

Transfer Pricing Laws



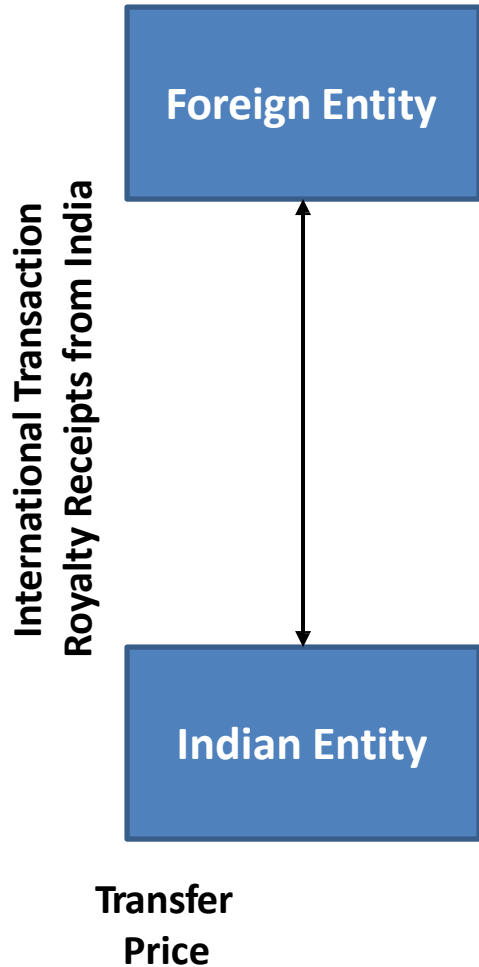
Introduction

- Transfer pricing refers to the pricing of cross border transactions between two related entities
- It is the value attached to goods or services when transaction proceeds between two related / associate parties
- Intent behind the transfer pricing (TP) provisions
 - Liberalization of trade and foreign exchange policy in 1991
 - Growth of investments by multinationals in India
 - Potential risk of erosion of India's tax base
 - Increase in cross border transactions of multinational enterprises in India
 - Need for statutory framework to examine intra-group cross border transactions
- The Finance Act, 2001 introduced TP regulations in India by introducing Sections 92A to 92F w.e.f. April 01, 2002
- *For instance:* Company A processes and produces apples. Company B acts as a distributor and seller of the product. Company C owns both company A and B. As per the transfer pricing provisions under Income Tax Act, 1961, Company A and B are considered as related / associate entities due to common control. Thus, transactions for sales of apple by Company A to Company B shall be subject to transfer pricing provisions

Applicability of Section 92

- Section 92(1)- Any income arising from an **international transactions** shall be computed having regard to **arm's length price**
- Explanation: The allowance for **any expense or interest** arising from an international transaction shall also be determined having regard to **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
- **Arm's Length Price** (ALP) means a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions
- Explanation: Price between unrelated parties in uncontrolled conditions is known as the arm's length price

Illustration



Foreign Entity is charging royalty to India @5% of sales (Sales – INR 100 crore, Royalty INR 5 crore – Tax 50 lakhs)

Royalty is taxable in India @10% as per treaty with the country and Indian Entity is paying tax @25%

