



**2nd All India Tax Summit
- Achromic Point**

Transfer Pricing

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Evolution of Transfer Pricing Mechanism in India

2001: TP regulations introduced

- Mandatory compliance agreement
- Stringent penalty provisions

2005: First TP audit cycle complete

- Focus on low hanging cycle captive service providers

2009: Indian TP authorities made a mark

- Regarded as most aggressive authorities
- First to introduce dispute resolution panel

2012: Highest in Numbers

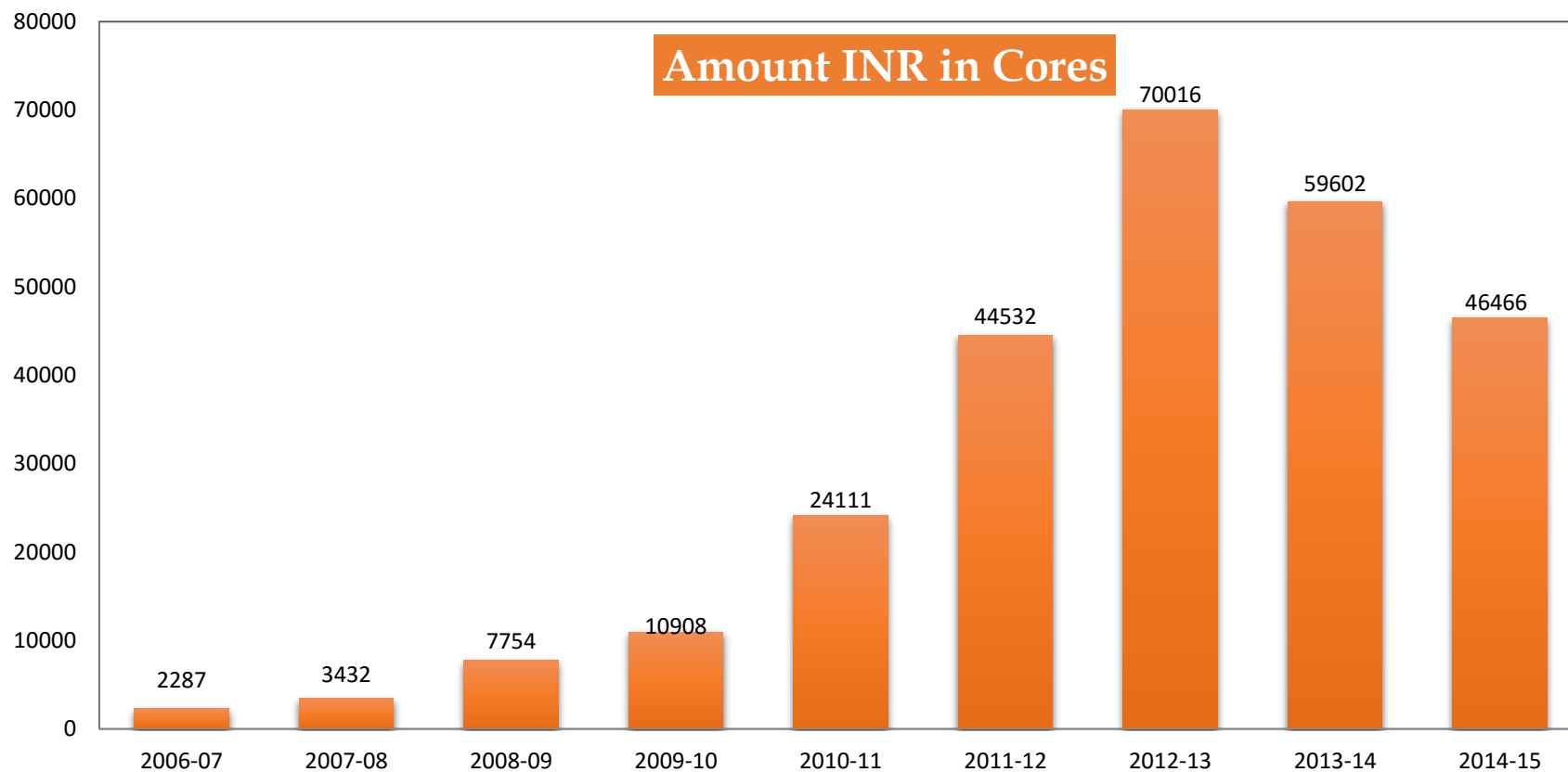
- Adjustment worth INR 45,000 crores carried out. This is the highest among any other country
- issues ranging from cost plus mark up to issues related to value of intangibles

2015: TP adjustment reached INR 46,465 crores

- Total adjustment of INR 2,23,862 made over the last 10 years of TP audit cycle
- new issues related to issuance of shares, working capital adjustment

