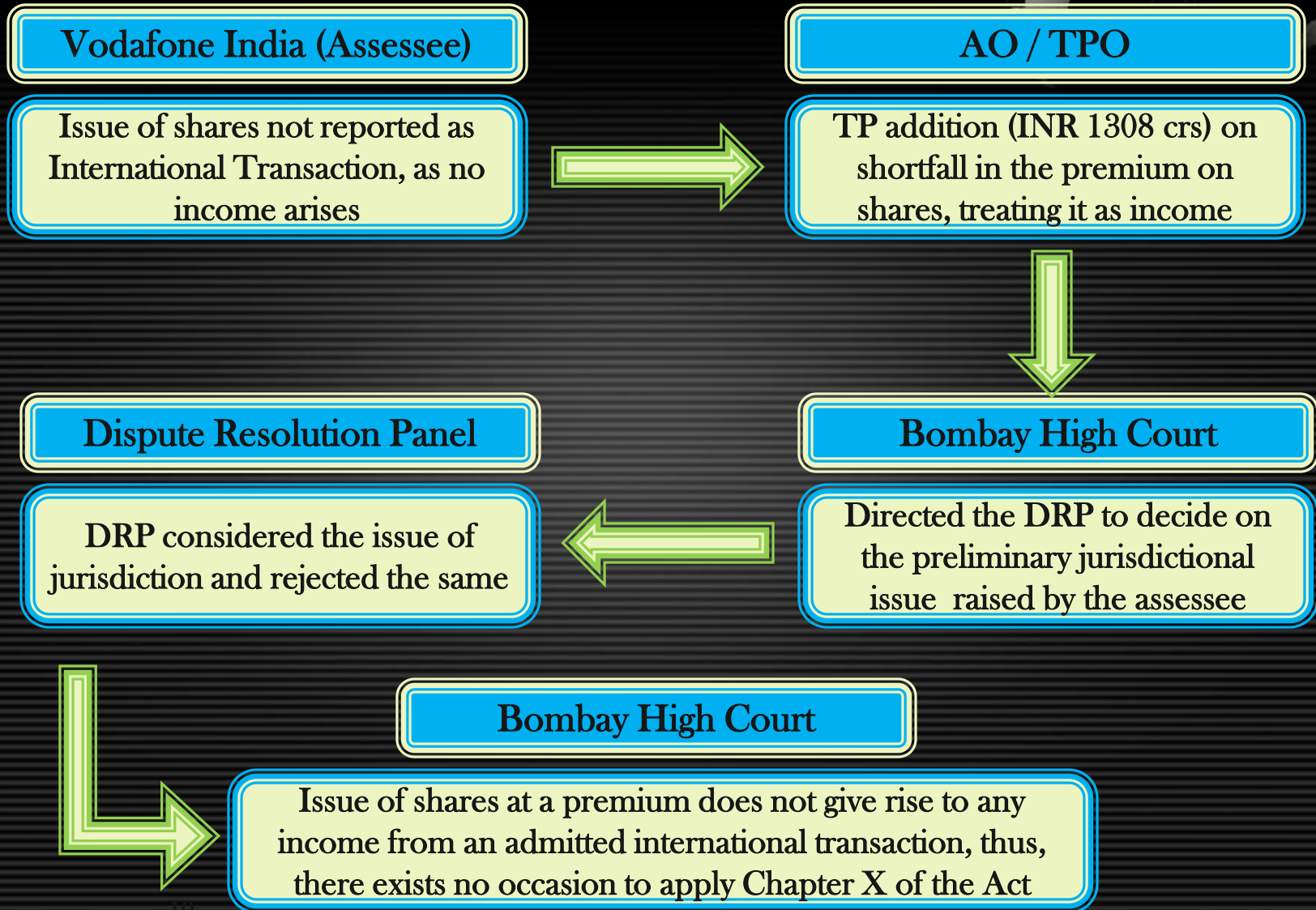


Vodafone India Services Limited...