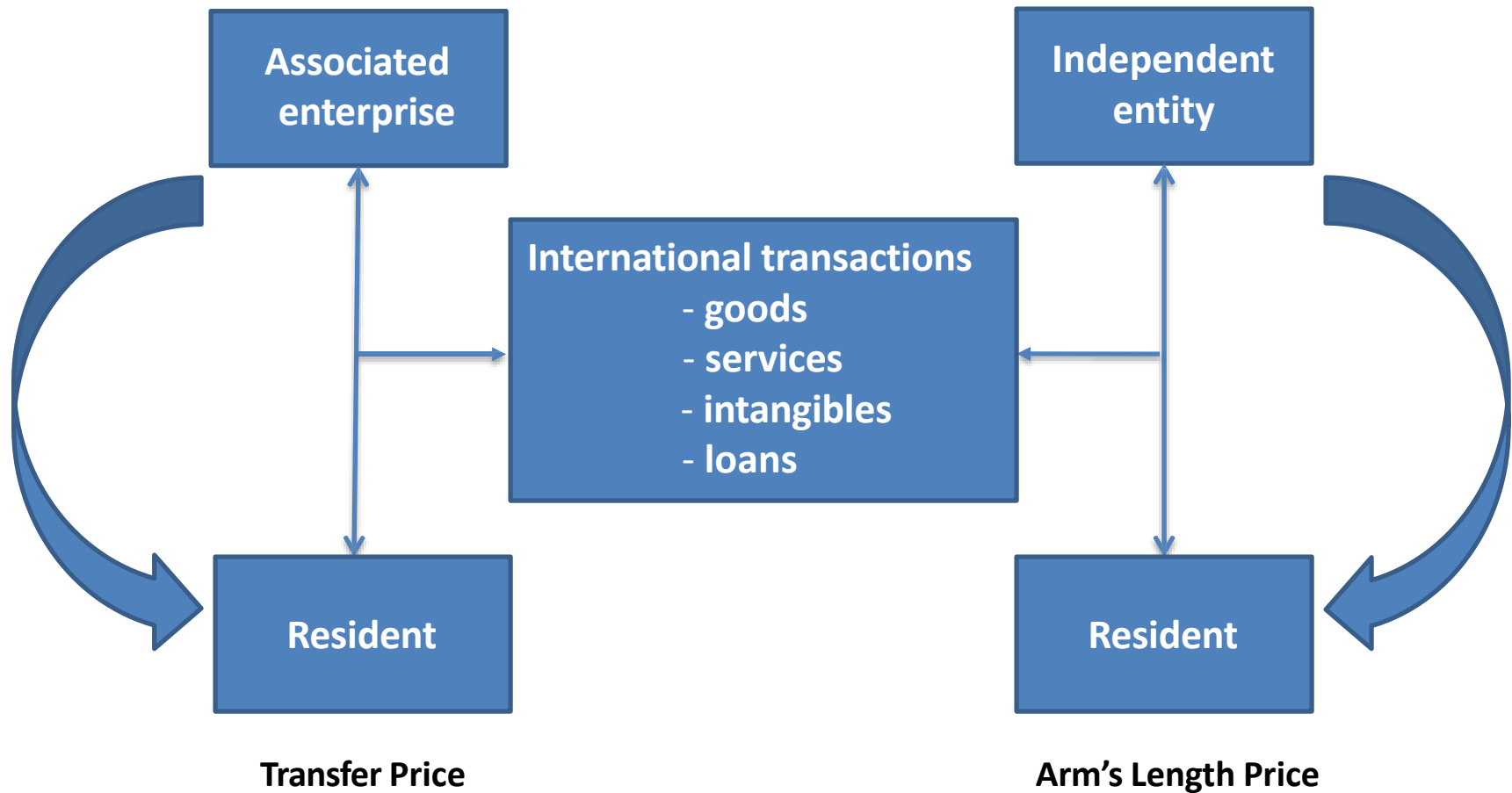
Transferring Pricing analysis lead a result of arm's length price of 8% of sales (Revised Royalty 8 crore, Tax 80 lakhs)

Should transfer pricing provisions be applicable in above scenario?

International Transactions (Sec 92 B)