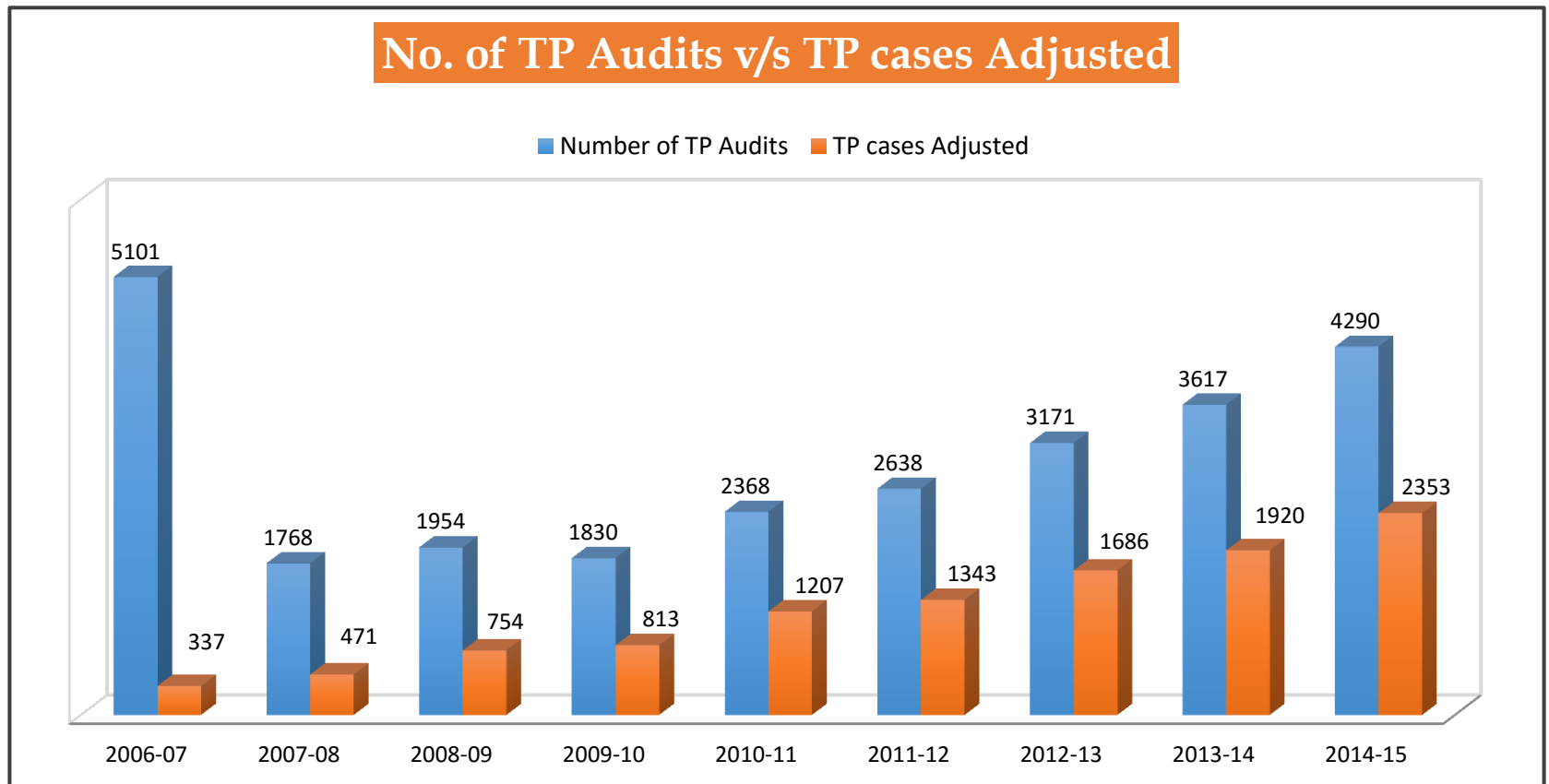
Transfer Pricing Adjustments

Year	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Amount INR in Cores	2287	3432	7754	10908	24111	44532	70016	59602	46466

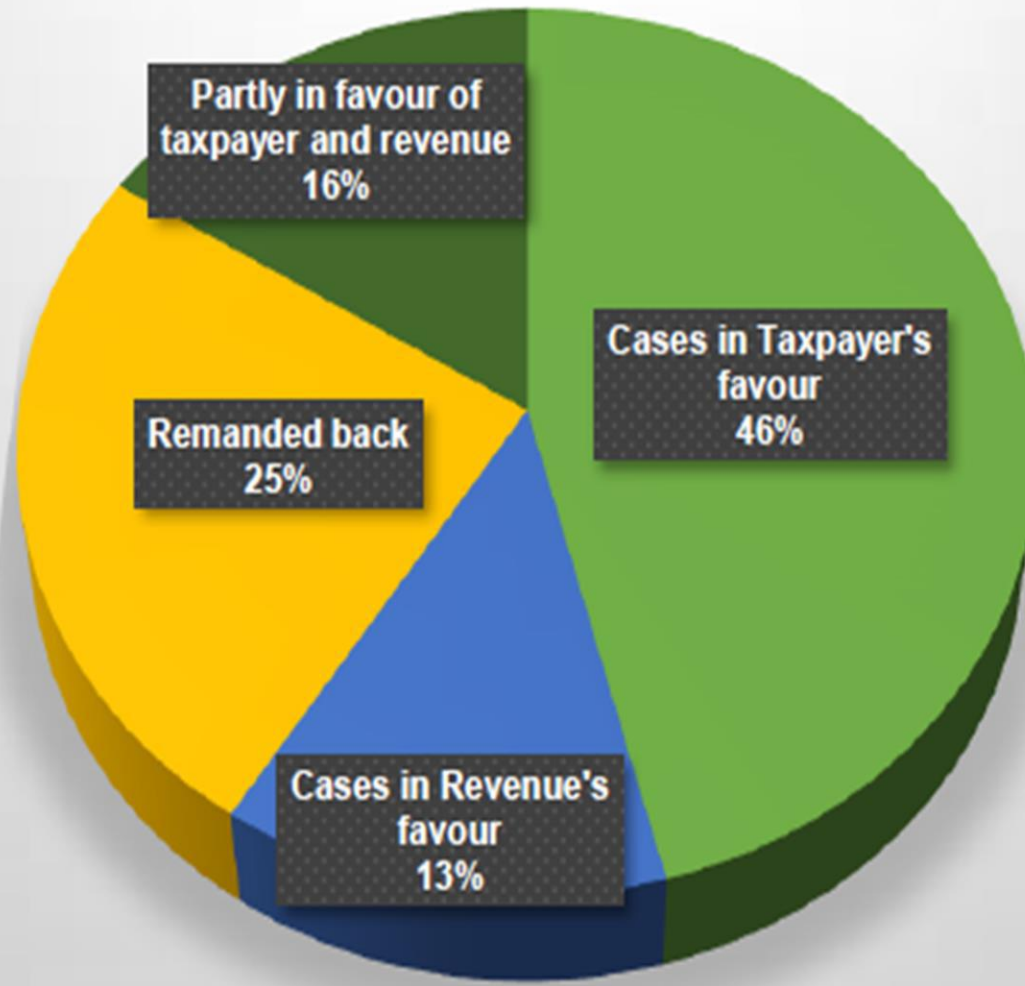


No of TP Audits Vs No of TP adjustments

Year	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Number of TP Audits	5101	1768	1954	1830	2368	2638	3171	3617	4290
TP cases Adjustment	337	471	754	813	1207	1343	1686	1920	2353




TP Litigation Trend Analysis (ITAT)



Source: ITRAF

Key Recent Developments

- 
1. Introduction of Range and multiple-year analysis – 2015 - India aligning to international best practices
 2. Guidance on implementation of Transfer Pricing Provisions (Instruction No.3 of 2016)
 3. OECD/G20 BEPS Releases – Final reports on various Action Plans (05 October 2015)

1. Introduction of Range and multiple-year analysis – 2015 - India aligning to international best practices



Arm's length range

- The OECD advocates the usage of inter-Quartile Range("IQR")
- The IQR is the range from the 25th to the 75th percentile of the results derived from the uncontrolled comparables
- TP Adjustments usually done to the median
- The concept of IQR has been adopted by majority of the countries having transfer pricing regulations including Austria, Australia, China, Denmark, Finland, France, Germany, Indonesia, Israel, Italy, Japan, Korea, Mexico, Netherlands, Poland, Portugal, Romania, Singapore, South Africa, Sweden, Taiwan, Thailand, UK and USA amongst others

Use of multiple year data

- The OECD strongly recommends the usage of multiple years data for the purposes of comparability analyses. As it provides useful insights in understanding long term arrangements, business and product cycles
- Globally, almost all countries use multiple year data, generally (a) two out of three years; or (b) three out of five years.
- Multiple year data usually used along with the use of multiple year averages to arrive at a reliable Arm's length range
- Multiple year data is used for comparables while comparing the single year of tested party. Some countries even accept multiple year analysis for both the tested party as well as the comparables

Range Concept in India

Applicable only in case the MAM used for determination of ALP is CUP, RPM, CPLM and TNMM

A minimum of 6 comparables / data points would be required – in case the number of comparables / data points is less than 6, arithmetic mean (AM) will continue to apply along with benefit of 3% tolerance band (1% for wholesale traders)*

A dataset shall be constructed by placing the prices/data points in an ascending order

The data points lying within the 35th to 65th percentile of the data set of series - arranged as above - would constitute the arm's length range

Arm's length test –If the transfer price is within the above arm's length range, no adjustment shall be made –If the transfer price of the tested party falls outside the above arm's length range, the median of the dataset would be taken as ALP for making an adjustment to transfer price

Range – An illustration

Scenario 1 – Benchmarking sale of goods

Three-year old weighted average margin of comparable companies	1	2	3	4	5	6	7	8	9
	10	15	16	-4	5	25	30	6	13
Ascending order	-4	5	6	10	13	15	16	25	30
Arithmetic mean	12.89%								
Range 35 th to 65 th percentile	10% to 15% (calculated)								