- ★ Machinery section cannot be read de-hors the charging section, relying on the observations of the Supreme Court in CIT v. B. C. Srinivas Shetty 128 ITR 294
- ★ The HC concluded that the issue of shares at a premium by the assessee to its non-resident holding company does not give rise to any income from an admitted international transaction
- ★ Thus, there was no occasion to apply Chapter X of the Act in such a case. The HC quashed all the orders of the Revenue authorities i.e. AO/ TPO/ DRP and set them aside as being without jurisdiction, null and void

Vodafone India Services Limited (Writ Petition No. 871 of 2014) Bombay High Court



**Toll Global Forwarding India Pvt. Ltd. [ITA
No. 5025/Del/10] Delhi Tribunal**



- ✦ Company is a joint venture between BALtrans International (BVI) Limited (holding 74%) and Kapil Dev Dutta (holding balance 26%); primarily engaged in the business of freight forwarding through air and ocean transportation
- ✦ Profits earned, after deducting transportation costs, in respect of import and export of cargo, are shared equally between the assessee and its AEs or independent third party business associates, as per the global practices in the industry
- ✦ In the transfer pricing study report submitted, the assessee adopted the Comparable Uncontrolled Price (CUP) Method for determining arm's length price

Toll Global....



- ★ The TPO contented that the CUP Method chosen for both imports and exports has not been demonstrated
- ★ It was also stated that even if the international transactions were to be analyzed on CUP Method, the assessee would be required to furnish the documents/vouchers related to third party for export and import transactions related to controlled and uncontrolled transactions
- ★ The TPO selected TNMM as the most appropriate method and proceeded to make an addition to the international transaction

Toll Global....



✦ Observations of the Tribunal

- ✦ Transfer pricing should not be viewed as a source of revenue
- ✦ It is an anti-abuse measure in character and all it does is to ensure that the transactions are not so artificially priced, with the benefit of inter se relationship between associated enterprises, so as to deprive a tax jurisdiction of its due share of taxes
- ✦ Limitations of the prescribed methods of ascertaining arm's length price should not be allowed to come in the way of substantive justice, particularly when it is beyond reasonable doubt that there is no influence of intra AE relationship on the determination of prices in respect of intra AE transactions



Toll Global....



- ✦ The connotations of ‘price’, as set out in Rule 10B(1)(a) are required to be taken to be something much broader than the expression ‘amount’
- ✦ Further, Rule 10B(1)(f) inserted vide notification dated 23rd May 2012 is not a residual method
- ✦ As Rule 10BA, confers the benefit of an additional method of ascertaining arm’s length price and, inter alia, relaxes the rigour of CUP method, it can only be retrospective in effect
- ✦ Considering all of the above observations, ITAT concluded that the business model adopted by the assessee, in principle, meets the test of arm’s length price determination under Rule 10BA as well

Global Vantedge Pvt. Ltd. [ITA No. 2763
& 2764/Del/2009] Delhi Tribunal



- ✦ Global Vantedge Pvt. Ltd. (GV – India) was engaged in rendering IT enabled services in the field of credit collection and telemarketing services
- ✦ GV – India rendered services to clients of its foreign AE and other independent clients
- ✦ The TPO chose the assessee itself as the tested party and arrived at an average operating margin of 11.88% as ALP by using Indian comparables as against the loss of 53.5% incurred by the assessee
- ✦ Accordingly, the TPO made an upward adjustment to the extent of Rs. 14,70,10,071/- in relation to service charges received from its AEs

Global Vantage....



- ★ The ITAT confirmed the findings of the CIT(A) after hearing the arguments of both the parties
 - ★ CIT(A) agreed that the least complex party being the simpler entity should be considered as the tested party as it requires a fewer and more reliable adjustments to be made to its operating profit margins.
 - ★ Under the revenue sharing arrangement between the entities, what may be questioned is the proportion of sharing between the entities and not the absolute amount of revenue itself which is subject of sharing because that is beyond the control of either the assessee or its AEs

Global Vantedge....



- ★ However, it cannot be logical to say that the fair amount of revenue to be received by the assessee is more than 100% of the total revenue earned by both the entities
- ★ Under such circumstances, AEs will have to pay the additional amount from its internal sources which in addition to being a highly absurd proposition, may also lead to the bankruptcy of its AEs since this cannot be sustained over a period of time
- ★ Therefore, applying the above logic the total adjustment made in the hands of the assessee cannot exceed the total revenue earned by the assessee and its AE from third party customer
- ★ Further, the adjustment to the ALP is to be limited to the international transactions

Global Vantedge....



- ✦ The revenue authorities filed appeal before the Hon'ble Delhi High Court [ITA No.1828/2010] where the appeals were dismissed
- ✦ Further, Supreme Court [CC 21808/2013] dismissed the Special Leave Petition against such High Court order



Cushman & Wakefield (I) Pvt. Ltd.
[ITA No. 475/2012] Delhi High Court



- ✦ The assessee company, a subsidiary of M/s Cushman and Wakefield Inc, its US based parent company, is engaged in the business of rendering services connected to acquisition, sales and lease of real estate and other services
- ✦ Assessee reimbursed certain costs incurred by the AEs for coordination and liaison services
- ✦ TPO found that no intra group services existed in this case and no benchmarking or transfer pricing analysis was conducted by the assessee, therefore disallowed the said expenditure
- ✦ On objections raised before the DRP, they concurred with the view taken by the TPO and the AO



Cushman & Wakefield....



