

Indian Transfer Pricing System

Vikram Vijayaraghavan

Subbaraya Aiyar, Padmanabhan & Ramamani (SAPR)

Advocates, Chennai

Outline of this talk

I. The Indian TP regime

- Indian TP provisions
- Indian TP vs. OECD - Snapshot view
- Indian TP assessment & litigation process
- Indian TP – few observations

II. TP theory meets reality - a look at Indian TP in practice

- Case studies #1-7
- Problems with Indian TP - Summarized

III. Indian Judiciary & TP

IV. Is TP fundamentally flawed?

- What are we trying to solve?
- Conceptual issues with Transfer Pricing

V. Suggested Solutions

- Sector-wide Safe harbors
- Formulary Apportionment
- Streamlining current TP regime

Part I. The Indian TP Regime

Indian TP provisions

- Indian TP provisions were introduced under **“Chapter X : Special Provisions Relating to Avoidance of Tax”**
 - **Chapter X, Section 92** of the Income Tax Act (1961) and **Rule 10A-D** of the Income Tax Rules (1962)
 - TP regime was introduced via Finance Bill 2001 w.e.f April 1st 2001.
 - In other words, India is a relatively new entrant into the TP vortex!
- **Birds-eye, one-line overview of Indian TP:**
 - Run-of-the-mill TP provisions, OECD-lite and delightfully vague (like most TP provisions)!

Indian TP Provisions – Section 92

Sections/Rules	Provisions
s 92	Computation of Income, expenses, CCA
s 92A	Associated Enterprises (“AE”)
s 92B	International Transactions
s 92C(1) (Rule 10B, 10C)	Computation of Arm’s Length Price (“ALP”)
s 92C/92CA	Powers of Assessing Officer (“AO”) and Transfer Pricing Officer (“TPO”)
s 92D (Rule 10D)	Documentation requirements
s 92E (Rule 10E, Form 3CEB)	Accountant’s report
s 271(1)(c), 271AA, 271BA, 271G	Penalties
s 92F (Rule 10A)	Definitions

Transfer Pricing Penal provisions (*a.k.a 'rubbing salt into the wound'*)

Reference under the Income-tax Act	Particulars	Penalty
271AA	Failure to maintain documentation	2% of the value of each international transaction
271G	Failure to furnish/submit any information / document to the transfer pricing officer	2% of the value of the international transaction for each such failure
271BA	Failure to furnish accountant's report	INR 100,000
271(1)(c)(iii) read with Explanation 7	Transfer pricing adjustment considered as concealed income	100-300% of amount of tax on adjustments