Scenario 2 – Benchmarking sale of goods

Three-year old weighted average margin of comparable companies	1	2	3	4	5	6	7	8	9
	10	15	16	-4	5	40	30	6	13
Ascending order	-4	5	6	10	13	15	16	30	40
Arithmetic mean	14.56%								
Range 35 th to 65 th percentile	10% to 15% (calculated)								

Range - An illustration

	Presumed Margin of assessee	+/- 3%	Arithmetic Mean	Range	Whether at AL under old law	Whether at AL under new law
Scenario 1	9.75	13.04	12.89%	10-15%	Yes	No
Scenario 2	10.50	13.82	14.56%	10-15%	No	Yes

- ✓ Arithmetic mean deviated from 12.89% to 14.56% when a smaller data point (i.e. 25) was replaced with a higher data point (i.e. 40), whereas the range remained static at 10% to 15% under both the scenarios
- ✓ This illustrates that the Arithmetic Mean reacted to the extreme values, whereas the range remained indifferent.
- ✓ As a result, compared with the arithmetic mean, one advantage of the range is that it indicates the spread or concentration from the middle of the distribution, ignoring the extremes of the distribution

Applicability of Range and Multiple year data

Methods	Applicability of	
	Multiple year data	Range Concept
CUP	x	✓
CPLM	✓	✓
RPM	✓	✓
PSM	x	x
TNMM	✓	✓
Other Method	x	x

2. Guidance on implementation of Transfer Pricing Provisions (Instruction No.3)

Key highlights

- Reference to TPO
 - If there is an income or potentiality of an income arising and/or being affected, the AO to record his satisfaction in the following 3 situations before proceeding to determine the ALP or making a reference to the TPO,
 - o Accountants Report (AR) has not been filed by the taxpayer
 - o AR has been filed but international transaction(s) has not been reported
 - o Taxpayer has made qualifying remarks in the AR
 - regarding impact on income of taxpayer
 - Quantum on transactions not to be criteria for referring cases to TPOs

- Procedural requirements
 - Taxpayer objection to applicability of TP provisions should be considered and specifically dealt with by the AO, before making a reference to the TPO
 - AO to provide an opportunity of hearing to the taxpayer
 - Approval of PCIT/CIT
 - TPO's - Additional/Joint CIT to be assigned not more than 50 cases

- TPOs to maintain database in prescribed format providing details / information about the assessment outcome e.g. Transfer Price and MAM declared by the taxpayer and determined by the TPO

- The above guidance would be applicable mainly in case of International Transactions and to SDTs till such time separate guidance is issued for SDTs



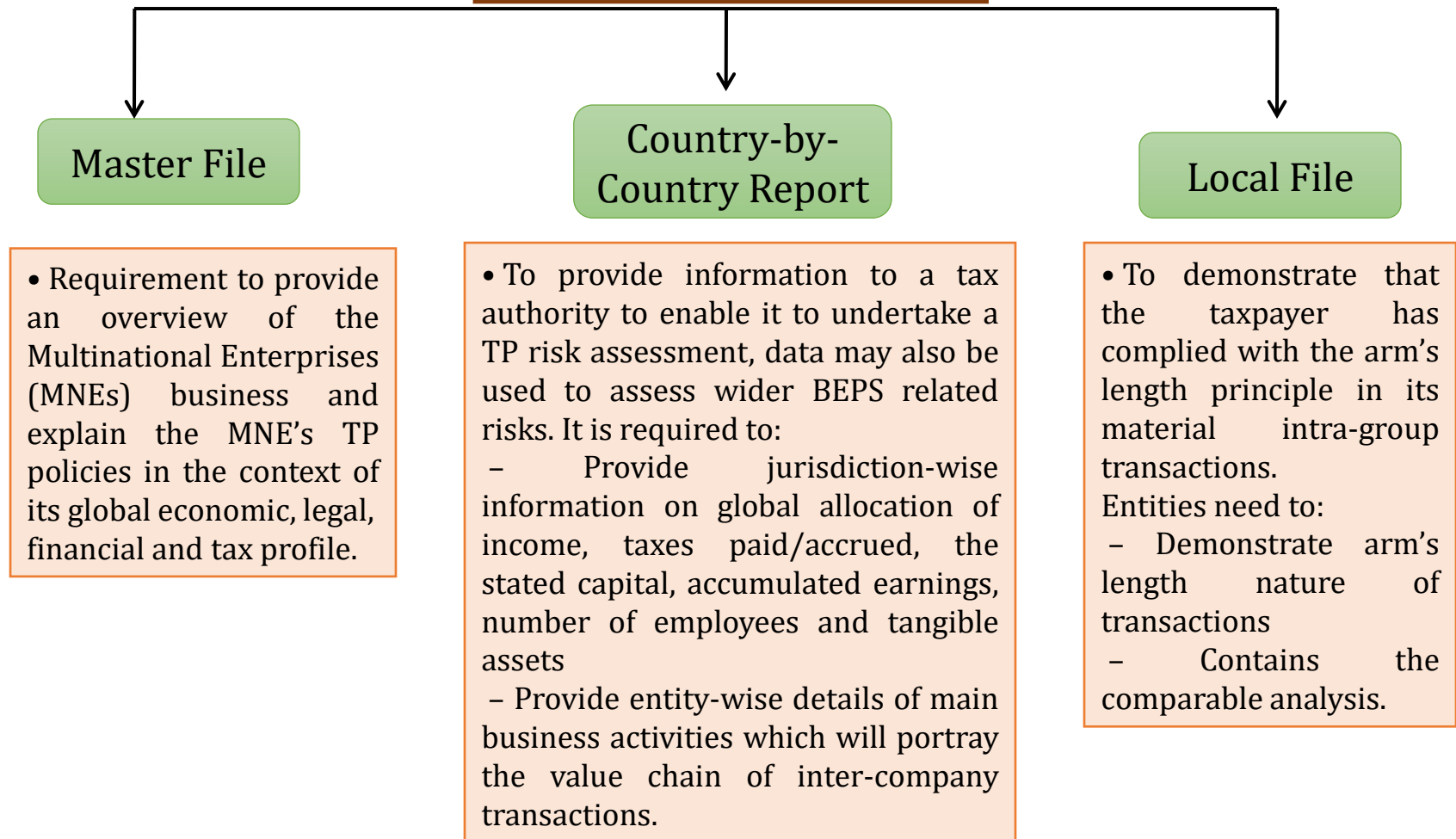
Reference to the TPO - Guidelines

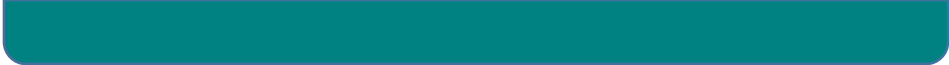
Case selected for scrutiny on TP risk parameter	Case selected for scrutiny on non-TP risk parameter
If TP risk pertains to International taxation (IT), then only IT to be referred to TPO	Form 3CEB is not filed or IT /SDT not disclosed
If TP risk pertains to SDT, then only SDT to be referred to TPO	TP adjustment of Rs 10 Cr or more is upheld by judicial authorities or pending in appeal. Cases Set-aside by the judicial authorities
If TP risk pertains to both IT and SDT, then both IT & SDT to be referred to TPO	Where search, seizure or survey operations carried out and finding reg TP issues in respect of IT/ SDT or Both have been recorded by the investigation team

3. OECD/G20 BEPS Releases – Final reports on various Action Plans (05 October 2015)

Sec. 286 of the Income-tax Act, 1961 – FA 2016

TP Documentation





Indian Advance Pricing
Agreement (APA) regime
and Roll back provisions

APA in India

- Advance pricing agreement (APA) is an agreement between a taxpayer and one or more national tax authorities that establishes the transfer pricing methods they must use for future transaction covered by the APA.
- Voluntary process initiated by tax payer – Any person who has entered into an international transaction or is contemplating to enter into an international transaction is eligible to apply for an APA.
- APA is binding on tax payer as well as tax authorities
- APA scheme was introduced in the Income-tax Act, 1961 w.e.f July 1, 2012; APA Rules were introduced as on 31 August 2012.