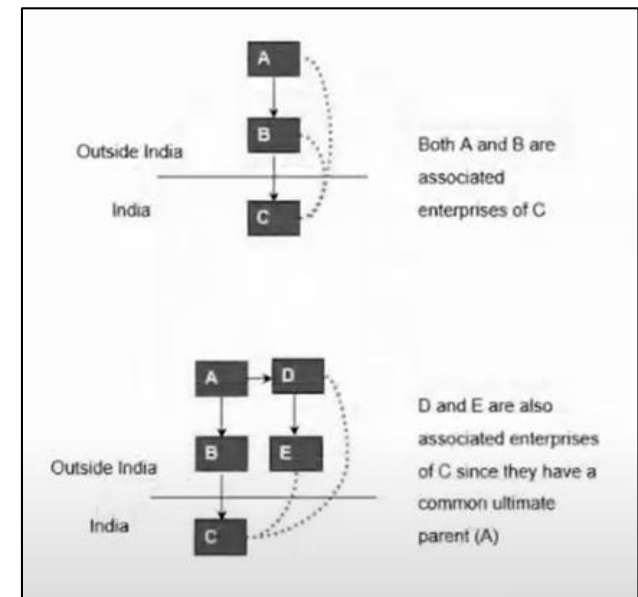
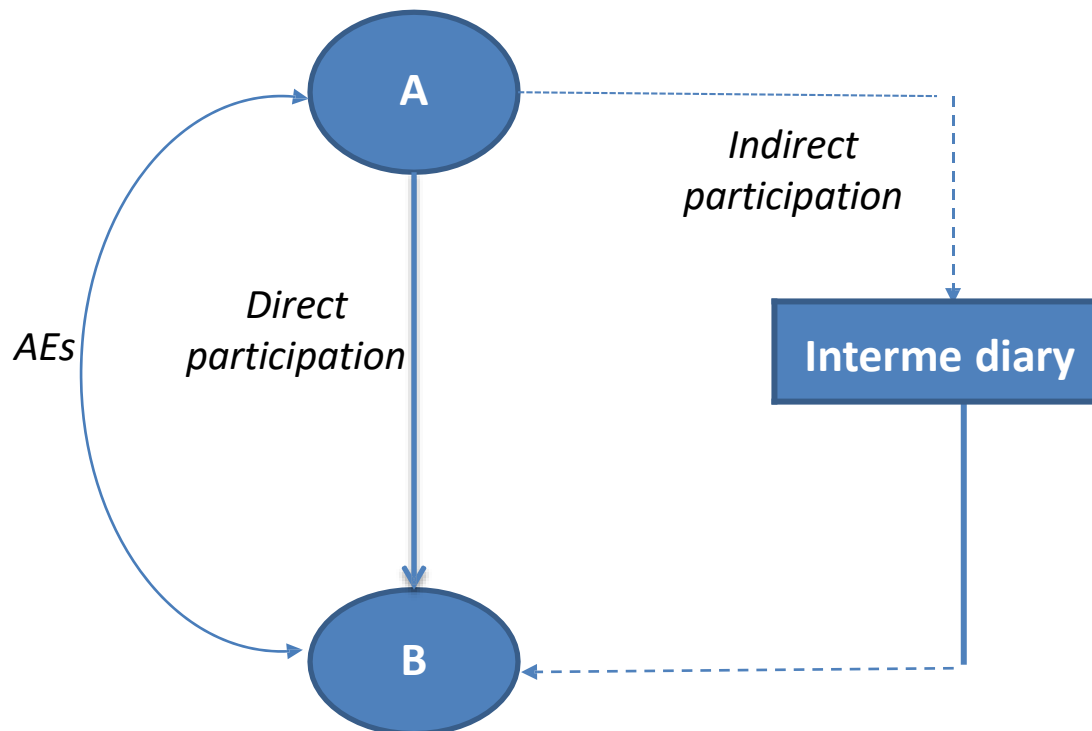
- Transaction between two or more AEs, **either or both** of whom are non-residents
- Transaction relates to:
 - Purchase or sale or lease of tangibles or intangible property; or
 - Provision of services; or
 - Lending or borrowing money; or
 - Any other transaction having a bearing on profits, income, losses or assets; or
 - Mutual agreements or arrangements for allocation or apportionment of, or any contribution to; any cost or expense incurred; or
 - Business restructuring or re-organizations irrespective of the fact that it has bearing on the profit, income, losses or assets.

Concept of Transfer Pricing



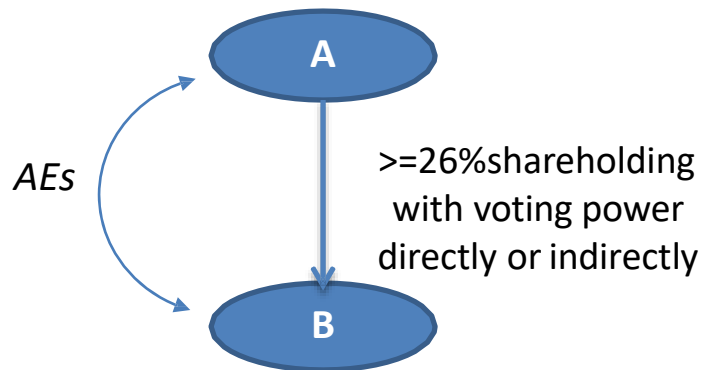
Who is an Associated Enterprise

- As per section 92A of Income Tax Act, AEs or related party means an enterprise which
 - Has **direct or indirect** participation (through one or more entities)
 - In **management** or in **control** or in **capital** i.e. ownership of the other enterprise