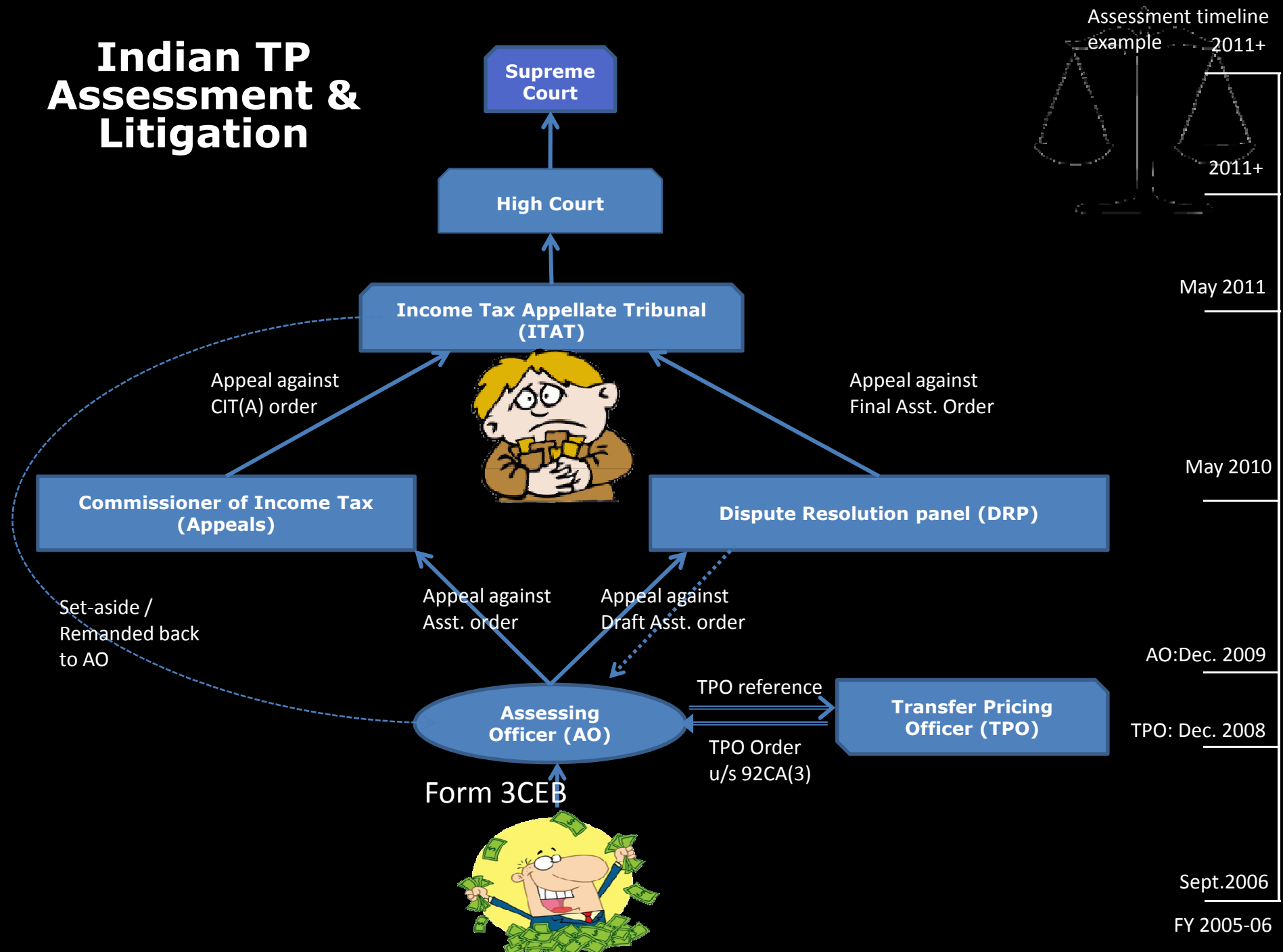
Indian TP vs. OECD Guidelines

Snapshot view*

Concepts	Indian regulations	OECD Guidelines
Associated Enterprises	Very wide definition	Restricted to controlled entities
Comparable range	(FY 2013) Allows 3% range band on avg. results of comparables	Allows for range of comparable data
Multiple year data	Only allows data for current year (and earlier 2 years under limited circumstances)	Permitted
Foreign comparables	Not permitted in practice	Permitted
Priority of methods	Most appropriate method rule	(Originally) preference for traditional methods
Use of unspecified method	Not specified	Permitted
Documentation	Stringent	Prudent business principles
Intangibles	Absence of definition and guidelines	Defined and described

* Modified version of table in 'Transfer pricing Law and Practice in India – a fine print analysis'

Indian TP Assessment & Litigation



Few observations about Indian TP

- **Five methods – no preferred method**
 - CUP, Cost-Plus, RPM, TNMM and Profit-split
- **TNMM** (and CUP) rule the roost
 - TNMM is like a panacea for its ease of application at the enterprise (or segment level) using an operating margin/cost PLI
 - Throw in some comparables in the same “industry” and you are set!
 - “Profit-Split” method is very rarely used
- ALP is calculated via **arithmetic mean** of comparable prices
- **Threshold limit of** international transactions for reference to TPO reference is Rs.15 crores (Rs.150 million)

Few observations about Indian TP

- **Prowess™ & CapitalLine™** company databases are used for TP reports by all parties including Revenue Department
- **High volume of transfer pricing litigation today**
 - Many cases pending at appellate stages (mainly, DRP and Tribunals)
 - Most TP litigations have not reached High Courts and Supreme Court
 - **“Litigation loop”** – in many of the cases Tribunal sends back the case to the AO/TPO with certain directions. Time consuming, costly & strain on the system. No quick closure to TP litigation.

Few observations about Indian TP

Finance Bill 2012 (Indian Budget)

- **Many new TP changes with recent Finance Bill 2012 (recent budget)**
 - Overall not pro-taxpayer but more a reaction to number of recent judicial rulings!
 - Retrospective amendments are strewn all over the Indian IT Act (300+ and counting). Budget 2012 introduced many controversial retrospective amendments in TP and otherwise.
- **Summary of main changes in Finance Bill 2012**
 - Specified domestic transactions to come under Indian TP regime
 - Increase in scope of powers of Transfer Pricing Officer (TPO)
 - Increased penalty provisions for TP
 - Allow “re-opening” of certain TP assessments
 - Arm’s-length range is restricted to +/- 3% tolerance band from FY 2013

Few observations about Indian TP Finance Bill 2012 (Indian Budget)

- **Summary of main changes in Finance Bill 2012 (continued)**
 - ***Retrospectively*** deny taxpayers benefit of 5% variation as standard deduction from 1/4/2002 though no reopening of cases completed before 1/10/2009
 - ***Retrospectively*** enlarge the scope of 'international transactions' to include guarantees, any debts, business restructuring etc.
 - Power of DRP to enhance TP variations
 - Power of appeal by Department against DRP order
 - GAAR introduced but then postponed
 - APA introduced - only real welcome step!