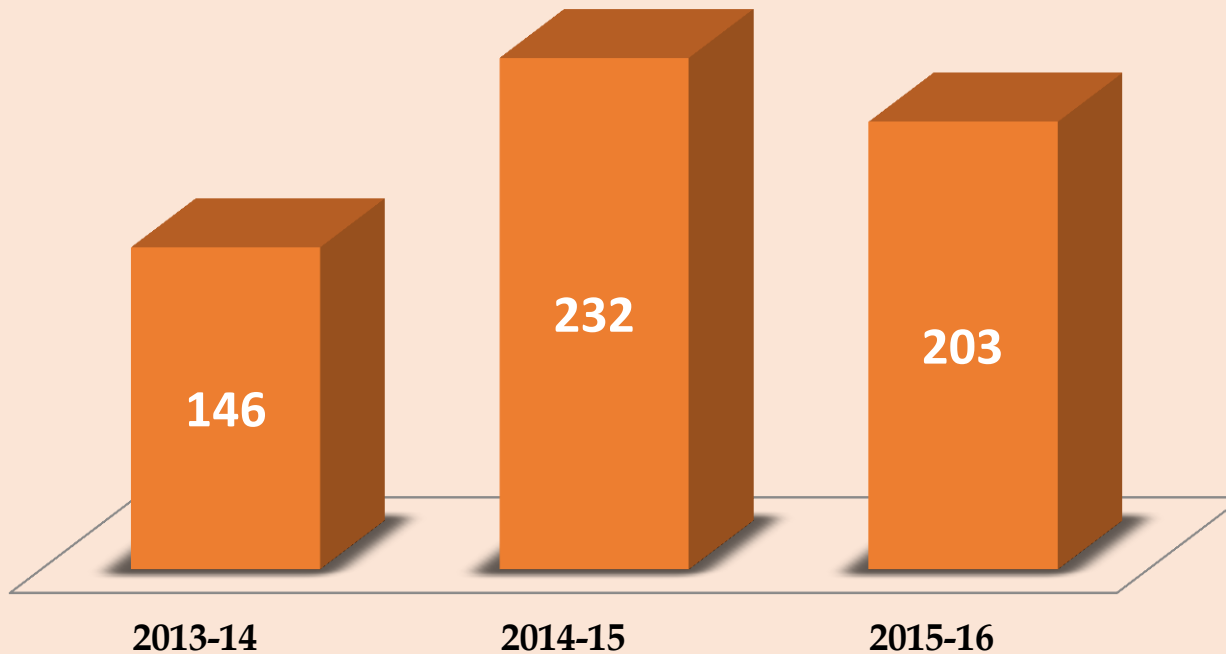
Key Features of APA in India

- Taxpayer have an option to seek either a unilateral or bilateral or multilateral APA(s) depending on the facts and circumstances of the case.
- Option of pre-filing consultation is prescribed. It is free.
- Prospective APA allowed for maximum 5 years
- Roll back benefit is available for 4 years
- APA application is to be filed before the first day of the financial year (i.e. before April 1, 2016 for financial year 2016-17) in respect of continuing transactions.
- Provision for renewal is provided
- Prior dispute will not impact APA negotiation.
- Fees for the APA application process is as follows:

International Transaction Value (in approx. USD)	APA filing fees (in approx . USD)
Value < 17 million	17,000
17 million < Value < 33 million	21,000
Value > 33 million	33,000
To avail roll back	8,000

CBDT - APA PROGRAM

Summary of APA's Application



ROLLBACK OF ADVANCE PRICING AGREEMENTS:



Who can apply ?
Any person who has
previously applied
for APA



Rollback shall apply
to International
transaction which is
already covered
under APA



Requirements

1. Filed Return of Income
2. Form 3CEB filed within due date for relevant years of rollback

ROLLBACK OF ADVANCE PRICING AGREEMENTS:



Terms

Rollback Provisions not applicable for the following situations

- The determination of ALP of the said international transaction for the said year has been the subject matter of an appeal before the Appellate Tribunal and the tribunal has disposed such appeal
- The application of the roll-back provision has the effect of reducing the total income or increasing the loss

Terms of roll-back provisions:

The Rules specify that the ALP or the method of determination of ALP for an international transaction covered under the roll-back year(s) shall be the same as determined for the same international transaction as covered for the APA period

Procedure for giving effect to Rollback Provision of an Agreement

- The applicant shall furnish modified return of income referred to in section 92CD
- The modified return to be furnished in respect of first of the previous years for which the agreement has been requested for in the application.
- If any appeal filed by applicant is pending before the CIT (A), ITAT or the High Court for a rollback year, on the issue which is the subject matter of the rollback provision for that year, the said appeal to the extent of the subject covered under the agreement shall be withdrawn before furnishing the modified return .
- If any appeal filed by the AO or the Principal Commissioner or Commissioner is pending before the ITAT or the High Court for a rollback year, shall be withdrawn by the AO or as the case may be, within three months of filing of modified return by the applicant.
- The person withdrawing the appeal, shall inform the concerned authority i.e DRP or the CIT (A) or ITAT or as the case may be the fact of an agreement containing rollback provision .
- In case effect cannot be given to the rollback provision of an agreement in accordance with this rule, for any rollback year to which it applies, on account of failure on the part of applicant, the agreement shall be cancelled.

Benefits of APA

Certainty with respect to tax outcome of international transactions by agreeing in advance the ALP or pricing methodology to be applied

Specific rollback provisions that enable taxpayers to attain certainty in transfer pricing international transactions for up to 9 years (including 4 years rollback provisions) in total

Removal of audit threat (minimize rigors of audit) and deliverance of a particular tax outcome based on the terms of agreement

Substantial reduction of compliance issues over the terms of the APA

For Tax authorities, an APA reduces the cost of administration and frees scarce resources

Consequently APAs provide a win-win situation for all the stakeholders involved

Implementation Issues

ADVANCE
PRICING
AGREEMENT

Inward Cash Repatriation – One of the terms and conditions under APA is Inward Cash Repatriation from its AE for the data in the agreed prices in APA and actual transfer price for prior year subject to APA resulting in practical difficulties:

- It is difficult for companies to pass such adjustments and bring in funds where APA settlement is taking place years after the transaction year has closed
- Sufficient financial provisions need to be created in advance for such transactions
- Implication for Minimum Alternate Tax (MAT) and consequential Interest payment by the taxpayer

No Rollback on Merger And Acquisitions: In case of mergers/demergers, only the APA applicant would be eligible for the benefit of Roll Back and not any of the merged or demerged entity connected with the APA applicant.