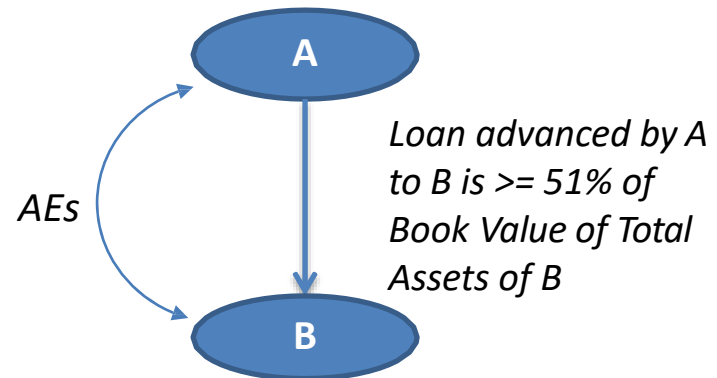


Who is an Associated Enterprise

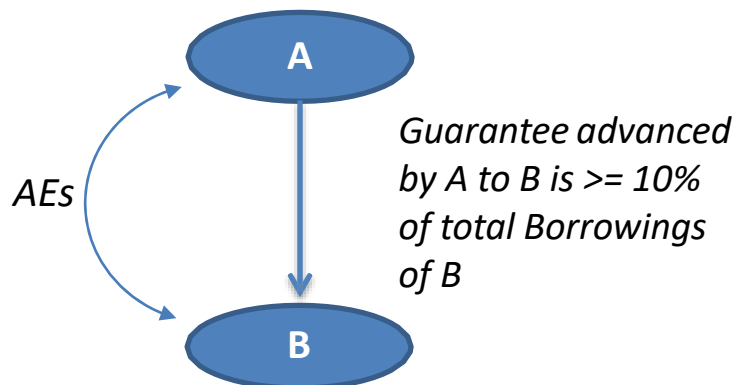
Example 1: Shareholding with voting power
(26% or more)



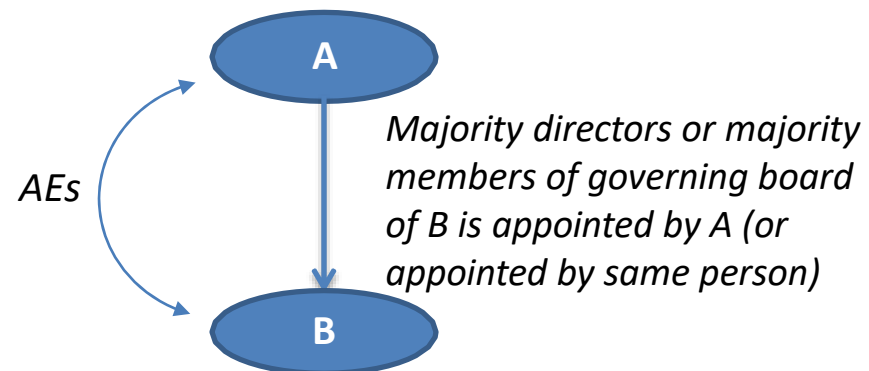
Example 2: Loan in excess of 51% of total assets



Example 3: Guarantees in excess of 10% of total borrowings

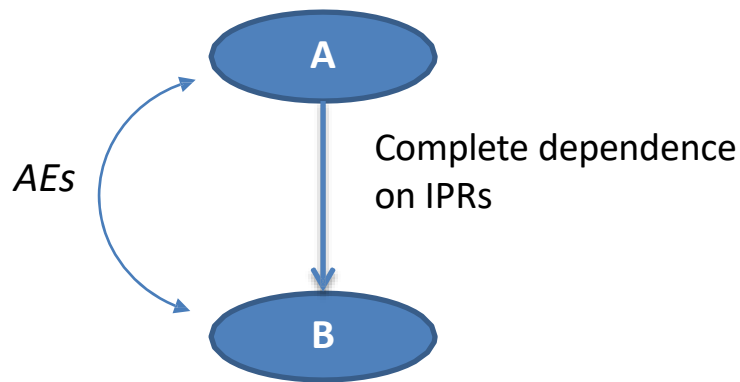


Example 4: Appointment of majority directors or majority members of governing board

