



TRANSFER PRICING (TP) - MAINTENANCE OF DOCUMENTATION AND RULES RELATING TO COUNTRY

- BY - COUNTRY REPORT (CbCR)

CMA MRITYUNJAY ACHARJEE

Associate Vice President, Tax and Chief Internal Auditor, Balmer Lawrie Limited

Need for reporting International Transaction and Transfer Pricing

Increasing participation of multi-national groups in economic activities in India has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same group. Hence, there was a need to introduce a uniform and internationally accepted mechanism of determining reasonable, fair and equitable profits and tax in India in the case of such multinational enterprises. Accordingly, the Finance Act, 2001 introduced law of transfer pricing in India through sections 92A to 92F of the Indian Income Tax Act, 1961 which guides computation of the transfer price and suggests detailed documentation procedures. This article aims to provide a brief overview on the applicability of transfer pricing regulations in India, methods of determining the transfer price and the documentation procedures.

Transfer Pricing Regulations ("TPR") are applicable to the all enterprises that enter into an 'International Transaction' with an 'Associated

Enterprise'. Therefore, generally it applies to all cross border transactions entered into between associated enterprises. It even applies to transactions involving a mere book entry having no apparent financial impact. The aim is to arrive at the comparable price as available to any unrelated party in open market conditions and is known as the Arm's Length Price ('ALP').

Associated Enterprises ('AEs') - How Identified?

The basic criterion to determine an AE is the participation in management, control or capital (ownership) of one enterprise by another enterprise. The participation may be direct or indirect or through one or more intermediaries.

The concept of control adopted in the legislation extends not only to control through holding shares or voting power or the power to appoint the management of an enterprise, but also through debt, blood relationships, and control over various components of the business activity performed by the taxpayer such as control over raw materials, sales and intangibles. It appears that one may go to

any layer of management, control or ownership in order to find out association.

- (a) Direct Control
- (b) Through Intermediary

Understanding What is an International Transaction?

An international transaction is essentially a cross border transaction between AEs in any sort of property, whether tangible or intangible, or in the provision of services, lending of money etc. At least one of the parties to the transaction must be a non-resident entering into one or more of the following transactions.

- a) Purchase, sale or lease of Tangible or Intangible Property
- b) Provision of services
- c) Lending or borrowing of money
- d) Any transaction having a bearing on profits, income, losses or assets
- e) Mutual agreement between AEs for allocation/apportionment of any cost, contribution or expense.

Methods applied for determining Arms Length Price

In accordance with internationally accepted principles, the TPR have provided that any income arising from an international transaction between AEs shall be computed having regard to the ALP, which is the price that would be charged in the transaction if it had been entered into by unrelated parties in similar conditions.

The ALP is to be determined by any one or more of the prescribed methods. The taxpayer can select the most appropriate method to be applied to any given transaction, but such selection has to be made taking into account the factors prescribed in the TPR. With a view to allow a degree of flexibility in adopting the ALP, a variance allowance of 5 percent has been provided under the TPR.

The prescribed methods have been listed below

- a) Comparable Uncontrolled Price Method ('CUPM')
- b) Resale Price Method ('RPM')
- c) Cost plus method ('CPM')
- d) Profit Split Method ('PSM')
- e) Transactional Net Margin Method ('TNMM')

Documentation needed for presenting Transfer Pricing

The provisions contained in the TPR are exhaustive as far as the maintenance of documentation is concerned. This includes background information on the commercial environment in which the transaction has been entered into, information regarding the international transaction entered into, the analysis carried out to select the most appropriate method and to identify comparable transactions, and the actual working out of the ALP of the transaction. This also includes report of an accountant certifying that the ALP has been determined in accordance with the TPR and that prescribed documentation has been maintained. This documentation should be retained for a minimum period of 8 years.

However, it may be noted that in case the value of the international transaction is below INR 10 million, it would be sufficient for the taxpayer to maintain documentation and information which substantiates his claim for the ALP adopted by him. In effect, they need not maintain the prescribed documentation.

Burden of proof of correctness of the documentation

The primary onus is on the taxpayer to determine an ALP in accordance with the TPR and to substantiate the same with the prescribed documentation. Where such onus is discharged by the taxpayer and the data used for determining the ALP is reliable and correct, there can be no intervention by the tax officer.

