

# Indian Transfer Pricing System

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**(Views are personal)**

# Transfer pricing – a journey across two centuries

- Indian Tax Legislation (ITL) dealt with some of the Transfer Pricing (TP) issues through general provisions. Concepts of “less than the ordinary profits which might be expected to arise in that business” “market value” and “fair market value” were used
- Special provisions establishing an obligation to comply with the arm’s length principle for international transactions were introduced in the ITL w.e.f 1.4.2002 (sections 92 to 92F of the Income Tax Act, 1961 and Rules 10A to 10E of the Income Tax Rules, 1962)
- Specified domestic transactions of a taxpayer in a year exceeding INR 50 million subjected to TP rules from F.Y 2012-2013 onwards

# Provisions – An overview

Sections	Subject
Sec 92	Determination of any income from an international transaction having regard to arm's length price ('ALP')
Sec 92A	Associated Enterprise ("AE")
Sec 92B	International Transaction
Sec 92C & Rule 10AB, 10B and 10C	Methods for Computation of ALP & variation from ALP
Sec 92CA	Reference to Transfer Pricing Officer ("TPO")
Sec 92D & Rule 10D	Documentation
Sec 92E & Rule 10E	Accountant's Report
Sec 92F & Rule 10A	Definitions (accountant, ALP, enterprise, transaction etc.)

# SOME PRINCIPLES

- The fundamental premise is that income and expenses in regard to an international transaction have to be determined having regard to the Arm's Length Price
- Adjustment to arm's length price not to be made if that reduces the income
- No corresponding adjustment
- Incentives like tax holidays not available for the adjustment made
- Evasion of tax or transfer of profit outside India, not a pre condition for adjustment

# Transactions to meet ALP

- International transaction is defined as a transaction between two or more associated enterprises either or both of whom are non-residents
- The transaction can be in the nature of
  - purchase, sale or lease of tangible or intangible property; or
  - provision of services; or
  - lending or borrowing money; or
  - any other transaction having a bearing on the profits, income, losses or assets of the enterprise; or
  - mutual agreements or arrangements for allocation or apportionment of, or any contribution to, any cost or expense incurred

# Transactions to meet ALP (contd.)

- A transaction with a non associated enterprise is deemed to be a transaction between associated enterprises in the event of prior agreement between the said enterprise and an associated enterprise
- Currently, taxpayers with aggregate international transactions of less than INR 150 million are not subjected to TP audit

# Definition of “international transactions”

- The span of the terms “international transactions” and “intangible property” has been clarified through the Finance Act, 2012
- International transactions include-
  - (a) the purchase, sale, transfer, lease or use of tangible property including building, transportation vehicle, machinery, equipment, tools, plant, furniture, commodity or any other article, product or thing;*
  - (b) the purchase, sale, transfer, lease or use of intangible property, including the transfer of ownership or the provision of use of rights regarding land use, copyrights, patents, trademarks, licences, franchises, customer list, marketing channel, brand, commercial secret, know-how, industrial property right, exterior design or practical and new design or any other business or commercial rights of similar nature;*

# Definition of “international transactions” (contd.)

*(c) capital financing, including any type of long-term or short-term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business;*

*(d) provision of services, including provision of market research, market development, marketing management, administration, technical service, repairs, design, consultation, agency, scientific research, legal or accounting service;*

*(e) a transaction of business restructuring or reorganisation, entered into by an enterprise with an associated enterprise, irrespective of the fact that it has bearing on the profit, income, losses or assets of such enterprises at the time of the transaction or at any future date.*



# Definition of intangible “property”

***The expression "intangible property" includes—***

- (a) marketing related intangible assets, such as, trademarks, trade names, brand names, logos;*
- (b) technology related intangible assets, such as, process patents, patent applications, technical documentation such as laboratory notebooks, technical know-how;*
- (c) artistic related intangible assets, such as, literary works and copyrights, musical compositions, copyrights, maps, engravings;*
- (d) data processing related intangible assets, such as, proprietary computer software, software copyrights, automated databases, and integrated circuit masks and masters;*
- (e) engineering related intangible assets, such as, industrial design, product patents, trade secrets, engineering drawing and schema-tics, blueprints, proprietary documentation;*
- (f) customer related intangible assets, such as, customer lists, customer contracts, customer relationship, open purchase orders;*

# Definition of intangible “property” (contd.)

*(g) contract related intangible assets, such as, favourable supplier, contracts, licence agreements, franchise agreements, non-compete agreements;*

*(h) human capital related intangible assets, such as, trained and organised work force, employment agreements, union contracts;*

*(i) location related intangible assets, such as, leasehold interest, mineral exploitation rights, easements, air rights, water rights;*

*(j) goodwill related intangible assets, such as, institutional goodwill, professional practice goodwill, personal goodwill of professional, celebrity goodwill, general business going concern value;*

*(k) methods, programmes, systems, procedures, campaigns, surveys, studies, forecasts, estimates, customer lists, or technical data;*

*(l) any other similar item that derives its value from its intellectual content rather than its physical attributes.*

# Associated enterprise

- Enterprises are associated when-
  - one enterprise directly or indirectly or through intermediary participates in management or control or capital of the other enterprise
  - same persons directly or indirectly or through intermediary participate in management or control or capital of both the enterprises