But, business is an ever changing reality

- Restrict Roll Back benefit and leaves open the disputes of prestructuring period to be subjected to protected litigation
- Many advanced and emerging tax administration provide sufficient width to the APA applicants to adequately cover the cases of merger and acquisitions if the international transactions remains same.

Implementation Issues

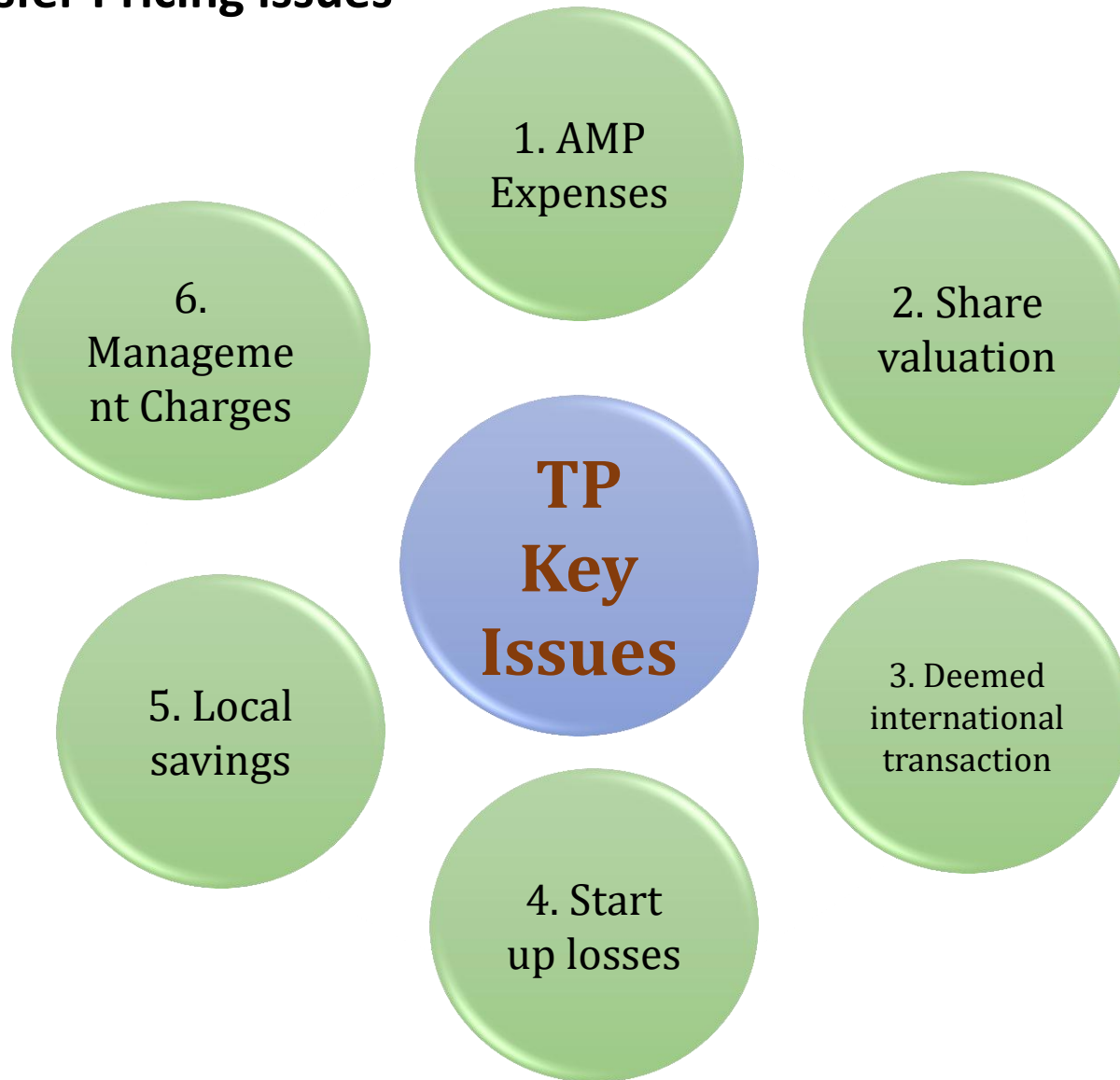
ADVANCE
PRICING
AGREEMENT

Range and Multiple year data- New Rules are applicable for international transactions entered into by the taxpayers after April 1, 2014, the arm's length price based on range and multiple year data are lower than the hitherto available arithmetic mean. This as result in the following question before the taxpayers:

- What should be the arm's length price for concluded APAs based on arithmetic mean
- What should be the TP for already filed APAs proposing TP based on arithmetic mean
- Will Indian APA authorities follow multiple year and range concept or will they continue with arithmetic mean concept
- Are taxpayer better off without APA

International taxation issues dispute continue- APA only determines the arm's length price of the covered transaction but it does not cover international taxation issues such as whether PE exist or not, whether withholding tax applies. The taxpayer has to make representation before both AAR and APA for the overall tax certainty.

Transfer Pricing issues



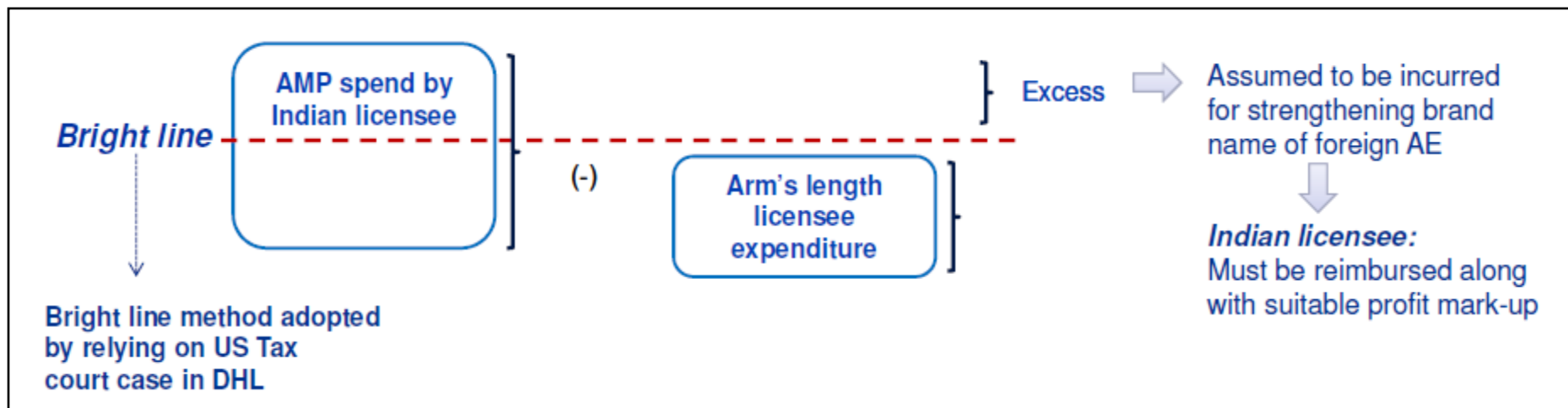
1. AMP Expenses

Issue involved / Approach of the Revenue:

Assessee spends significant amount on AMP expense benefitting the AE by creating marketing intangibles without corresponding compensation/ reimbursement to the assessee.

Revenue authorities compare expense to sales ratio of assessee with other comparables – disallows AMP expense in excess of “bright-line” as TP adjustment alleging contribution by taxpayer is towards strengthening AE owned brands.