- ✦ The counsel for the assessee argued that it is undisputed that as per agreement AEs have only charged cost without any mark up; which was accepted by the ITAT

- ✦ ITAT remarked that the amount payable under any other uncontrolled transaction would necessarily be greater, as the cost would be supplemented with some profit margin and thus hit by the provisions of 92(3)]

- ✦ Further, on appeal before the High Court, it divided the issue in two parts,
 - ✦ whether services have indeed been provided by AEs to the assessee and;
 - ✦ whether these services ought to be benchmarked to determine the ALP considering the provisions of Section 92(3)

Cushman & Wakefield....



- ✦ High Court observed that whether a third party, in an uncontrolled transaction with the assessee would have charged amounts lower, equal to or greater than the amounts claimed by the AEs, has to be tested under the various methods prescribed in Section 92C of the Act
- ✦ This being a transaction between related parties, whether that cost itself is inflated or not, is a matter to be tested under a comprehensive transfer pricing analysis
- ✦ The assessee did not benchmark these costs in its transfer pricing study
- ✦ To this extent, for the consideration of ALP in respect of these transactions, the matter was remanded back to the file of the concerned AO, for an ALP assessment by the TPO

Cushman & Wakefield....



- ✦ Another issue raised by the AO is the disallowance of the referral fees as a deductible expenditure, stating that no benefit was derived by the assessee from the referral fees paid to its AEs [under Section 37(1)]
- ✦ However, the same was considered to be at arm's length by the TPO under Section 92CA
- ✦ On appeal, the DRP concurred with the AO, leading to a final assessment order under Section 143(3) read with Section 144C
- ✦ ITAT held that the assessee has submitted ample evidence to support the expenditure and it was shown that such expenditure is incurred with respect to revenue earned by the assessee on property transaction referred to the assessee by its associate enterprise

Cushman & Wakefield....



- ✦ On Appeal before High Court it observed that;
 - ✦ The jurisdiction of the AO, under Section 37, and the TPO, under Section 92CA, are distinct
 - ✦ A reference by the AO to the TPO is only for the limited purpose of determining the ALP
 - ✦ It does not imply a concrete view as to the existence of services, or the accrual of benefit (such that allowance under Section 37 must be permitted);
 - ✦ The AO can determine under Section 37 that the expenditure claimed was not for the benefit of the business, and thus, disallow that amount
 - ✦ This does not restrict or in any way bypass the functions of the TPO

Watson Pharma Private Limited, Mumbai Tribunal, ITA No. 1423/Mum-2014 & 1565/Mum-2014 ...



- ✦ Watson Pharma Private Limited (taxpayer) was engaged in contract manufacturing for its associated enterprises (AEs) and provided contract research and development services to its AEs
- ✦ Taxpayer selected TNMM as the MAM
- ✦ The taxpayer was compensated by its AEs on a total operating cost plus arm's length mark-up basis
- ✦ The transfer pricing officer (TPO) made primary adjustment on account of locations savings, purportedly accruing to AEs owing to transfer of these activities from US (location of the AE) to India subject to FDA forms
- ✦ TPO made the adjustment on the basis of articles available in public domain (contained an analysis of costs undertaken in different jurisdictions)
- ✦ The DRP confirmed the approach of TPO/AO, except to exclude Alphageo Ltd from the set of comparables



Watson Pharma Private Limited...



✦ Taxpayer's contention:

- ✦ There was no super profit which arose in the entire supply chain as the taxpayer did not have exclusive access to the factors that may have resulted in location-specific advantages
- ✦ Local Indian comparables operating in similar economic circumstances were selected for the purpose of benchmarking analysis
- ✦ Therefore, if at all any benefit existed on account of location savings, that would have anyway been embedded in the operating margin of comparables *
- ✦ Accordingly, if the taxpayer was remunerated based on comparable margins, then no location savings were required to be attributed

***Reliance placed on ruling in case of GAP International Sourcing (India) Pvt. Ltd. v. ACIT [2012] 149 TTJ 437 (Delhi Tribunal) and on the OECD Guidance on Transfer Pricing Aspects of Intangibles (released pursuant to Action 8 of OECD/G20 BEPS Project)**

Watson Pharma Private Limited...