Bottomline: No real positive change in the Indian TP regime

Part II. TP theory meets reality

A look at Indian TP in practice

Issue #1

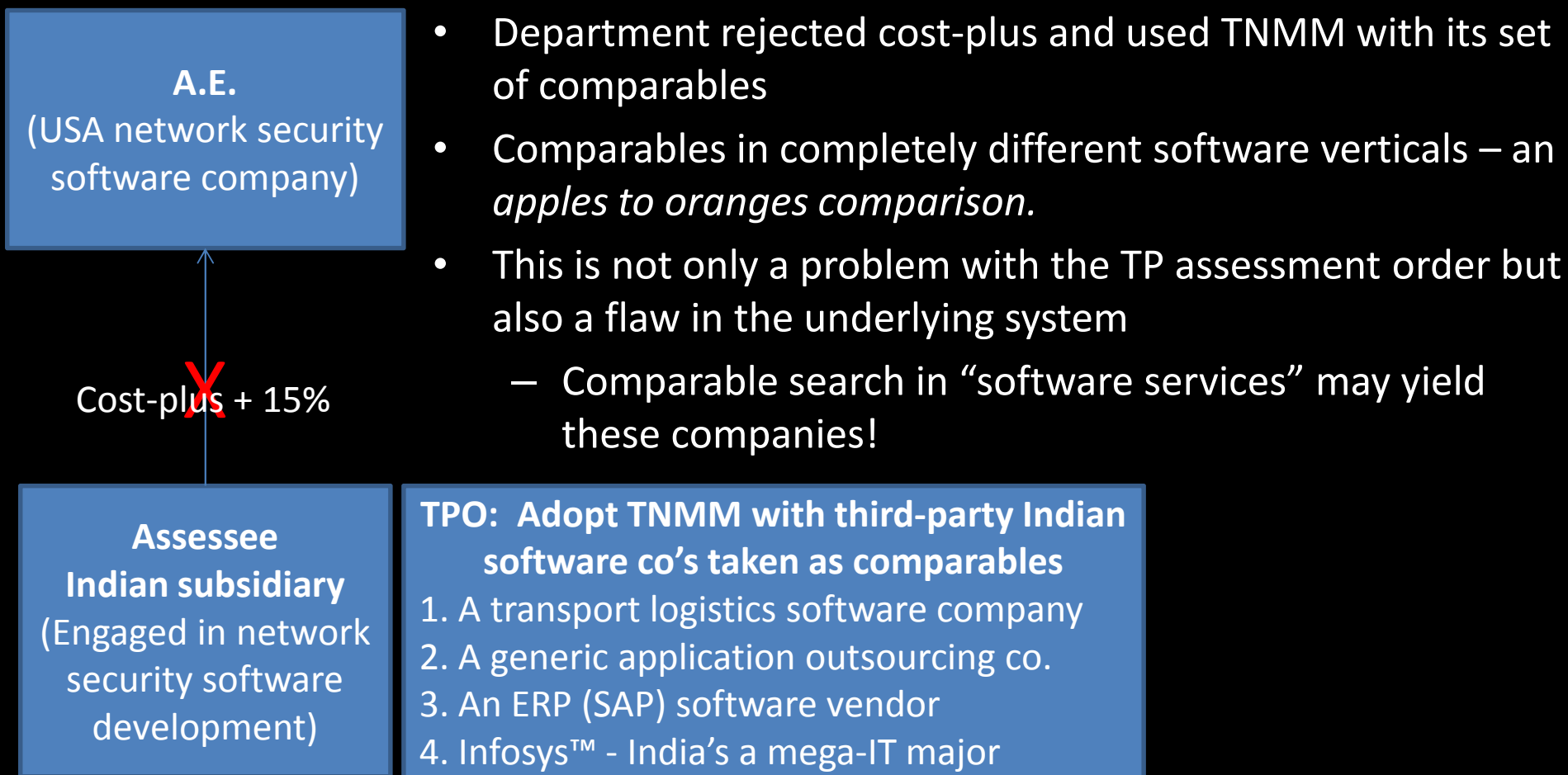
Comparables: *Whither art thou?*

- There is a complete lack of comparables in many segments
 - Problem especially acute in developing countries where there are a number of 'sunrise' industries
- Result of this data paucity is not merely a lack of comparables but the serious consequence of using incorrect comparables in the TP assessment
 - Corners are cut when choosing comparables. Absurd comparables seem to get into the mix
 - International comparables data is nearly impossible to gather
 - No truly effective analysis of comparables possible with lack of resources and data
 - It often becomes a case of non-technical people trying to do technical work (*example: choosing software verticals*)

Bottomline: The whole comparability analysis exercise is at times unsound and indefensible

Issue #1

Example 1 : Software development industry

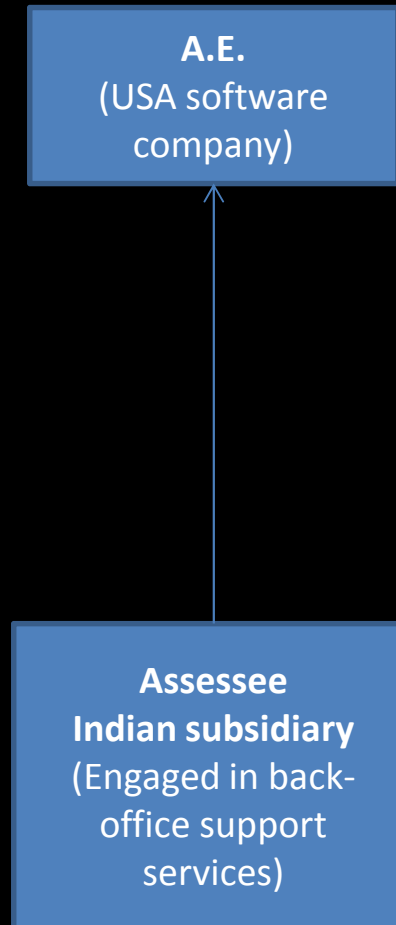


Bottomline: An apple and orange are both fruits – hence valid comparables under TP!

Issue #1

Example 2: The Comparables Barter

- AE is USA software company, Indian assessee provides back-office support services. Department rejects cost+plus and adopts TNMM. **Barter begins!**



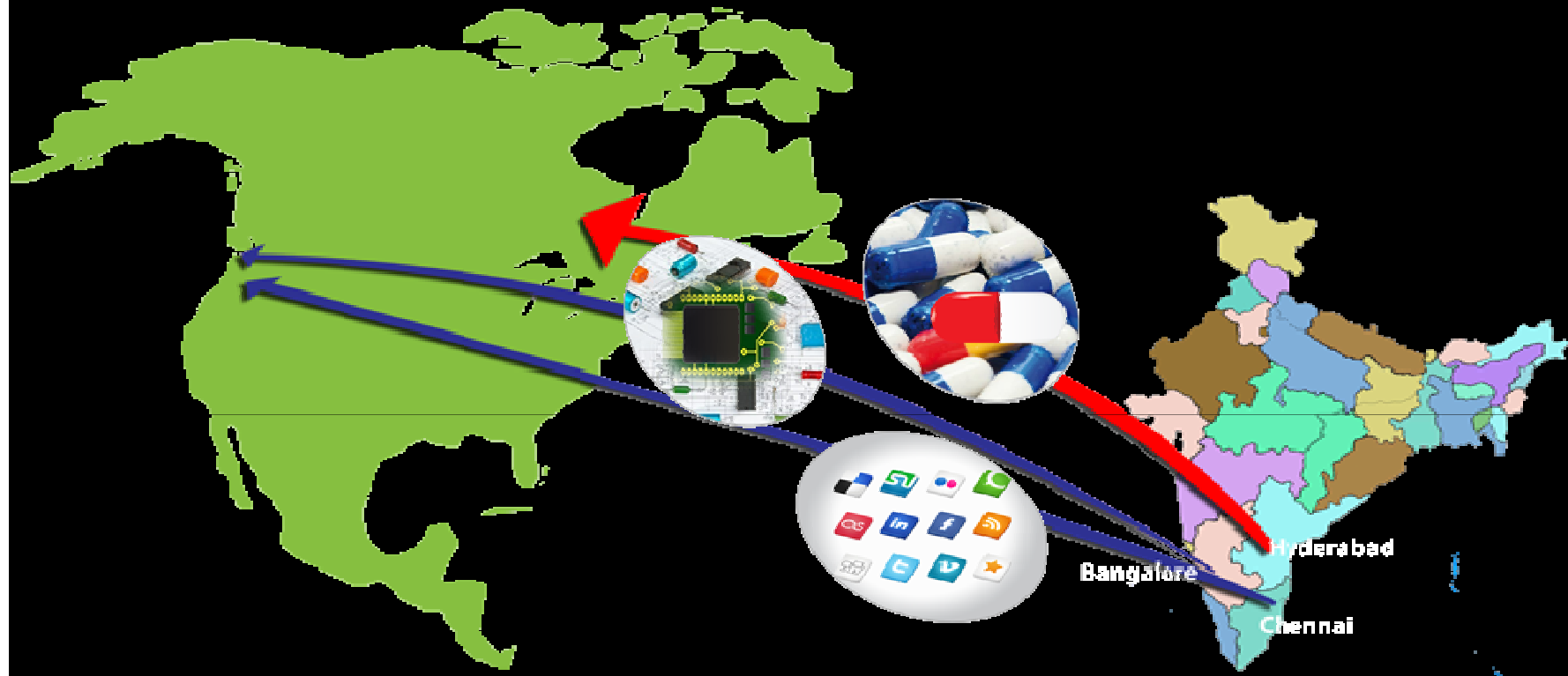
Assessee (taxpayer) says...	TPO says....
Reject high-turnover companies	Reject low-turnover companies
Reject super-profit companies	Reject loss making comparables
Reject company X , Y and Z - it is functionally different. (Look, my % is within arm's-length range!)	Reject company X, Y and add company X1, Y1 (Look your % is outside arm's-length range!)
Risk adjustment of 10% (ad-hoc!)	No risk adjustment whatsoever
Working capital adjustment 2%	Working capital adjustment of 1.5%
.....

