



Transfer Pricing Rules in India & their Impact.

Seventh
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MEANING



The process of fixation of Pricing of any Transaction between Associated Enterprises of MNC's is Known as **“Transfer Pricing”**

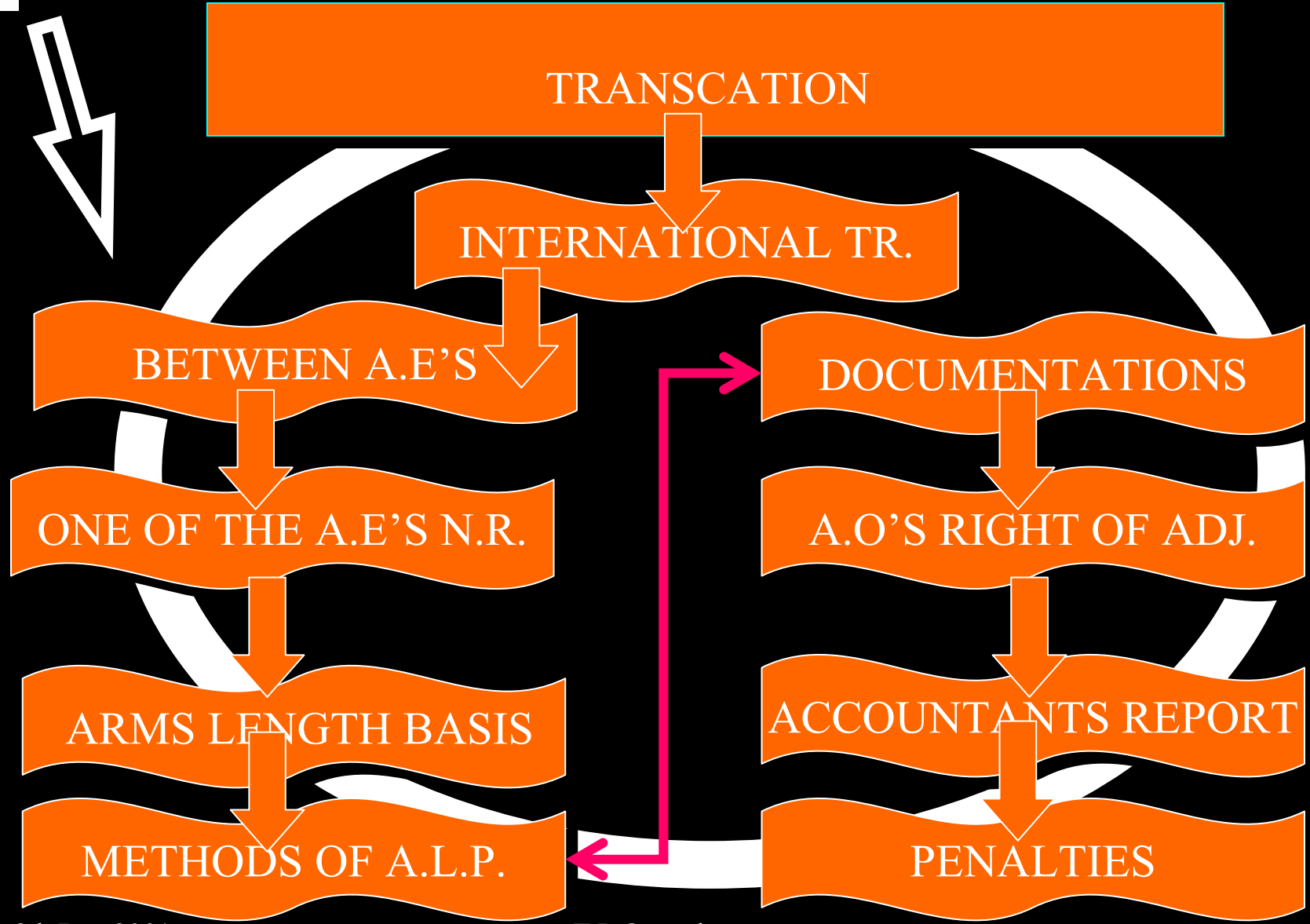


FEATURES

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OVERVIEW





Introduction of Arm's Length Principles

In determining

- Income
- expenses
- Cost Contribution Arrangements

92 (F)(ii) defines, Arms length price : means a price applied or proposed to be applied in a transaction between person other than associated enterprises in uncontrolled condition