However, where the tax officer is of the view that the

- a) price charged in the international transaction has not been determined in accordance with the methods prescribed,
- b) or information and documents relating to the international transaction have not been kept and maintained by the assessee in accordance with the TPR,
- c) or the information or data used in computation of the ALP is not reliable or correct,
- d) or the assessee has failed to furnish any information or document which he was required to furnish under the TPR the tax officer may reject the ALP adopted by the assessee and determine the ALP in accordance with the TPR. For this purpose, he would then refer the

matter to a Transfer Pricing Officer ('TPO') (a special post created for valuation of ALP) who would determine the ALP after hearing the arguments of the taxpayer.

In case the ALP determined by the TPO indicates understatement of income by the taxpayer, it could result into the following:

- a) Adjustment to reported income of the taxpayer
- b) Levy of penalty

The tax officer is bound to adjust the reported income of the taxpayer with the amount of adjustment proposed by the TPO. This would have an effect of increasing the assessed income or

alternatively decreasing the assessed loss. Furthermore, the eligible deductions available to the taxpayer under section 80 could not be availed on the enhanced income. However, those taxpayers who are eligible for deductions under section 10A and 10B remain unaffected as these deductions remain available on the enhanced income.

Transfer Pricing documentation

Objective is to ensure towards Developing transfer pricing documentation and defence files, aligned with global and local requirements, coordinated across all the territories in which the entity is operating:

Documentation requirement under Section 92D read with Rule 10D

10D(1)(a)	A description of the ownership structure of the assessee enterprise („AE“) with details of shares or other ownership interest held therein by other enterprises.
10D(1)(b)	A profile of the MNC group of which the assessee enterprise is a part along with the name, address, legal status and country of tax residence of each of the enterprises comprised in the group with whom international transactions have been entered into by the assessee and ownership linkages among them.
10D(1)(c)	A broad description of the business of the assessee and the industry in which the assessee operates, and of the business of the AE with whom the assessee has transacted.
10D(1)(d)	The nature and terms (including prices) of international transactions entered into with each AE, details of property transferred or services provided and the quantum and the value of each such transaction or class of such transaction.
10D(1)(e)	A description of the functions performed, risks assumed and assets employed or to be employed by the assessee and by the AE involved in the international transaction.
10D(1)(g)	Complete record of the uncontrolled transactions taken into account for analysing their comparability with the international transactions entered into, including a record of the nature, terms and conditions relating to any uncontrolled transaction with third parties which may be of relevance to the pricing of the international transactions.
10D(1)(h)	A record of the analysis performed to evaluate comparability of uncontrolled transactions with the relevant international transaction.
10D(1)(i)	A description of the methods considered for determining the arm's length price (ALP) in relation to each international transaction or class of transaction, the method selected as the most appropriate method along with the explanations as to why such method was so selected, and how such method was applied in each case.
10D(1)(j)	A record of the actual working carried out for determining the ALP, including details of the comparable data and financial information used in applying the most appropriate method, and adjustments, if any, which were made to account for difference between international transactions, or between the enterprises entering into such transactions
10D(1)(k)	The assumptions, policies and price negotiations, if any, which have critically affected the determination of the ALP.
10D(1)(l)	Details of the adjustments, if any, made to transfer prices to align them with ALP determined under these rules and consequent adjustment made to the total income for tax purposes.
10D(1)(m)	Any other information, data or document, including information or data relating to the AE, which may be relevant for determining ALP.