- In the Fiscal year 2006-07, two sets of comparables were seen widely used by TPO for determining ALP of IT (Software) and ITES (Back-office/BPO) companies
 - ✓ IT set: 26 comparables, OP/Total cost from 1.38%-60.23% (avg. 25.04%)
 - ✓ ITeS set: 27 comparables, OP/Total cost from 13.55%-113.49% (avg. 30.24%)

Bottomline: Most TP studies, especially software, end up being a re-hash of same comparables

Issue #1

Example 3: Startup companies *“an incomparable confusion”*



- What are the comparables for these three startup scenarios?
 - If cost-plus is used, the dispute will be on % markup. We will end up with TNMM again looking at sub-optimal comparables
 - All these transactions involve **intangibles**. There is absolutely no guidance whatsoever on intangibles in Indian TP

Issue #2

Adjustments to comparables

- TP provisions are delightfully vague!

“(iii) the net profit margin referred to in sub-clause (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market” Rule 10B(e)(iii) on TNMM

Issue #2

Adjustments to comparables

- TP adjustments in practice is not the same as theory. For example in India it is observed that:
 - Foreign AE's are typically not accepted as tested party
 - Indian TP typically does not allow for adjustments to tested party but only comparables
 - Foreign comparables are almost always not accepted due to data paucity on adjustments
- What are the adjustments which will be accepted?
 - No specific guidance on this. From practice, adjustments typically not accepted by Revenue are:
 - Idle capacity, depreciation, risk, differences in accounting policy
 - Working capital adjustments are accepted to some extent

Issue #2

Adjustments to comparables

- How to quantify these TP adjustments?
 - How to quantify risk?
 - How to quantify adjustments for different geographical markets?
- Quantification of adjustments are usually ad-hoc or supported using suitably tweaked formulae
 - Department and taxpayer spar regularly on this issue

Bottomline: Fundamental lack of clarity & guidance with respect to Transfer Pricing Adjustments

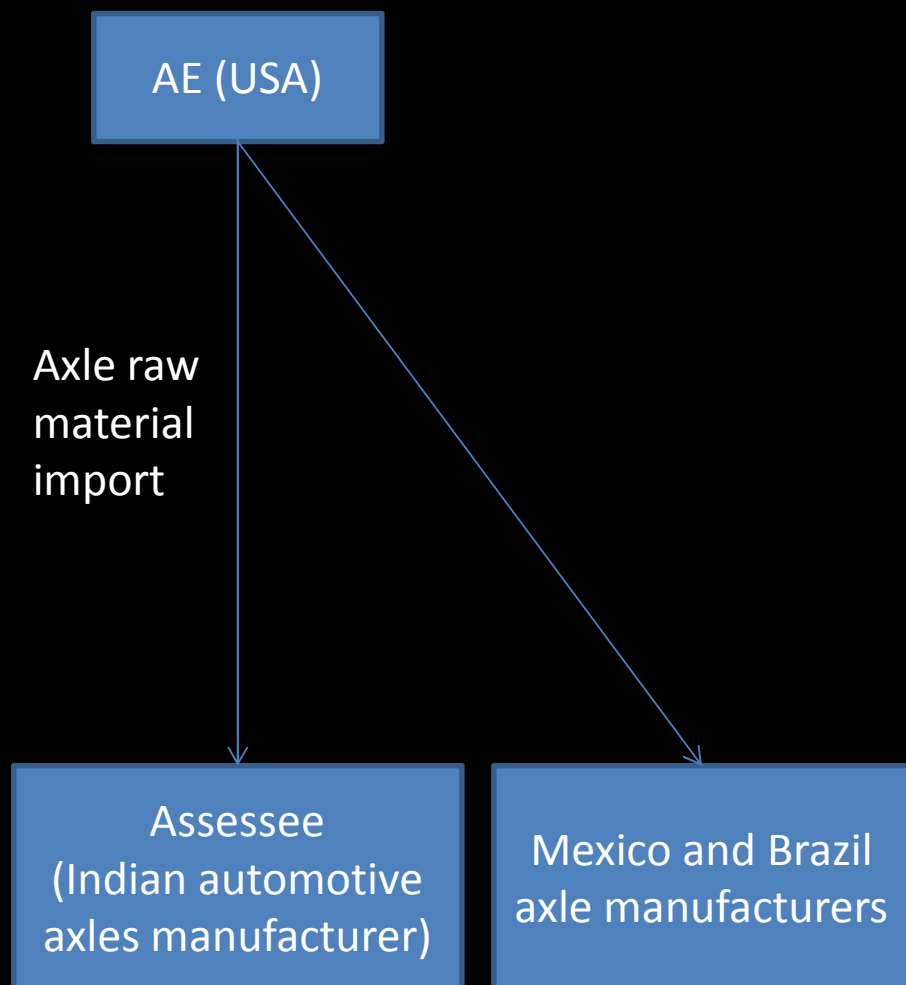
Issue #2

Adjustments to comparables (contd.)

