



**THE INSTITUTE OF
COST ACCOUNTANTS OF INDIA**

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Certificate Course on International Trade



Transfer Pricing

What is Transfer Pricing?

- Transfer pricing is a practice used by multinational companies to determine the prices of goods, services, or intellectual property transferred between their different subsidiaries or divisions located in different countries.
- When two related entities enter into any cross border transaction, the price at which they undertake their transaction is called transfer price.
- Due to the special relationship between related companies, transfer price may be different than the price that would have been agreed between two unrelated companies.

Definition: as per OECD

"Prices at which an enterprise transfers physical goods and intangibles or provides services to associated enterprises"

**Definition:
as per Sec.92 of the Income Tax Act, 1961**

"Any income arising from an international transaction shall be computed having regard to the arm's length price"

Why Transfer Pricing?

- T.P Manipulation can affect the tax liability of an Individual or Group of Persons / Entities.
- Conflicting Govt. Pressures relating to Customs valuations, anti-dumping duties and exchange or price controls.
- Cash Flow requirements of MNE Group.
- Factors responsible for TP Mis-pricing - UN TP 2017
 - Rapid advances in technology, transportation and communication
 - Existence of Tax Heavens and Tax Friendly Jurisdiction
 - Dominance of MNCs in World Trade
 - Rise of Service Sector

Rationale For TP Regulations

- Differences in tax rates across tax jurisdictions.
- Pricing flexibility between associated enterprises.
- Every government wants to prevent erosion of their tax base and plug potential tax leakages.

Nature of Transfer Pricing

- Transfer pricing is a complex issue which requires knowledge of multiple disciplines
 - Taxation Issue
 - Accounting Issue
 - Economic Issue
 - Legal Issue
 - Statistical Issue
- Over a period of time, it is becoming more and more mathematical and statistical issue.

Evolution of Transfer Pricing

- It is estimated that, 60 % of international trade is carried on between related or Associated Enterprises (AEs)
- To counter the effect of transfer of profits using favorable transfer prices among AEs, many developing and developed countries introduced Transfer Pricing Regulations (TPR)
- The TPR have increased the burden of proof on taxpayers, to demonstrate arm's length price of controlled transaction
- Price between unrelated parties in uncontrolled conditions is known as the “arm's length price”

Evolution of Transfer Pricing - OECD's View

- Transfer pricing can deprive governments of their fair share of taxes from global corporations and expose multinationals to possible double taxation. No country - poor, emerging or wealthy - wants its tax base to suffer because of transfer pricing. The arm's length principle can help.



TRANSFER PRICING REGULATIONS IN INDIA

Background of Indian TPR

- Liberalization of trade and foreign exchange policy started in India in the year 1991
- This created huge increase in interest of MNEs in India
- The Standing Committee in March 1991 observed that provisions of Income Tax Act, 1961(Act) were inadequate to curb transfer pricing among MNEs

Brief History of Transfer Pricing

- The Expert Group constituted by Central Board Of Direct Taxes (CBDT) recommended complete revision of existing section 92 of the Act
- The Finance Act, 2001 introduced TPR in India by substituting existing Section 92 of the Act and introducing new sections 92A to 92F w.e.f 01.04.2002

Scheme of TP regulations in India

- Relevant Provisions

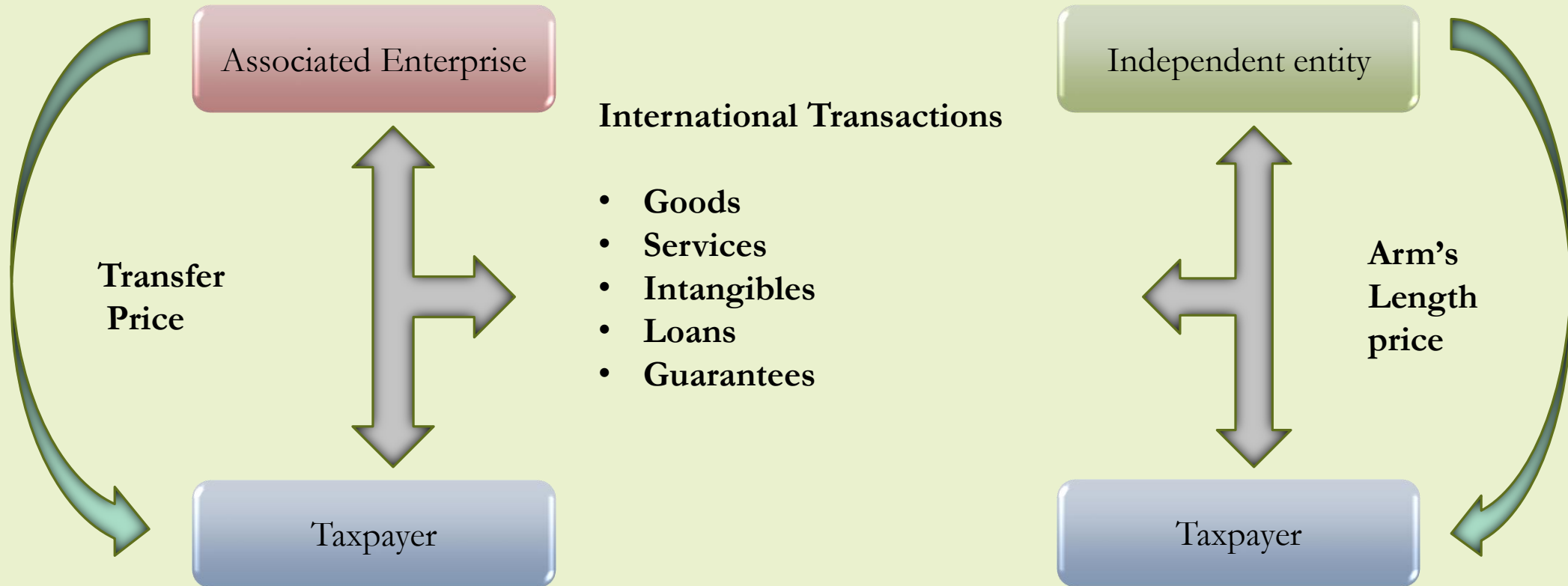
- Computation of Income from International Transaction having regard to ALP Sec.92
- Associated Enterprises Sec. 92A
- International Transaction Sec. 92B
- Specified Domestic Transactions Sec. 92BA
- Arm's Length Price - Sec. 92C + Rule 10B/ 10C
- Power of AO and TPO - Sec. 92CA
- Safe Harbour Sec. 92CB + Rules 10TA to 10TG
- Advance Pricing Agreements Sec. 92CC and CD+ Rules 10F to 10T
- Secondary Adjustment – Sec. 92CE
- Documentation and Certificate Sec. 92D and Sec. 92E
- Definitions of certain terms relevant to computation of ALP etc. Sec.92F
- Dispute Resolution Panel - Sec. 144C
- Penalties - Sec. 271 (1) (c), 271AA, 271BA, 271G, 271GB
- Furnishing of report in respect of International Group – Sec.286