Expectation of mark-up on recovery of AMP expense in excess of bright line. The average AMP expenses incurred by companies in the industry are considered as Bright Line for the purpose of Transfer Pricing analysis.



2. Share valuation



General contentions of the Taxpayers:

- Issue of equity share capital does not constitute 'income' hence not covered by section 92(1) of the Income Tax Act and therefore there is no requirement to satisfy the arm's length test laid down by the Act.
- The shortfall in the value of equity shares cannot be considered as a deemed loan, as no actual loan has been given by the taxpayer and hence there is no question of Transaction as defined under section 92F of the Act.
- The action proposed by the revenue in considering the shortfall as a deemed loan would tantamount to consider every transfer pricing adjustment as a notional loan/receivable.

General contentions of the Revenue:

- All type of transactions being in nature of Capital Financing under clause (v) of explanation to section 92F of the Act have been included in the definition of international transactions from retrospective effect from 1st April 2002.
- Issue of equity shares is in nature of Capital Financing and hence is an international transaction which is required to be at arm's length under the Indian Transfer Pricing regulations.

2. Share valuation

High Court Observations

- 1) No express legislation on capital account transaction
- 2) The amount received on issue of share capital including the premium is on capital account.
- 3) Thus neither the capital receipts received by the Petitioner on issue of equity shares to its holding company, nor the alleged shortfall can be considered as income as defined under the Act
- 4) Charge and measure of tax entirely different
- 5) Transaction on capital account or on account of restructuring would become taxable to the extent it impacts income
- 6) Income pre requisite for applicability of Section 56(1)
- 7) Section 92(2) has no relevance in the present issue of fact

3. Deemed International Transaction

Issue:

MNEs enter into global contracts with suppliers and service providers, which are leveraged by their group companies. Under the global contract, the parent entities enter into an umbrella contract and their respective affiliates in their respective jurisdiction/ region enter into a separate contract to maintain consistency in the practices and products/ services.

As per Sec 92B (2) of the Act,

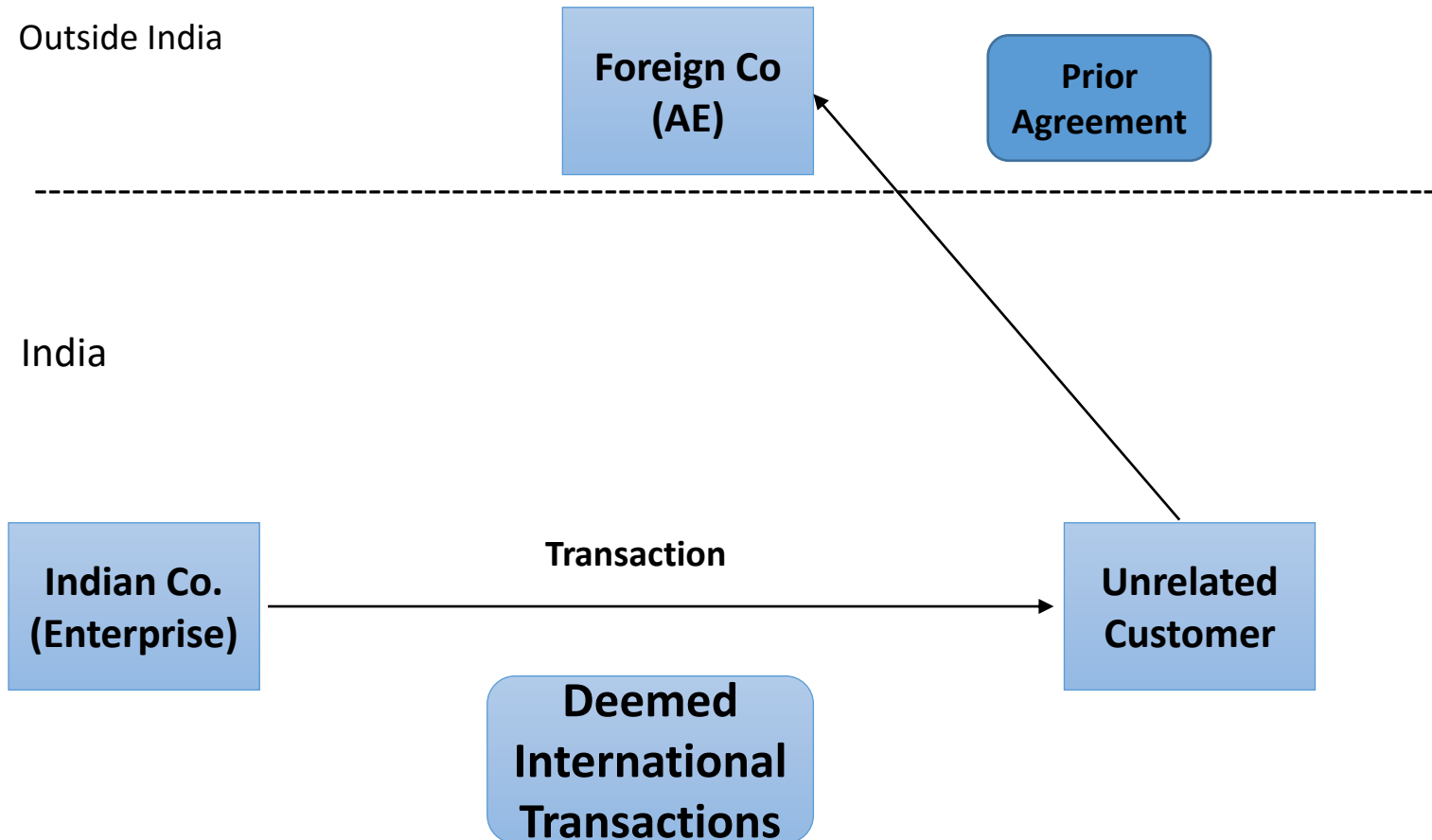
A transaction entered into by an enterprise with a person other than an AE shall be deemed to be an international transaction if:

There exists a prior agreement in relation to the relevant transaction between such other person and the AE