- Comparables are rejected using “filters” . Some popular filters used are:
 - Minimum employee cost of 25% over sales
 - Different year ending filter
 - Diminishing revenue filter
 - Related party filter
 - On-site revenue filter
 - Turnover filters
 - Super-profit (& loss-making) filters
 - Functional difference filters
- **These filters are not prescribed in any provision or Rule nor any sort of guidance is provided for them.**

Issue #2

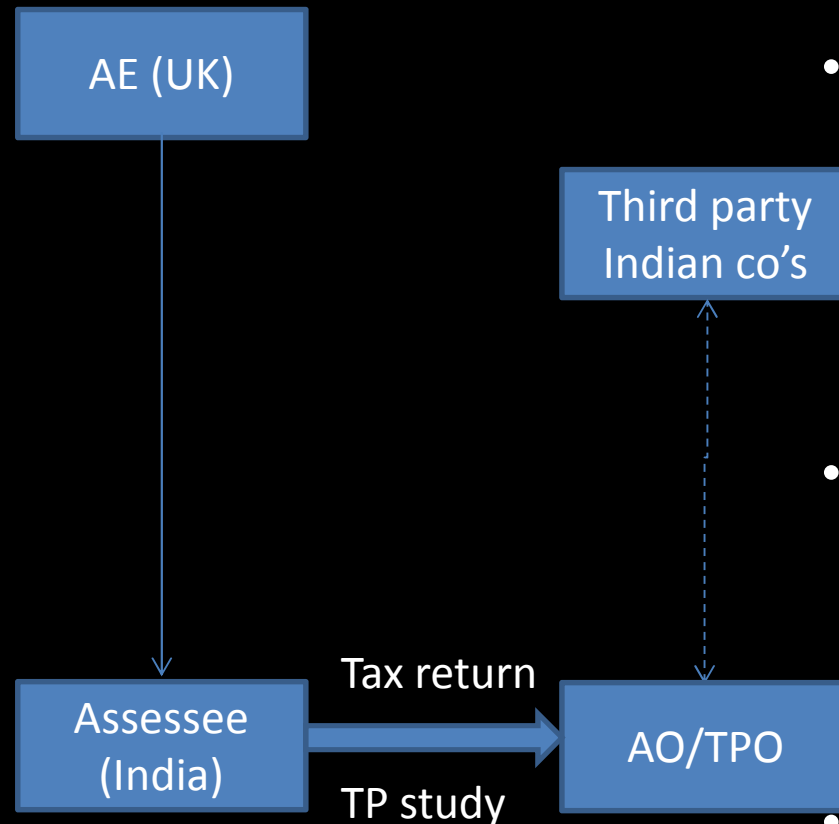
Example 1: Adjustments to comparables



- Internal CUP with company AE as tested party rejected by TPO
 - Typically foreign companies are not allowed as tested parties.
 - No good answers for India vs. Brazil, India vs. Mexico geographical market adjustments
- TNMM chosen with “Auto ancillaries”
 - Only one proper comparable but no segmental data available
 - Other comparables are in “shock-absorbers”, “battery companies”
- Moving from one incomplete puzzle (CUP) to an incorrect result (TNMM) is better?

Issue #3

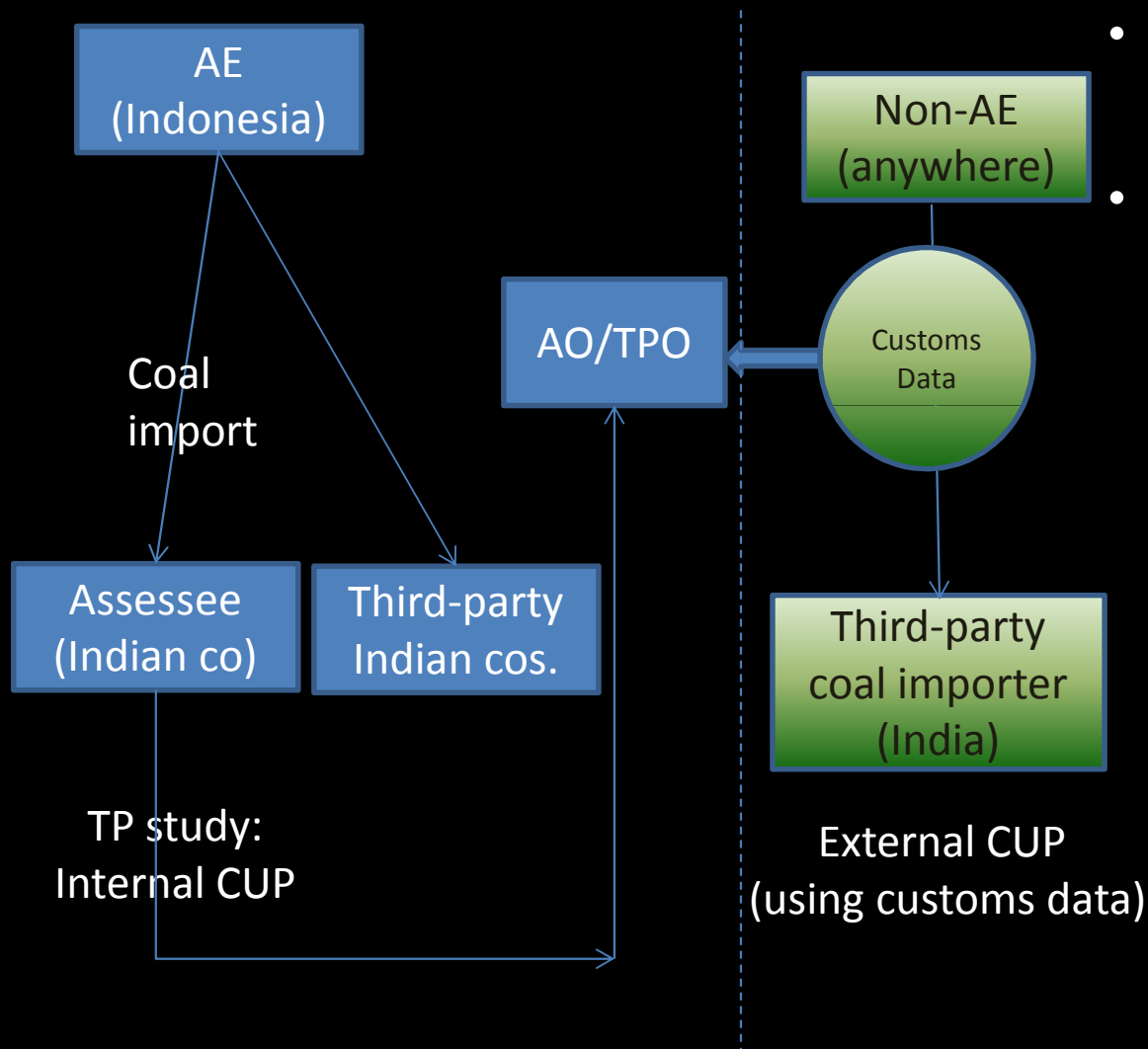
Data sources – TPO data gathering powers