Documentation Requirement for Transfer Pricing

- A detailed description of the ownership of the entity with details of shares or other ownership interests held therein by other enterprises.
- A profile of the multinational group of which the entity is a part along with the name, address, legal status and tax residence of each of the enterprises comprised in the group with whom specified domestic transactions have been entered into by the entity and ownership linkages among them.
- A broad description of the business of the entity and the industry in which the entity operates, and of the business of the associated enterprises with whom the entity has transacted.
- The nature and terms (including prices) of specified domestic transactions entered into with each associated enterprise, details of property transferred or services provided and the quantum and the value of each of such transaction or class of such transaction.
- A description of the functions performed, risks assumed and assets employed or to be employed by the entity and by the associated enterprises involved in the specified domestic transaction.
- A record of the economic and market analyses, forecasts, budgets or any other financial estimates prepared by the entity for the business as a whole and for each division or product separately, which may have a bearing on the specified domestic transactions entered into by the entity.
- A record of uncontrolled transactions taken into account for analysing their comparability with the specified domestic transactions entered into, including a record of the nature, terms and conditions relating to any uncontrolled transaction with third parties which may be of relevance to the pricing of the specified domestic transactions.
- A record of the analysis performed to evaluate comparability of uncontrolled transactions with the relevant specified domestic transaction.
- A description of the methods considered for determining the arm's length price in relation to each specified domestic transaction or class of transaction, the method selected as the most appropriate method along with explanations as to why such method was so selected, and how such method was applied in each case.
- A record of the actual working carried out for determining the arm's length price, including

details of the comparable data and financial information used in applying the most appropriate method, and adjustments, if any, which were made to account for differences between the specified domestic transaction, and the comparable uncontrolled transactions, or between the enterprises entering into such transactions.

- The assumptions, policies and price negotiations, if any, which have critically affected the determination of the arm's length price.
- Details of the adjustments, if any, made to transfer prices to align them with arm's length prices determined under the Income-tax Rules and consequent adjustment made to the total income for tax purposes.
- Any other information, data or document, including information or data relating to the associated enterprise, which may be relevant for determination of the arm's length price.

Penalty for Not Maintaining Documents

As mentioned above, entities entering into international transactions are required to maintain certain documents as listed above. Failure to maintain such document or failure to report or furnishing incorrect information can attract a penalty of upto 2% of the value of each transaction, where non compliance exists.

Penalty for Not Producing Documents

Tax authorities may, in the course of any proceeding, require any person who has entered into international transactions to furnish any related information or document. The taxpayer must furnish such information or document within a period of 30 days from the date of receipt of a notice. Failure to furnish information can attract a penalty equal to 2% of the value of the specified transaction for each such failure.

Changing documentation regime – Country by Country Reporting Rules [CbCR] under the BEPS initiative:

The Central Board of Direct Taxes (CBDT) had issued draft rules relating to Master File and country by country (CrbC) reporting Rules on 6th October, 2017. The CBDT has invited comments & suggestions from the public on such draft rules, to be submitted by 16th October, 2017. This new Rule is in line with

the BEPS Action Plan. The term BEPS stands for “Base erosion and profit shifting (BEPS)” which refers to tax planning strategies used by multinational companies, that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity.

Following are some of the basic thoughts & observations on the draft rules:

Information and documents to be kept and maintained under proviso to sub - section (1) and to be furnished in terms of sub -section (4) of Section 92D.

Master file

In accordance with Action 13, the master file should provide an overview of the MNE group business, its overall TP policies, and its global allocation of income and economic activity in order to place the MNE group’s TP practices in their global economic, legal, financial and tax context. The master file shall contain information which need not be restricted to the transaction undertaken by a particular constituent entity situated in particular country. In that aspect, information in the master file would be more comprehensive than typical current documentation standards.

Taxpayers who are subject to master file compliance in India

Under the ITL, as amended through *Finance Act, 2016*, entities that are constituents of an international group, shall be required to maintain such information and documents as prescribed (i.e., master file) in addition to the information related to the international transactions undertaken by such constituent entity in the contemporaneous local documentation. The Draft Rules provide that the master file requirements apply to every taxpayer, being a constituent entity of an international group, if the following two conditions are satisfied:

- The consolidated revenue of the international group, of which such taxpayer is a constituent entity, as reflected in the consolidated financial statement of the international group for the accounting year preceding such previous year, exceeds INR5 billion (approx. US\$76.9 million).
- Either of the below transactional threshold is achieved for the reporting year:

- The aggregate value of international transactions as per the books of accounts maintained by the taxpayer exceeds INR500 million (approx. US\$7.7 million).
- The purchase, sale, transfer, lease or use of intangible property (IP) as per the books of accounts maintained by the taxpayer exceeds INR100 million (approx. US\$1.5 million).

Upon meeting the above thresholds, each taxpayer, being a constituent entity of an international group resident in India, would be required to maintain the prescribed information and documents as part of the master file for annual compliance purposes.