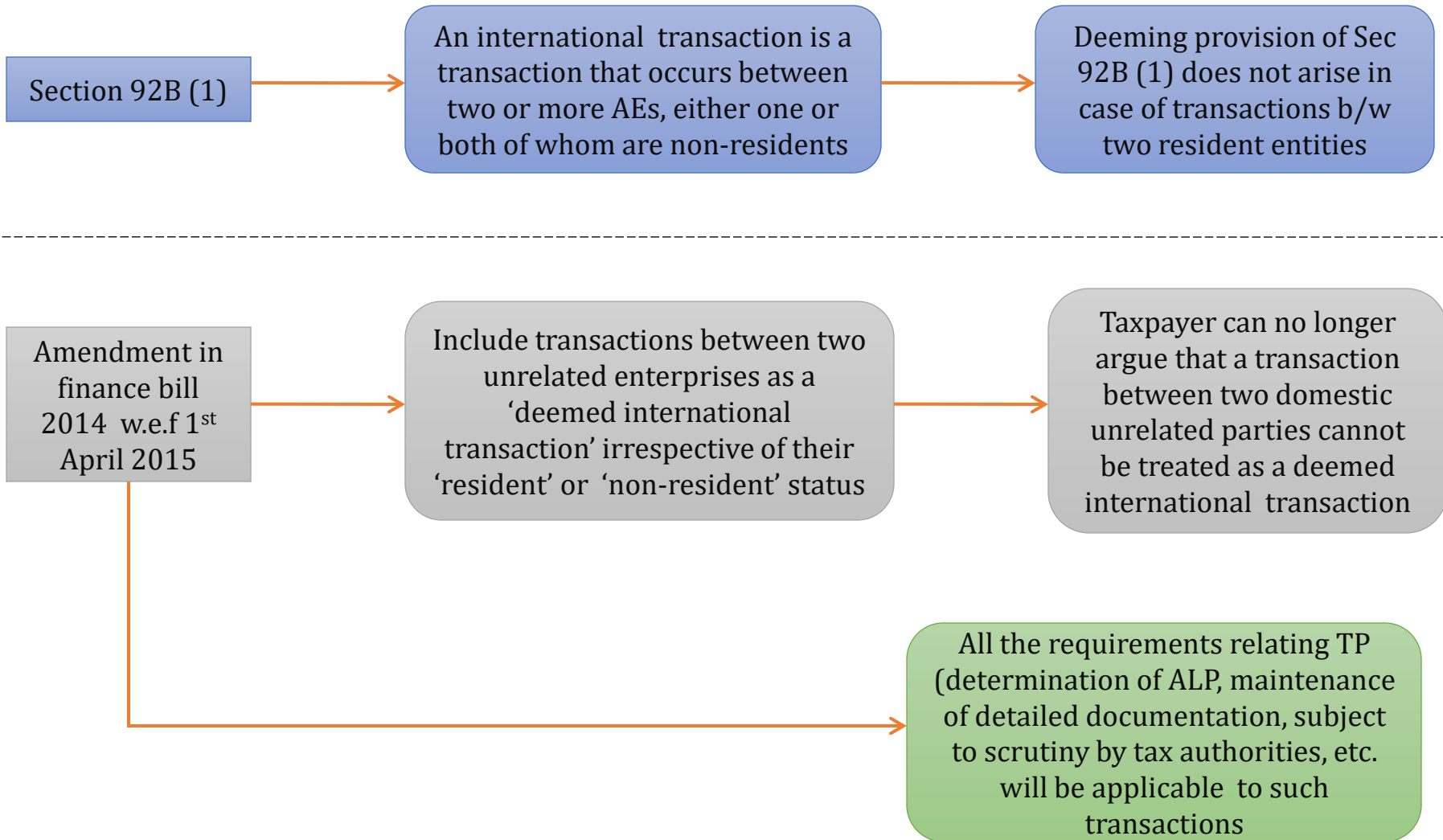
or

The terms of relevant transaction are determined in substance between such other person and the AE

Definition of Deemed International Transactions.

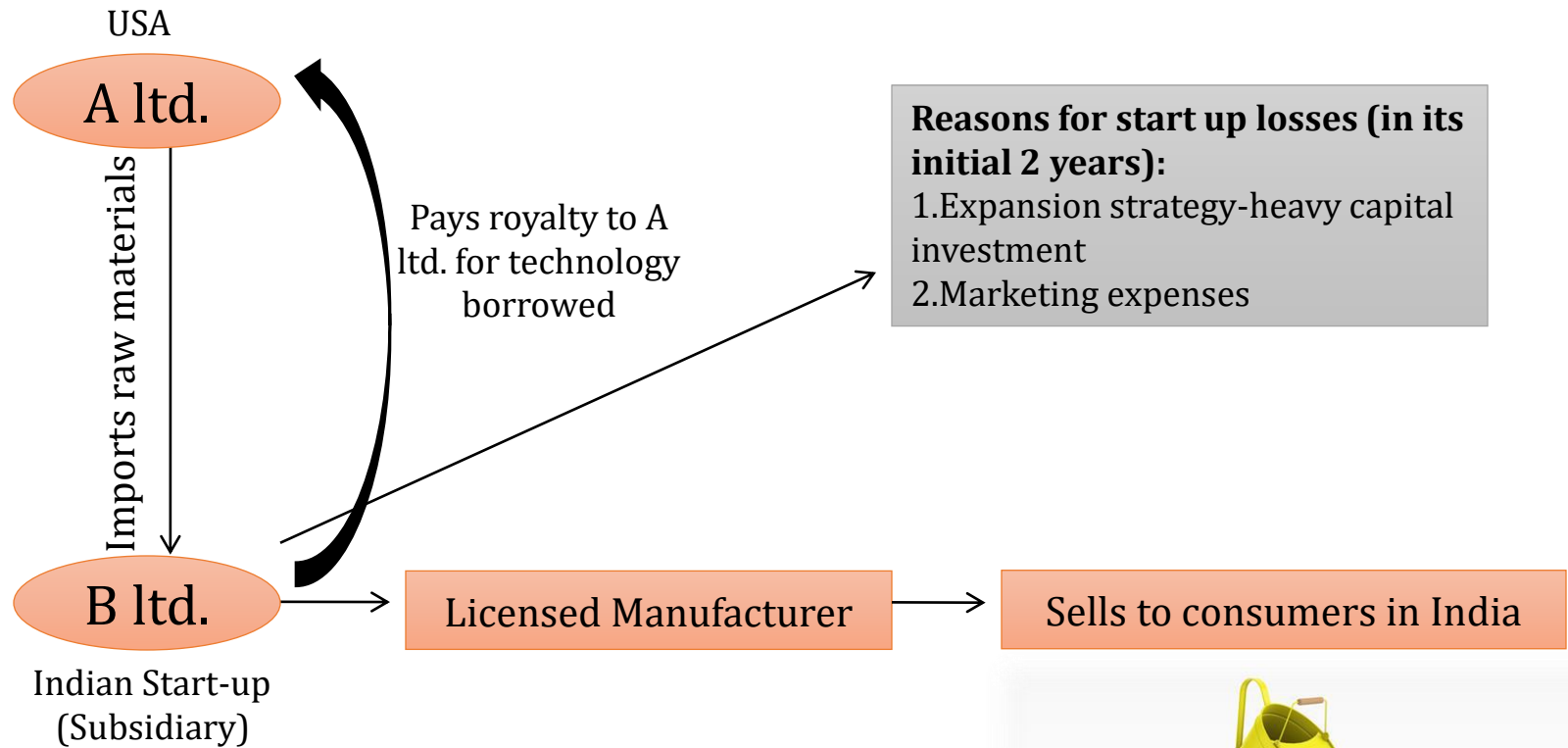


3. Deemed International Transaction (Amendments in Finance bill 2014 – Domestic unrelated party transaction)



4. Start-up Losses

The start-up losses are explained with the following example:



4. Start-up Losses

1. AE consistently realizes losses while the other MNE group as a whole is profitable – triggers TP issues
2. The loss making enterprise may not be receiving adequate compensation from the group of which it is a part in relation to benefit received from its activities.
3. Independent enterprise perform such activities only if it is compensated adequately.
4. Losses over a limited period is acceptable . If it goes beyond reasonable period TP adjustment is necessary.
5. **In L'oreals case, market penetration strategy was contributing to losses.** Net losses of the assessee in the distribution segment are only for three years and after which the assessee has been earning increasing profits.

5. Location Savings



When a Multinational Enterprise (MNE) saves costs by relocating facilities from a high-cost jurisdiction to a low-cost one, it is considered location saving under transfer pricing terminology.