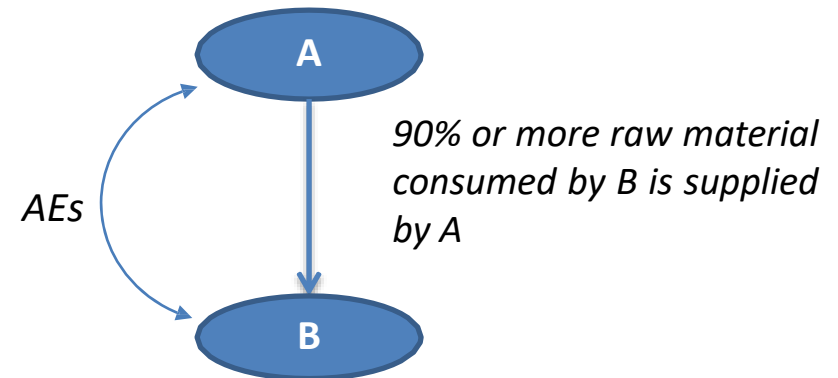


Who is an Associated Enterprise

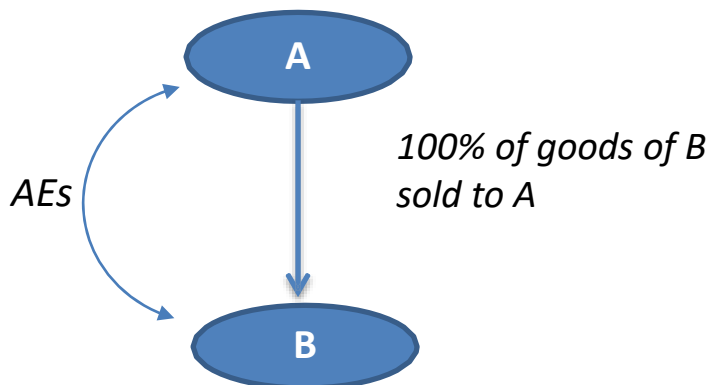
Example 5: Complete dependence on IPRs



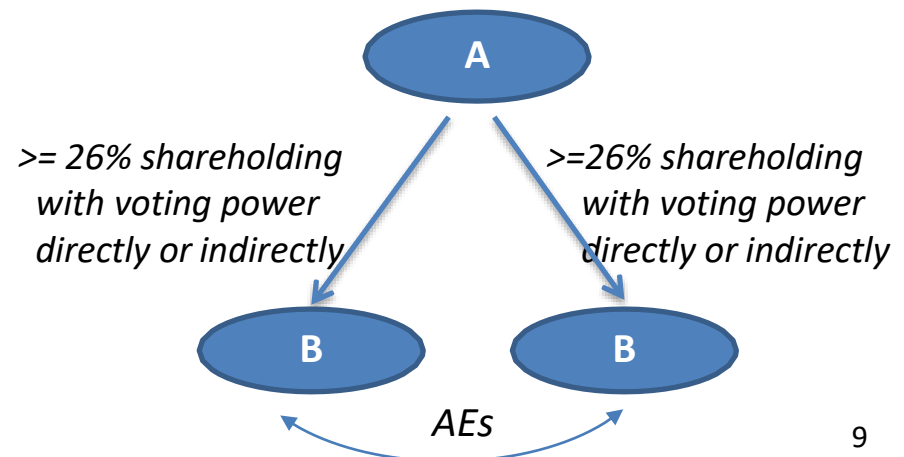
Example 6: Supply of Raw Material (90% or more)



Example 7: Complete dependence on one buyer/customer



Example 8: Associates



Meaning of Specified Domestic Transaction

- Scope of TP provisions expanded w.e.f. AY 2012-13 by including SDT if aggregate value of such transactions exceed INR 5 crores
(Threshold increased to INR 20 crores by Finance Act 2015 w.e.f. April 01, 2016)
- Section 92BA of the Act defines “specified domestic transaction” as any of the following transactions, not being an international transaction namely:
 - Any expenditure in respect of which payment has been made or is to be made to a person referred to u/s 40A(2)(b);
(Omitted by Finance Act 2017, w.e.f. FY 2016-17)
 - Tax holiday related transactions (eligible business);
 - Any transaction referred to u/s 80A;
 - Any transfer of goods or services referred u/s 80-IA;
 - Any business transactions referred u/s 80-IA(10);
 - Any transaction under Chapter VI-A or u/s 10AA, to which provisions of sec 80IA (8) or (10) applies; or
 - **Any business transacted between the persons referred to u/s 115BAB(4)**
 - Any other transaction as may be prescribed,and where the aggregate of such transactions entered into by the assessee in the previous year exceeds a sum of **INR 20 crore** rupees.