Every person, being a constituent entity of an international group shall,

(i) if the consolidated revenue of the international group, of which such person is a constituent entity, as reflected in the consolidated financial statement of the international group for the accounting year preceding such previous year, exceeds five hundred crore rupees; and

(ii) the aggregate value of international transactions, (A) during the reporting year, as per the books of accounts, exceeds fifty crore rupees, or

(B) in respect of purchase, sale, transfer, lease or use of intangible property during the reporting year, as per the books of accounts, exceeds ten crore rupees, keep and maintain the following information and documents of the international group:

a) list of all the operating entities of the international group along with their addresses;

(b) a chart depicting the legal status of the constituent entity and ownership structure of the entire international group;

(c) a description of the business of international group during the reporting accounting year including,

(I) the nature of the business or businesses;

(II) the important drivers of profits of such business or businesses;

(III) a description of the supply chain for the five largest products or services of the international group in terms of revenue plus any other products and/or services amounting to more than five per cent of group turnover or revenue;

(IV) a list and brief description of important service arrangements among members of the international group, other than those for research and development services;

(V) a description of the capabilities of the main service providers within the international group;
(VI) details about the transfer pricing policies for allocating service costs and determining prices to be paid for intra-group services;
(VII) a list and description of the major geographical markets for the products and services offered by the international group;
(VIII) a description of the functions performed, assets employed and risks assumed by the constituent entities of the international group that contribute at least ten per cent of the revenues, assets and profits of the group; and
(IX) a description of the important business restructuring transactions, acquisitions and divestments during the accounting year;

(d) a description of the overall strategy of the international group for the development, ownership and exploitation of intangibles, including location of principal research and development facilities and their management;
(e) a list of all the entities of the international group engaged in development and management of intangibles along with their addresses;
(f) a list of all the important intangibles or groups of intangibles owned by the international group along with the names and addresses of the group entities that legally own such intangibles;
(g) a list and brief description of important agreements among members of the international group related to intangibles, including cost contribution arrangements, principal research service agreements and license agreements;
(h) a detailed description of the transfer pricing policies of the international group related to research and development and intangibles;
(i) a description of important transfers of interest in intangibles, if any, among entities of the international group, including the name and address of the selling and buying entities and the compensation paid for such transfers;
(j) a detailed description of the financing arrangements of the international group, including the names and addresses of the top ten unrelated lenders;
(k) a list of group entities that provide central financing functions, including their place of operation and of effective management;
(l) a detailed description of the transfer pricing policies of the international group related to financing arrangements among group entities;
(m) a copy of the annual consolidated financial statement of the international group; and

(n) a list and brief description of the existing unilateral advance pricing agreements and other tax rulings in respect of the international group for allocation of income among countries.

The report of the information referred to in this rule shall be submitted in Form No. 3CEBA and it shall be furnished to the Director General of Income-tax (Risk Assessment) on or before the due date for furnishing the return of income as specified in sub-section (1) of section 139 of the Act, Provided that the information in Form No. 3CEBA for the reporting accounting Year 2016-17 may be furnished at any time on or before the 31st day of March, 2018.

Furnishing of Report in respect of an International Group. [Rule 10DB.]

Every constituent entity resident in India, shall, if its parent entity is not resident in India, notify the Director General of Income - tax (Risk Assessment) in Form 3CEBB, the following, namely:

- (a) whether it is the alternate reporting entity of the international group; or
 - (b) the details of the parent entity or the alternate reporting entity, as the case may be, of the international group and the country or territory of which the said entities are residents.
- 2) The notification referred to in sub rule shall be made on or before sixty days prior to the due date for furnishing of report as prescribed.
- (3) Every parent entity or the alternate reporting entity, as the case may be, resident in India, shall, for every reporting accounting year, furnish the report as prescribed.

Rule 10DB(2) proposes that every constituent entity resident in India, belonging to a non-resident international group, would need to notify the Indian Tax Administration, by filing Form No 3CEBB, of whether it is the alternate reporting entity for the purposes of filing CbC report in India; or whether the said obligation shall be fulfilled in another country, either by the non-resident parent entity or any other alternate constituent entity, on or before 60 days prior to the due date of furnishing the CbC report.