- TPO has the “*power to call for information*” under **Section 133(6)** of the Act to obtain information from **any firm**
 - This power is used often in the TP assessment to gather data on comparables
- Practically speaking, assessee may not be given a chance to analyze or provide rebuttal to the info
 - Also many companies supply information which are prone to wide interpretation
- This is a common issue across the board in TP assessments in India

Issue #3

Data sources – Using *customs* data



- **Taxpayer:** Internal CUP with Indonesian AE as the tested party was submitted
- **TPO:**
 - **Rejects Internal CUP** and uses External CUP
 - Uses ***customs data*** of third-party transactions not in public domain
 - **Cherry-picks** data and chooses transactions without reference to gross-calorific value (quality) of coal, quantity etc.
 - Assessee requests competitors and obtains few invoices used by TPO which show **even CIF vs. FOB difference ignored!**

Issue #4

Multiple year data

Rule 10B(4) states

“The data to be used in analysing the comparability of an uncontrolled transaction with an international transaction shall be the data relating to the financial year in which the international transaction has been entered into

Provided that data relating to a period not being more than two years prior to such financial year may also be considered if such data reveals facts which could have an influence on the determination of transfer prices in relation to the transactions being compared.”

Issue #4

Multiple year data

- Not accepting multiple year data flies against the face of logic
 - What about business cycles, recessionary effects, gestation period for industries and startups etc. ?
- Onus on the assessee to prove usefulness of multiple-year data in the transfer pricing study
 - Guess what? Rarely there is a case where multiple year data has been accepted

Issue #5

The Indian arm's-length range fiasco

- ALP is computed with reference to arithmetic mean of comparables with a uniform tolerance of 5% around the transfer price (*Proviso's to Section 92C(1)*)
 - *Example:* arithmetic mean of comparable PLI of operating profit/total cost is 10% would mean an arm's-length range of 4.76% to 15.79%
- It was further interpreted by taxpayers to mean that this +/-5% *standard deduction* was available to the taxpayer and not a *binary band*.
 - *Example:* In case of *standard deduction*, if net profit margin were 4.75% in the above scenario then only 0.01% is the adjustment and not entire 4.75% as in the case of a *band* where you are either in the band or out.
 - Number of cases in different Tribunals in favour of and against the assessee

Issue #5

The Indian arm's-length range fiasco

- Amendment in **Finance Act 2009** tried to rest controversy about arm's-length range by saying the 5% tolerance is not a standard deduction (as well as changed base of determination of allowable band linking it to transaction price instead of arithmetic mean)
 - However post 2009 period also remained ambiguous due to conflicting judicial decisions
- *Retrospective amendment* recently in **Finance Act 2012** w.e.f 1/4/2012 clarifying the 5% is not a standard deduction (from 1/4/2013 to be 3%)

Bottomline: Lots of litigation on simple issues due to lack of clarity

Issue #6

Documents, documents everywhere; not a sheet to think!

- Indian TP documentation requirements are staggering
 - Rule 10D prescribes detailed set of requirements pertaining to
 - Organizational Structure
 - Nature of business/industry and market conditions
 - Controlled transactions
 - Background documents
 - Comparability, functional and risk analysis
 - Selection of transfer pricing method
 - Application of the transfer pricing method
 - Assumptions, strategies, policies
 - Supporting information

Issue #6

Documents, documents everywhere; not a sheet to think!

- Too much data to decipher and analyze meaningfully given the systems resource constraints
- Key details tend to be overlooked in this **data deluge**
- Foreign comparables are really tough to obtain – prohibitive costs, lack of resources and knowledge.
- Penal provisions are in place for not maintaining documentation and enforced
- **Strain on the entire system** including Dept. and taxpayer

Bottomline: Is TP not just bad for taxpayer but also bad for the environment?! 😊

Issue #7

Practical TP oddities - Few nuggets from the field

1. TNMM Adjustments applied to all transactions of taxpayer enterprise:

1. TPO to make adjustments to international transactions only and not entire transactions of taxpayer (*Il Jin Electronics India Pvt. Ltd. – ITAT Delhi*)

2. Adjustments resulting in illogical results

1. Total amount of adjustment made, along with ALP already reported, exceeded total revenues earned by the taxpayer and its AE from dealing with third party clients! (*Global VantEdge Pvt. Ltd – ITAT Delhi*)

Issue #7

Practical TP oddities - Few nuggets from the field

3. **Excess profits being disallowed under regular provisions**

1. AO held that excess profits (above ALP) would be disallowed u/s 10B i.e., special tax exemption provisions for IT companies in export zones (*ACIT vs. Tweezerman India Pvt. Ltd. – ITAT Chennai*)