Associated Enterprise

- An enterprise which participates, directly or indirectly, or **through one or more intermediaries**, in the Management, control or capital of another enterprise
- Enterprises in which common persons participate directly or indirectly, **through one or more intermediaries** in their management, control or capital



DEEMED ASSOCIATED ENTERPRISE

- Holding 26% or more voting powers.
- Loans advanced in case they exceed 51% of book value of total assets
- Guarantees given which are not less than 10% of total borrowings
- Right to appoint more than 50% of Board of Directors.
- Dependency Wholly on manufacturing process, know-how, patents, copyrights, licenses.
- Supply of 90% or more of raw materials or sale of goods manufactured or processed by an enterprise where the other enterprise is able to influence price and other conditions relating to the supply or sale.
- Other Criteria's in the case of Individuals, HUF, AOP, Firms etc.



International Transaction

means :

A transaction between two Associated Enterprises,

Either or both of whom are Non Residents,

in the nature of

Purchase

sale,

lease of tangible

intangible property,

provision of services,

lending or borrowing money,

any other transaction having a bearing on

profits, income, losses or assets

Cost Sharing arrangements



Deemed International Transaction

Transactions with third parties
are deemed to be covered



where there exist
A prior agreement or,

Terms are determined in
substance between the parties



METHODS OF ALP

- (a) comparable uncontrolled price method; } *Traditional*
- (b) resale-price method; } *Transactional*
- (c) cost-plus method; } *Method*
- (d) profit-split method; } *Profit*
- (e) transactional net margin method; or } *Methods*
- (f) such other method as may be prescribed by the board.

Rule 10 B prescribes the manner of application of ALP Methods



Selection of Most Appropriate Method

Factors considered are :

- Nature and class on international transaction
- Class of Associated enterprise and functions performed
- Availability, Coverage and reliability of data
- Degree of comparability between:
 - International Transactions and uncontrolled transaction
 - Enterprise entering into such transactions
- Extent to which reliable and accurate adjustments can be made
- The nature, extend and reliability of assumptions for application of the method



A.O's Powers to make Adjustments

- the price charged or paid in an international transaction has not been determined in accordance with methods and;
 - If no information and document are maintained
 - the information or data used in computation of the arm's-length price is not reliable or correct; or
 - the assessee has failed to furnish within the specified time any information or document
-
- ✓ an opportunity is to be given to the assessee
 - ✓ Denial of deduction U/s 10 A , 10 B and Chapter VI-A.



Information & Documentation

Basic

- Description of functions performed, risks assumed and assets utilised.
- Record of transactions considered for determining price of international transactions
- Analysis performed to evaluate comparability
- Description of all methods considered and reasons for selection of the most appropriate method
- Record of actual working for determining arm's length price
- Details of comparable data used in applying most appropriate method



Information & Documentation

Other

- Government Publications, reports, studies, database
- Market research studies and technical publications of recognised national or international institutions
- Price publications including stock exchange and commodity market quotations
- Relevant agreements and contracts entered into with associated enterprises or with unrelated parties
- Letters and correspondence documenting terms negotiated with the associated enterprise.



Information & Documentation

Information & Documentation to be kept and maintained as per Rule 10 D

As far as possible it should be contemporaneous

Shall be kept and maintained for a period of 8 years

Accountant's Report under Rule 10 E in form 3CEB



PENALTIES

- 2% of transaction value if prescribed information or documentation not maintained
- 2% of transaction value if prescribed information or documentation not Furnished
- 100% to 300% of Tax adjustment *
- Rs 1 Lac for failure to submit Accountant's report



Defense against Penalties

- **Penalty in case of non-compliance of documentation requirement / accountant's report**
No penalty in case taxpayer can demonstrate reasonable cause for non-compliance
- **Penalty in case of additions made/amount disallowed**
No penalty in case taxpayer can demonstrate good faith and due diligence



