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Secondary Adjustment – An Update

The cornerstone of every industry practice is a tiny – yet impactful leap towards improving them. In a bid to adopt global best practices in tax and its commitment towards BEPS India introduced secondary adjustments with the Finance Act, 2017 in its transfer pricing regime. While the concept of secondary adjustments have already been successfully adopted in few developed economies, it would be interesting to see how such concept will practically operate in the Indian transfer pricing regime.

The new provision of section 92CE of the Income Tax Act, 1961 is now proposed to be applicable from Assessment Year ("AY") 2018-19 (as per Finance Bill 2017), however it also considers transfer pricing adjustments made in AY 2017-18 – As ROI filled for AY 2017-18 shall only come up for assessment/scrutiny during AY 2018-19.

What is primary adjustment?

Primary adjustment refers to increase in the total income or reduction in the loss of the Assessee due to non-maintenance of arm's length price for the transactions between the Associated Enterprises ("AE").

What is Secondary Adjustment?

Secondary Adjustment means an adjustment in the books of account of the Assessee and its AE to reflect that the actual allocation of profits between the Assessee and its AE are consistent with the transfer price determined because of primary adjustments, thereby removing the imbalance between cash account and actual profit of the Assessee.

As per the OECD's Transfer Pricing Guidelines, secondary adjustment can be considered as deemed dividends, constructive equity contributions, or constructive loans or advance. Section 92CE has proposed to treat the secondary adjustments as advances given (if not repatriated to India within the prescribed time) to respective AE which shall suffer transfer pricing adjustment.

Secondary adjustment can be understood with the help of the following simple example:

Total declared income Rs. 100 Crore

Adjustment of Rs. 10 Crore on the international transaction

The computation would be as follows:

Particulars	Amount (Rs. crore)
Declared income	100
Add: Primary adjustment	10
Total adjusted income	**110**
Later years….	
Secondary adjustment (treat 10 crores as advance given to AE if not repatriated within the prescribed time limit. *Say repatriated after 12 months from the prescribed date* Interest will be levied @ 10% on the deemed advance amount and will be considered as part of income of next AY since repatriation of 10 crores shall happen only after the due date of filing return of income in which primary adjustment was carried out.	

In what situation Secondary Adjustment will be applicable?

Secondary adjustment is attracted when primary adjustment is made by:

- Assessee himself in Return of Income – Self Adjustment;
- Assessing officer and accepted by Assessee – Assessed Income;
- Assessing officer/Assessee based on Advance Pricing Agreement (APA) entered by Assessee under section 92CC;
- Assessing office as per Safe Harbour Rule frame under section 92CB;
- Assessing office on account of result of an assessment by way of Mutual Agreement Procedure (MAP) under an agreement entered into under Section 90 or Section 90A.

What is the time limit for making Secondary adjustment

Rule 10CB of the Income Tax Rules, 1961 prescribes that the secondary adjustment should be carried out on or before 90 days of filing return of income for the relevant AY. In case where Secondary adjustment is to be carried out in pursuance to an order of AO or Appellate body – 90 days from the date of the said order.

If the excess money is not repatriated within the prescribed time limit of 90 days, interest is levied on such excess money at one year SBI marginal cost of fund lending rate PLUS 325 basis points where the international transaction is denominated in INR. Where international transaction is denominated in foreign currency 6 months LIBOR as on 30th September of the relevant previous year.

What are the exceptions to Secondary Adjustment?

The provision of Secondary Adjustment will not be applicable in the following two scenarios, i.e.

- Where primary adjustment does not cross threshold of Rs. 1 crore in any previous year, ***and***
  (Here AND should be read as OR – Clarified by CBDT Notification 52/2017 dated 15th June, 2017)
- Primary Adjustment made on or before Assessment Year 2016-17.

MCA Comments

Where a primary adjustment is computed and the same does not fulfil the above mentioned exceptions, then it is inevitable to avoid secondary adjustment, provided the deemed advance is not settled in cash.

Following are our suggestions:

- Planning of transfer prices goes a long way in avoiding transfer pricing disputes
- Important to document the price setting mechanism in a transfer pricing policy document
- While a primary adjustment is foreseen, it is important to settle the adjustment in cash position.

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