4. **“Contemporaneous” data used even if not available at specified date**

1. TPO empowered to determine ALP by using public domain data even after “cut-off date” (*Kodiak Networks India vs. ACIT – ITAT Bangalore*)

5. **Current hot-topic of TP litigation**

1. Whether in financial transactions i.e., corporate guarantees, interest-free loans etc.) between AE’s arm’s-length rate of interest to be charged? (*Retrospective amendment in Finance Act 2012 puts this to rest*)

Problems with (Indian) TP summarized

- **TP is not art, its not science..... its magic!**
 - No proper comparables available
 - Grossly improper comparables being used
 - No clear method or quantification for adjustments
 - Cherry-picking of comparables by all parties
 - Disparate Data sources are a bone of contention
 - Documentation requirement overload
 - Lack of knowledge & skill-set
 - Concepts such as 'location savings' not even acknowledged
 - Growth of "intangible" economy ignored completely
 - Overburdening of taxpayer

Bottomline: Current TP implementation devolves frequently into absurdities and can provide inequitable results

Part III. Indian judiciary & TP

Unfortunately, a number of conflicting judicial decisions abound in TP litigation. The silver lining are a few **landmark decisions** have provided a sane & guiding voice to Indian TP

Assessee / Taxpayer	Judicial forum	Short point of ruling
DIT vs. Morgan Stanley	Supreme Court	Once TP analysis is undertaken, no further need to attribute profits to a PE
E-Gain Commn. P. Ltd	ITAT Pune	TNMM may afford a practical solution to otherwise insoluble transfer pricing problems if used sensibly and with appropriate adjustments
TNT India	ITAT Bangalore	For arriving at the net margin of operating income, only op. income & expenses for relevant business activity of assessee to be taken into consideration
Aztec Software & Technology	ITAT SB	All characteristics of controlled transaction which are likely to affects its open market value must be taken into account
Mentor Graphics Ltd.	ITAT Delhi	If one point in arm's length range is satisfied, onus shifted to Dept. ALP not mean max. price or profit in range
UCB India (P) Ltd.	ITAT Pune	Method adopted by assessee is rejected, Revenue duty bound to compute ALP and substantiate and justify use of its method

Assessee / Taxpayer	Judicial forum	Short point of ruling
Schefenacker Motherson Ltd.	ITAT Delhi	Depreciation cost may be adjusted to eliminate material differences in 'asset' profile
ACIT vs. Wockhardt Ltd.	ITAT Mumbai	TNMM refers only to net margin realized by enterprise from international transactions but not operational margins of enterprise as a whole
Il Jin Electronics (India) Pvt. Ltd.	ITAT Delhi	Proportionate adjustment under TNMM on the ratio of international transactions with AEs to transactions with non-AEs
ACIT vs. Frost & Sullivan Pvt. Ltd.	ITAT Mumbai	No basis for excluding only loss making comparables and not excluding high profit margining comparables or companies which are not at all comparable based on size, turnover and other factors
Global Vantage Pvt. Ltd.	ITAT Delhi	Total amount of adjustment made, along with ALP already reported, cannot exceed total revenues earned by the taxpayer and its AE from dealing with third party clients
Genisys Integrating Systems	ITAT Bangalore	TP adjustment restricted to AE segment, exclusion of super-profit making companies, application of upper turnover filter, std. deduction of +/- 5%, capacity utilization adj. granted. Sent-back to TPO

Assessee / Taxpayer	Judicial forum	Short point of ruling
Philips Software vs. ACIT	ITAT Bangalore	Rule 10A(a) means co. having even single rupee of related party txn. not comparable
Sony India	ITAT Delhi	Contractual terms agreement to be looked into, consider cos. with less related party txns & losses too
Demag Cranes & Components	ITAT Pune	Duty of AO/TPO/DRP to minimize/eliminate difference which is likely to materially affect the price
Vertex Customer Services	ITAT Delhi	No penalty under S.271(1)(c) for bonafide TP adjustments
Honeywell Automation India Ltd.	ITAT Pune	Under Indian TP, consideration of subsequent year or average profits not permitted though OECD prescribes the same
In Re Dana Corporation	AAR	No capital gains in a business reorg. if consideration not determinate. TP law does not apply if there is no income
SSL-TTK Ltd.	ITAT Chennai	Penalty under 271G not to be levied for benign reasons in nature of procedural issues
Delphi TVS	ITAT Chennai	Re-visit by TPO for correctly assessing the prices under CUP for comparison after adj.
Ranbaxy Labs & Devel. Consultants	ITAT Delhi	Selection of overseas comparable maybe allowed provided such data is available in public domain
Quark Systems	ITAT Chandigarh (SB)	Filters to be based on 'cogent reasoning' and not unsound assumptions

Part IV. Is TP fundamentally flawed?

What are we trying to solve?

(Let's take a step back)

- **Question:** What are we trying to solve by these TP regulations?
 - **Answer:** “Who gets what share of the tax pie”
- It is agreed by all parties that India **SHOULD** get a share of the revenue from these huge international cash flows.
 - **The ends however don't justify the means.** While the objective of transfer pricing may be correct, the implementation simply doesn't hold water
- So, given that the Department is doing an incredible job, the accountants are doing their job and the lawyers always do their job....what gives?
 - **Is it not merely the specific TP provisions but something more?**
 - **Is there an underlying conceptual difficulty with TP?**

Transfer Pricing

Conceptual-level issues

- **Inequitable results : result of process to find ALP**
 - Arm's length price good in theory, makes no sense in practice.
 - No two transactions are really comparable let alone identical.
 - Separate-entity not the answer to all problems
 - In practice, we see **inequitable results** in trying to arrive at ALP
 - Artificial distinction between legal entities - branch, liaison office, dependent agent, subsidiaries etc.
 - The entire process and outcome seems to defeat the very purpose of the TP regime
- **TOO MANY VARIABLES** to factor in (*similar to weather modeling!*)
 - Engineering shout-out : this seems like a *NP-hard* problem.
 - Research theories may be complex, **laws should be simple**

Transfer Pricing

Conceptual-level issues (contd.)