INADEQUACIES

- Secondary adjustments - not provided
- Alternative Dispute Resolution Mechanism – not provided
- APA – Unilateral/Bilateral/multilateral
- Arbitration
- MAP applies only where DTAA exist
- TP review committee
- Absence of Thin Capitalisation Rules



Double Taxation Avoidance Agreements

- Treaty Overrides
- Article 9 Associated Enterprise
 - In the same transaction different interpretation
- Transfer Pricing Rules in different jurisdictions
 - Interpretational Issues
 - Cost of Compliance



Double Taxation Avoidance Agreements

- Mutual Agreement Procedures (Article 26)
 - Provision for correlative adjustments of enhanced income/ expenditure of the other party

Exists in DTAA with key countries viz UK, USA, Japan, Australia, the Netherlands, Ireland

Does not exist in DTAA with Switzerland, Austria, Germany, Belgium, Canada, Mauritius, France, Sweden, Singapore, Italy



IMPACT

- ✉ Associated Enterprises V/s Related Parties under ICAI's Accounting Standard 18
- ✉ Finding Appropriate comparables
- ✉ Challenges of New Business Models such as E-Commerce & Knowledge Based Industries
- ✉ Old Economy V/s New Economy



IMPACT

- ✉ Traditional MNE's V/s Specialised MNE's
- ✉ Developing and Complying with contemporaneous Documents
- ✉ Applying Traditional Transactional Method
- ✉ Creation of database immerging new business model
- ✉ Withholding tax due to uncertainty of tax treatment on cross-border transactions



IMPACT

- E&Y Transfer Pricing 1999 Global Survey include:
- MNC's through out the world increasingly regard transfer Pricing as the most important international tax issue organisation will face over the next two year. The proportion of MNC's citing transfer Pricing issue from 52 %in 1997 to 61% in the 1999 Survey
- By an overwhelming majority subsidiaries on MNC's regard transfer pricing as their most important tax issue. Indeed 97% of MNC subsidiaries cited transfer pricing as the most important international tax issue they will face over next two years



IMPACT

- Nearly two third of the MNC's headquartered in the 12 countries included in the 1997 survey report that this intercompany transactions have already been the target of a tax authority examination. A smaller number (about 40 %) of the MNC' headquartered in the seven countries added to the 1999 survey report that their transfer pricing has been the subject of a tax authority examination
- Once again there is a one-in-two chance of defending profit in a transfer pricing inquiry any where in the world. Of those reporting adjustments, 42 % said that transfer pricing adjustments resulted in double taxation



IMPACT

- As was the case in the 1997 survey, eight in ten MNC's expect to face a transfer pricing examination within the next two years
- Intercompany services continue to be viewed by MNC's as the transactions most susceptible to transfer pricing dispute worldwide.
- Despite the growing importance of transfer pricing the percentage of companies making it an integral part of planning has not increased since the 1997 survey. Instead a majority of companies tend to view it largely as a compliance exercise .
- However tax and finance executives believe the up front involvement of transfer pricing in strategic decisions could help maximize operating performance and reduce the global tax burden



IMPACT

- MNC's continue to identify maximisation of operating performance and reduce the global tax burden
- MNC's increasingly recognise the advantages of an integrated global documentation approach but few have achieved this goal
- MNC's continue to use transaction based pricing method more often than profit based method
- Advance pricing agreement processes are becoming better understood around the world . Whereas in 1997 the majority of companies indicated that they would not consider using as APA the revenue is true for th 1999 survey more said they would consider using APA than would not and
- Tax authorities have increased cross-border dialogues and transfer pricing enforcement abilities.



Industry Specific Impact

- Inter Branch commission payments relating to letter of credit
- Derivative Transactions (Currency & Interest rate swap)
- Cost allocation of direct expenses & overheads by head-office to India branch
- Interest Income from foreign branches for overseas placement of FCNR deposit
- Offshore fee and fund based transactions generating income attributable to the India branch (e.g. ECB transaction)
- Secondment of employees by head office/foreign branches to India branch



THANK YOU