Location Specific Advantages (LSA)

- Access and proximity to growing local / regional market;
- Large Customer Base with a higher spending capacity
- Market Premium;
- Advanced Infrastructure
- Highly specialized local knowledge and personnel

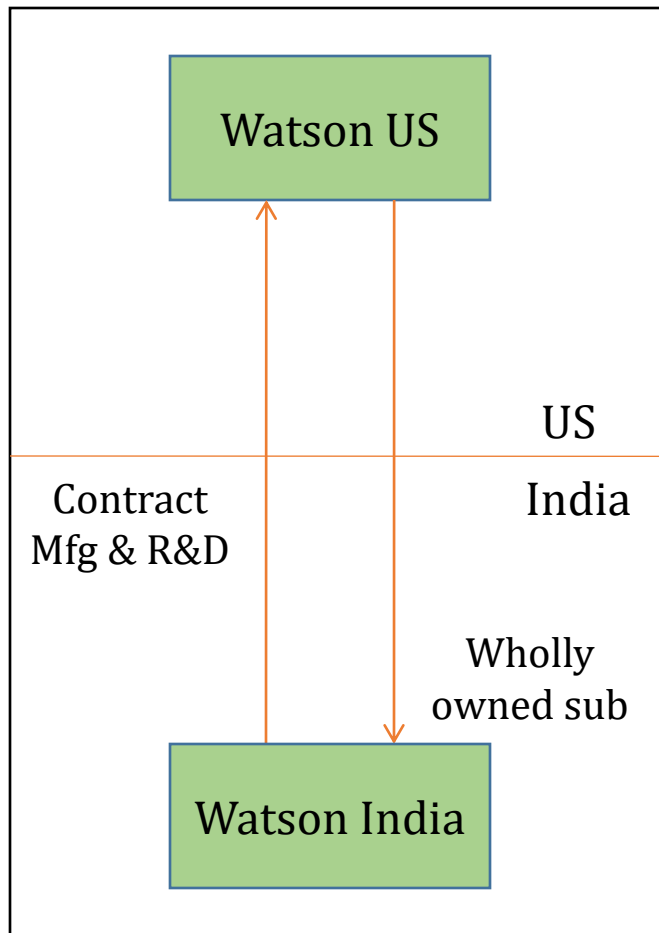
Location Specific Disadvantages (LSDA)

- Termination cost for the existing operations
- Higher transportation cost if the new operation is more distant from the market
- Training costs of local employees

Location Savings
= LSA - LSDA



5. Location Savings



Watson laboratories Inc. – US
Watson Pharma Pvt. Ltd. – India

Discussion – Watson Pharma Pvt. Ltd.
(ITA 1423/Mum/2014 and 1565/Mum/2014)

Case in Brief

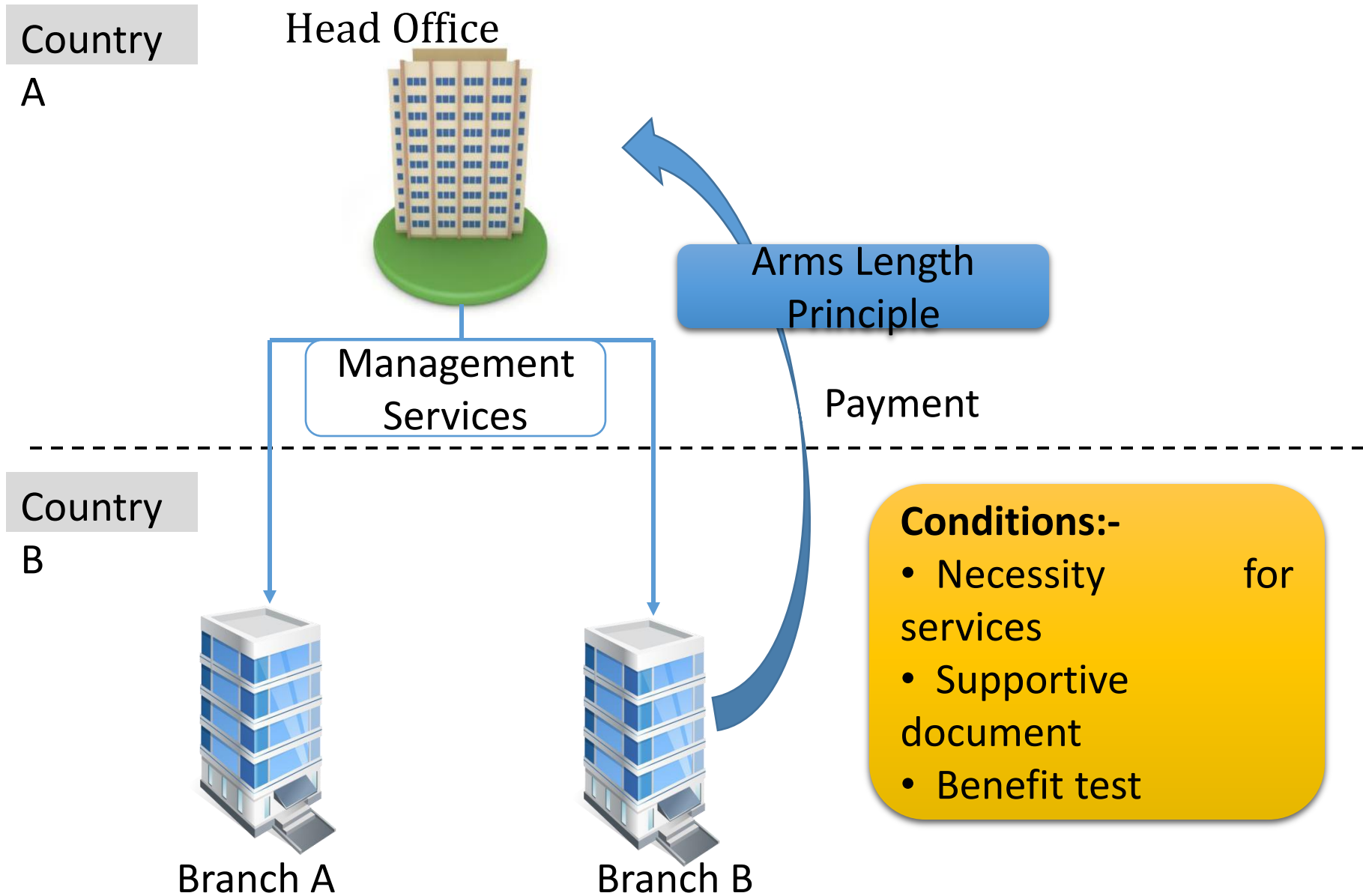
- Remuneration paid by Watson US - Total OC plus arm's length mark-up
- TPO/DRP contention - Location saving (LS) arises as manufacturing activity transferred from US/Europe (high cost) to India (low cost jurisdiction)
- The ITAT rejected TPO's contentions citing following reasons:

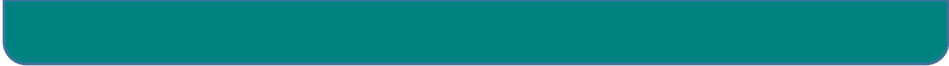
→ The taxpayer as well as AE operated in a perfectly competitive market. Therefore, the taxpayer did not have any unique advantage, and there was no super profit arising in the entire supply chain.

→ Where local market comparables were available and used, specific adjustment for location savings was not required. Any benefit/ advantage to the AE was irrelevant if PLI of the taxpayer was within the range of comparables.

→ The Indian chapter of the UN TP manual represents a view of Indian Tax administration and it is not binding on Appellate Authorities

6. Management Charges





Thank
You