# Deemed associated enterprises

- Enterprises are deemed to be associated when:
  - one has direct or indirect share holding carrying not less than 26% voting power in the other
  - a person holds 26% of voting power in both
  - one advances loan constituting not less than 51% of book value of total assets of the other
  - one guarantees not less than 10% of total borrowings of the other
  - more than half of board of directors of one is appointed by the other
  - more than half of the board of directors of both enterprises is appointed by the same person or persons
  - one is wholly dependent on use of IPRs of the other

# Deemed associated enterprises (contd.)

- at least 90% of raw materials and consumables required by one are supplied by the other, or by persons specified by the other who also influences prices and conditions relating to such supply
- goods or articles manufactured or processed by one are sold to the other or to persons specified by the other who also influences prices and conditions relating to such supply
- one is controlled by individual or HUF who or his relative / member also controls the other directly or jointly
- one being a firm, association of persons or body of individuals, the other holds not less than 10% interest therein
- there exists between the two enterprises, any relationship of mutual interest, as may be prescribed

# TP and non-cooperative jurisdictions

- Persons located in jurisdictions specified through a notification for lacking effective exchange of information with India are deemed to be associated enterprises and transactions with them are deemed to be international transactions for purposes of TP laws
- No jurisdiction notified till date

# METHODS FOR DETERMINING ALP

## (no hierarchy in methods)

- Comparable Uncontrolled Price Method
  - Resale Price Method
  - Cost Plus Method
  - Profit Split Method
  - Transactional Net Margin Method
  - *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 non-associated enterprises, under similar circumstances, considering all the relevant facts*
- Most appropriate method to be applied in determining ALP

# DETERMINING ALP

- The most appropriate method is the method best suited to the facts and circumstances of each particular international transaction and providing the most reliable measure of ALP
- Comparability is analyzed using single year data instead of multiyear data unless data of earlier years reveals facts influencing price determination
- Comparability is judged using the following factors:
  - Specific characteristics of the property/services
  - Functions performed
  - Contractual terms dividing responsibilities, risks and benefits
  - Market conditions –geographical location, size of market, laws, cost of labour and capital, level of competition ,wholesale or retail etc.



# DETERMINING ALP

## (contd.)

- ALP is the arithmetical mean if more than one price is determined by applying the most appropriate method
- CBDT vested with powers to notify Safe Harbour Rules in 2009– rules yet to be notified
- Tolerance range-if the variation between ALP determined and taxpayer's price does not exceed the % to be separately notified (not exceeding 3%)

# Reference to TPO

- Assessing Officer (AO) may refer the computation of ALP in relation to an international transaction to the TPO and has to accept the ALP determined by him
- TPO is required to give an opportunity to the taxpayer to produce evidence to support the computation made by him and determine ALP in relation to the international transaction(s) after taking into account the material available with him in accordance with methods specified in the Act
- TPO may also determine ALP of
  - any other international transaction that comes to his notice during course of proceedings
  - any international transaction in respect of which the taxpayer has not furnished report from an accountant as required under law

# Documentation

- Documentation requirements which are entity related, price related and transaction related are prescribed through Rule 10D and a report from an Accountant in a specific form is to be furnished before the due date of filing the tax return
- The information and documents have to be contemporaneous and are required to be kept for 8 years
- Exemption from documentation requirements, if the aggregate value of international transactions does not exceed INR 10 million
- Simplified documentation for subsequent years for international transactions which continue to have effect over more than one year

# Advance Pricing Agreement (APA)

- CBDT w.e.f 1-7-2012 has power to enter into an APA with a taxpayer determining ALP or specifying the manner in which ALP is to be determined
- APA will be valid for a period not exceeding 5 consecutive years and shall be binding both on the taxpayer and the tax authorities
- APA, however, shall not be binding if there is a change in law or facts having bearing on the agreement
- APA can be based on the methods applicable for normal TP adjustments or any other method with such adjustments or variations as may be necessary or expedient
- CBDT is expected to notify the scheme shortly
- Possibility of entering into bilateral APAs through MAP process?

# Dispute Resolution

- Dispute Resolution Panel (DRP)
- Income Tax Appellate Tribunal (ITAT)
- High Court
- Supreme Court

# TP Regime: Indian approach

- Transfer Pricing adjustments are regulated by domestic law and not by tax treaties
- Only economic double taxation is resolved under the treaties through MAP, provided there is a stipulation on the lines of paragraph 2 of Article 9 of the UN or OECD Model
- OECD TP guidelines reflect an agreement amongst the OECD member countries and do not address the concerns of developing countries

# TP Regime: Indian approach (contd.)

- Functions and assets are as important as risks
- Risks are not independent elements but are by products of functions and assets
- Location of functions and assets are relevant factors in deciding control over risk
- Capital contribution can not be the only relevant factor in deciding control over risk
- Concepts like control over function and risk need careful scrutiny

# TP Regime: Indian approach (contd.)

- Location saving and location rent due to location specific advantages are important elements in determining ALP
- Source country has right over location savings/rents
- Economic ownership of intangible is relevant in transfer pricing
- Several intangibles like marketing intangible, human asset intangible and supply chain intangible, are important in transfer pricing



# Transfer Pricing Adjustments (2008-2012)

Financial Year	Number of TP Audits Completed	Number of Adjustment Cases	% of Adjustment Cases	Amount of Adjustment (in INR million)
2008-09	1726	670	39	61400
2009-10	1830	813	44	109080
2010-11	2301	1138	49	232370
2011-12	2638	1343	52	445310

Total TP adjustments in last four years = INR 848,160 million  
(USD 15.42 billion)

**THANK YOU**