✧ Taxpayer's contention:

- ✧ The taxpayer and its AEs operated in a perfectly competitive market, and did not have any monopoly in the market in which they operated
- ✧ If at all there were any locational savings, then they were passed on to the ultimate customer
- ✧ Arm's length allocation should be based on relative bargaining power of the taxpayer and the AE
- ✧ In the instant case, the AEs had operations across the globe and could have procured the goods/ services from other group companies or third parties as well. Therefore, the AEs had several alternatives available with them, which gave bargaining powers to the AEs

Watson Pharma Private Limited...



- ✦ The Tribunal deleted the adjustment citing several reasons, notably including the following:
 - ✦ Revenue authorities were unable to substantiate their adjustments from any authenticated/ global material
 - ✦ Non-submission of records could not form the basis of making adjustments in ALP on bald assertions*
 - ✦ One of the reasons for making the ALP adjustment was without any basis*
 - ✦ The taxpayer as well as AEs operated in a perfectly competitive market, and the taxpayer did not have exclusive access to factors leading to location-specific advantages
 - ✦ Therefore, the taxpayer did not have any unique advantage, and there was no super profit arising in the entire supply chain

***Reliance placed on ruling in case of UCB India (P) Ltd vs ACIT, 124 TTJ
289, Special Bench**

Watson Pharma Private Limited...



- ✦ Where local market comparables were available and used, specific adjustment for location savings was not required*
- ✦ Any benefit/ advantage to the AE was irrelevant if the profit level indicator (PLI) of the taxpayer was within the range of comparables
- ✦ The Indian chapter of the United Nations Transfer Pricing (UN TP) manual (which amongst other issues also discusses location savings) represents a view of Indian tax administration and is not binding on Appellate authorities
- ✦ Facts remaining the same, no adjustment was made in the preceding assessment year on account of location savings, and therefore, the TPO's approach was inconsistent
- ✦ Method followed by the TPO in making the adjustment was not prescribed by the provisions of the Act, and hence his computation was based on an incorrect method

*Reliance placed on ruling in case of GAP International Sourcing (India) Pvt. Ltd. v. ACIT [2012] 149 TTJ 437 (Delhi-Tribunal) and OECD Guidance on Transfer Pricing Aspects of Intangibles (released pursuant to Action 8 of OECD/ G20 BEPS Project). Tribunal noted that G-20 countries had given their concurrence to this position, and India was a part of G-20

Emerging international tax issues and effect on tax policies



- ✦ Increasing concern for both developed and developing countries on ‘base erosion and profit shifting (BEPS)’, double non-taxation
- ✦ Impact of BEPS report and other changes on existing structures and proposed commercial transactions



BEPS Action Plan

Action 1 : Addressing the tax challenges of the digital economy

Action 2: Neutralising the effects of hybrid mismatch arrangements

Action 3: Strengthen CFC rules

Action 4: Limit base erosion via interest deductions and other financial payments

Action 5: Countering harmful tax practices more effectively, taking into account transparency and substance


Action 6: Preventing the granting of treaty benefits in inappropriate circumstances

Action 7: Prevent the artificial avoidance of permanent establishment status

Action 8: Transfer pricing aspects of intangibles

Action 9: Consider transfer pricing for risks and capital

Action 10: Low value-adding intra-group services – Discussion Draft



Action 11: Establish methodologies to collect and analyse data on BEPS and actions addressing it

Action 12: Require taxpayers to disclose their aggressive tax planning arrangements

Action 13: TP Documentation and Country-by-Country (CbC) reporting

Action 14: Making dispute resolutions more effective

Action 15: Developing a multilateral instrument to modify bilateral tax treaties

Action 13 - TP Documentation and CbC Reporting



Three Tier documentation structure proposed for all countries

Template for master file - To provide the MNE's blueprint	The group's organisation structure
	A description of the group's business, intangibles, intercompany financial activities and financial and tax positions
Template for local file - To provide material transfer pricing positions of the local entity/ taxpayer with its foreign affiliates	Demonstrates arm's length nature of transactions
	Contains the comparable analysis
Country-by-Country (CbC) Report	Jurisdiction-wise information on global allocation of income, taxes paid/ accrued, the stated capital, accumulated earnings, number of employees and tangible assets
	Entity-wise details of main business activities which will portray the value chain of inter-company transactions

THANK YOU



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