Computation of ALP

- Not every method can be applied to each taxpayer and business transactions between AEs
- Applicability of method depends on
 - the characteristics of property or services
 - Functions performed (including asset and risk assumed)
 - Contractual terms
 - Economic circumstances
 - Business strategies
 - Availability of information and reliability of assumptions

Most Appropriate Method (MAM)

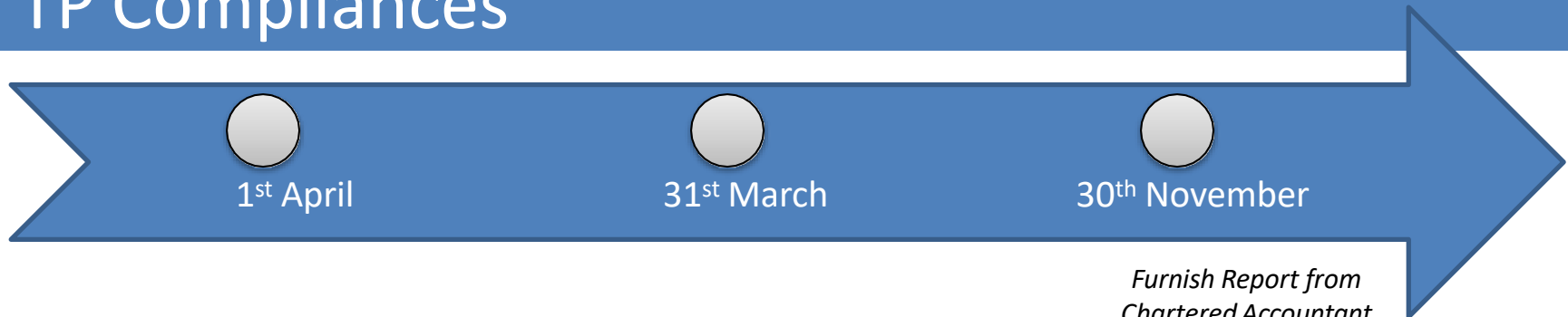
- **Comparable Uncontrolled Price (CUP) Method** : Comparable intra-group price to prices earned in comparable uncontrolled transactions under comparable circumstances.
- **Resale Price Method (RPM)**: Compares the intra group resale margin (gross margin) to resale margin earned in comparable uncontrolled transactions under comparable circumstances.
- **Cost Plus Method (CPLM)**: Compares the markup on costs of the tested party to the markups earned in comparable uncontrolled transactions under comparable circumstances .
- **Profit Split Method (PSM)**: Splits the profits between the related companies engaged in the same transaction(s) based on the related value of each company's contribution to the combined profit
- **Transactional Net Margin Method (TNMM)**: Compares the controlled company's profitability to the one of similar companies
- **Any other Method**

TP Documentation

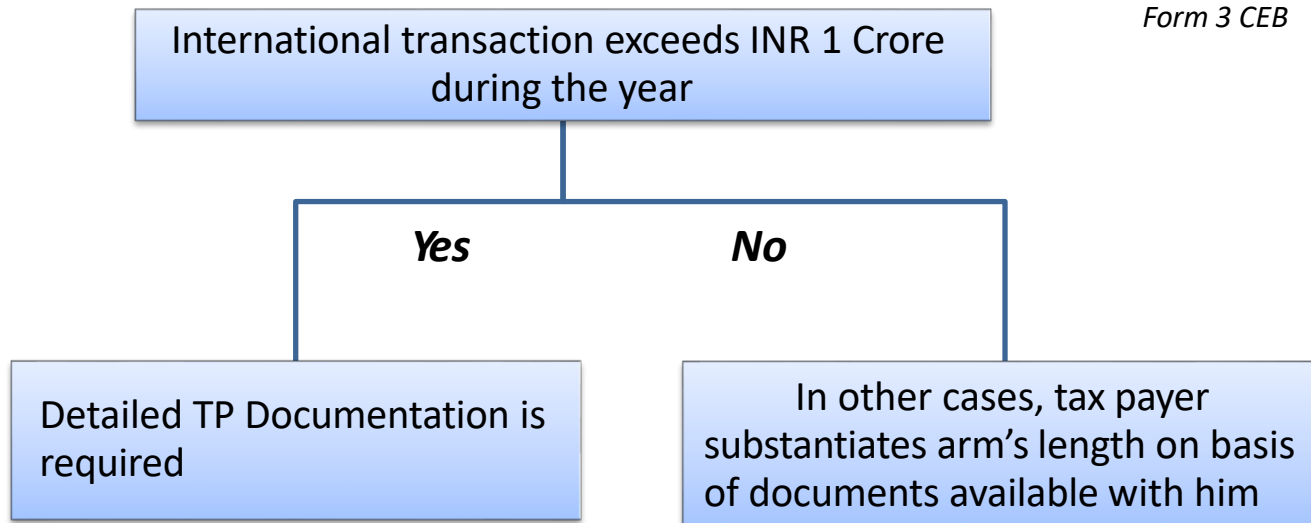
A detailed list of mandatory documents are given in Rule 10D:

- Ownership Structure
 - Profile of multinational group
 - Business description / Profile of Industry
- } Entity Related
-
- Nature & terms (including price) of international transactions
 - Description of functions performed, risks assumed and assets employed (functional analysis)
 - Record of the economic and market analysis (economic analysis)
 - Record of budgets, forecasts, financial estimates
 - Any other record of analysis to evaluate the comparability of international transaction with uncontrolled transactions
 - Description of method considered with reasons of rejection of other methods
 - Details of transfer pricing adjustments made, if any
- } Price Related
-
- Any other information such as data, documents, price related correspondence etc.
- } Transaction Related

TP Compliances



*Furnish Report from
Chartered Accountant
Form 3 CEB*



In case of specified domestic transactions, transfer pricing shall be applicable i.e., Form 3 CEB and TP documentation where transactions exceeds INR 20 crores

Introduction to BEPS

- In line with the Base Erosion Profit Shifting (BEPS) Action 13, the Finance Act 2016 has introduced new provisions under section 92D(4) read with section 286 in relation to master file and CbCR requirements applicable from FY 2016-17 onwards
- With a view to curtail tax losses, the Indian government, in line with OECD guidelines, has introduced a three-tier transfer pricing documentation structure, viz. Country-by-Country Reporting (CbCR), Master File regulations and existing local transfer pricing documentation
- Master file is applicable on entities whose group revenue exceeds INR 500 crores
- CbCR is applicable on entities whose group revenue exceeds INR 5,500 crores

Master File

A global consistent overview

- Group organizational structure
- Description of global value chain
- Intangibles
- Financing activities
- Global Transfer pricing policies
- Applicable form- 3CEAA (Part A & Part B)

Local File

Specific to country analysis

- Description of Intercompany transactions
- Comparability analysis
- Selection and Application of TP Method(s)
- Financial information

CbCR

Key data points for each group entity

- Main business activity
- Capital & Assets
- Revenue (AE & Non-AE), Profits, Taxes
- Number of employees
- Tax jurisdiction 76
- Applicable form- 3CEAC & 3CEAD

Penalties

Section	Penalty	Quantum of Penalty
270 A	<ul style="list-style-type: none"> Post-inquiry adjustment (deemed concealment of income) 	50% / 200% of tax on the adjusted amount
271AA(1)	Penalty for: <ul style="list-style-type: none"> failure to maintain documentation prescribed under Section 92D of the Act, failure to report a transaction, or maintaining or furnishing incorrect information/ document 	2% of the value of international transaction or specified domestic transaction
271AA(2)	Penalty for failure to keep and maintain Master File	INR 500,000
271BA	Penalty for failure to furnish Accountant's Report in Form 3CEB	INR 100,000
271G	Penalty for failure to furnish documentation prescribed under Section 92D of the Act	2% of the value of international transaction or specified domestic transaction

Penalties

Section	Penalty	Quantum of Penalty
271GB	<p>Failure to furnish the prescribed documents required to be maintained by the India parent entity of the international group:</p> <p>a. Where period of failure is equal to or less than 1 month</p> <p>b. Where period of failure is greater than 1 month</p> <p>c. Continuing default after service of penalty order</p>	<p>a. INR 5,000 per day upto one month; or</p> <p>b. INR 15,000 per day beyond one month</p> <p>Failure continues after penalty order INR 50,000 per day</p>
271GB	For non-furnishing information asked for u/s286(6)	<p>INR 5,000 per day;</p> <p>Failure continues after penalty order INR 50,000 per day</p>
271GB	Inaccurate report/ information	INR 500,000
271 J	Penalty on accountants, merchant bankers and registered valuers for furnishing incorrect information in reports and certificates	INR 10,000 for each such report or certificate by way of penalty

Thank You!!

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