– Current TP regime is against inherent nature of MNE's:

- A global corporate setup is an incredibly complex beast. *Corporate synergies* are very hard to quantify.
- What is the real cause of difference in comparable %'s ?
 - Different business strategies?
 - Volume discounts?
 - Long-standing business relationships?
 - Different target markets?
 - Internal process and Innovation differences?
 - A good marketing person?!
 -<fill in the blanks>.....
- Current TP system is a '*Rube Goldberg*' solution!

Why don't we fix the system?

- It is not “Yes, we can” but rather “No, we won’t”!
 - No incentive for change
- Change is not in the interest of
 - the Revenue Department: current TP regime yields huge revenue as the demands involved are massive
 - the Accountants: current TP audits are highly priced and hugely sought after
 - the Lawyers : TP litigation has breathed life into the dry practice of Indian domestic tax law
 - only affected party is the ignored one i.e., the taxpayer!

Part V. Suggested Solutions

Solutions?

“Only the guy who isn't rowing has time to rock the boat.” - Jean-Paul Sartre

TP is a hard problem to solve but easy to criticize.
So, what are some possible solutions which may work in the Indian context?

Solution #1

Sector-wide safe harbors

- Revenue vs. Certainty
 - India wants **its share of revenue**, the taxpayer **wants certainty**.
“Never the twain shall meet?”
- “Perfect is the enemy of the good” – the Indian TP system is a good example of this
 - Prescribing verbose yet non-specific and ambiguous ways of arriving at an arm’s-length price provides no certainty to the taxpayer
 - Even if he/she has to pay more tax, as long as the tax effect is clear, it can be factored in and the business will factor it in.
- The biggest problem in India & its TP regime (and daresay TP in general) is the vagueness and uncertainty it brings to the table

Solution #1

Sector-wide safe harbors

Activity	Major Area	Minor area	%
Services	Software	Generic Development	15%
	BPO/Support	Generic services	5%
	Hardware	Assembly	1.5%
.....			
Products	Automobile	Electricals	3%
		Axles/Cranks hafts	4%
.....			
Trading	Software	Distributor	5%
	Hardware	Printers & OE	1.5%

- Margins can be prepared by existing Govt. bodies along with industry associations
 - Revised every year (Annual budget) or once in five years (Planning Commission)
 - Every industry has detailed metrics (forecasts, estimates etc.)

Solution #1

Sector-wide safe harbors

Arguments against sector-wide safe harbors

Question	Answer
Too simplistic & gross	Fact is TP assessments in practice results in messier, not to mention inequitable results
Throwing up our hands and giving up on complexity	Laws are better simple than complex.
My sector A is not covered in the list	<ul style="list-style-type: none">• Classification is tried & tested under Indian Indirect taxes (Service Tax) and under Depreciation schedules (IT)• Providing for generic catch-call per-sector margin %'s is a simple first step

- Taxpayer can always choose to submit for lesser % margin and substantiate its case.
 - Do you know India already has experience with these type of tax provisions?!
 - **Section 44BB** prescribes 10% tax on aggregate payments / receivables of taxpayer engaged in exploration of mineral oils

Solution #2

Formulary Apportionment

- Formulary apportionment is very promising and ought to be tried
 - Attacks the crux of the TP problem that at end of the day it is a *tax-sharing formula* which all governments want to work out
 - Highlights the broken system of using “*five methods to rule them all*”
 - Correct approach of using math to solve an economics problem. Run predictive models, tweak the formula and try again....
 - DTAA's implicitly use (simple) formula in their tax sharing already.
 - FA does away with the overburdening of taxpayers and the entire system
 - FA should not be *taboo* by any stretch of imagination, it is after all another method. No big difference between a *method* and a *formula*!

Solution #2

Formulary Apportionment

- FA is intuitive and simple - will help Indian TP
 - FA formula (*payroll, property and sales*) addresses the *intangible* economy which is a huge deal in India which has software as its primary growth driver. This *intangible* economy is ignored currently in Indian TP
 - Similarly, in India, retail “*brands*” are usually controlled by MNE’s abroad. Job work and local sales are given to Indian cos. Again, FA can probably address this more adequately than the current TP regime.
- Practically speaking though FA is a hard sell in Indian context.
 - Tremendous inertia in India – the time and effort for any change is enormous
 - Profit-split at its simplest level is almost unused in India. What about FA’s chances then?

Solution #2

Formulary Apportionment

- **Key questions** experts can answer to aid FA adoption in India:
 - Can FA be achieved without active cooperation between governments?
 - What is the starting point for implementing FA?
 - Can there be a gradual transition to a FA system?
 - What happens if there is asymmetric use of FA and other methods?
 - Need to come up with best strategy to pitch FA to the Govt.
 - Lot more resources (literature, data, models etc.) required to push FA in India. Need to generate interest at industry level as well as Department

Solution #3

Streamlining current TP provisions (aka “Bring out the bandages”)

- Allow 3% *standard deduction* as arm’s-length range
- Use inter-quartile ranges instead of arithmetic mean
- Allow multiple year period data across the board
- Allow foreign comparables, allow foreign AE as tested party
- Provide clear guidance on adjustments specifically risk, idle capacity, depreciation and working capital
- Prescribe clear turnover range filters for comparables
- Do not reject loss-making comparables outright
- Allow technical expert reference for selecting functionally similar comparables

Solution #3

Streamlining current TP provisions (contd.)

- Ameliorate the data gathering system by the TPO and mandatorily involve the assessee at every step
- Use Advance Pricing Arrangements (APAs)
 - APAs were recently introduced and are a welcome addition
 - Not sure of the practicality of APA however in Indian context given resource and data constraints
- MAP process should be pursued more and made time-bound and effective

Bottomline: Current Indian TP regime has to change to help both the Department and taxpayer to achieve respective goals

The End!

Thanks to

Mr. T.P.Ostwal (T.P.Ostwal & Associates), Mumbai

Vikram Vijayaraghavan

vvikram@saprlaw.com

vvikram@gmail.com