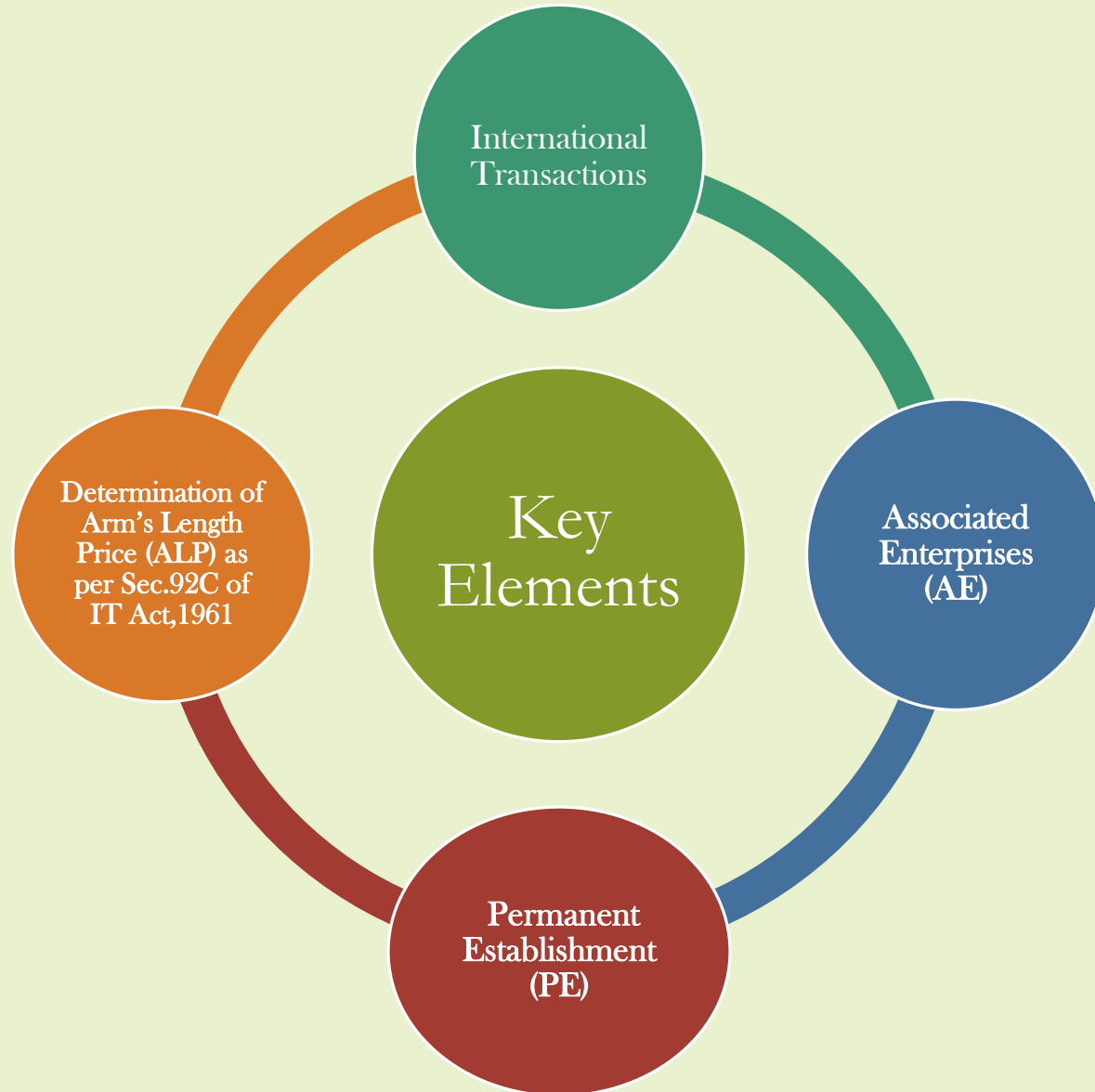
Scheme of TP regulations in India

- Relevant Provisions

- Rule 10A - Meaning of expressions used in computation of arm's length price
- Rule 10AB - Method of determination of arm's length price
- Rule 10B - Determination of arm's length price under section 92C .
- Rule 10C - Most appropriate method
- Rule 10CA - Computation of arm's length price in certain cases
- Rule 10D - Information and documents to be kept and maintained under section 92D .
- Rule 10DA&DB - Information and documents to be kept and maintained under section 92D & Furnishing of Report in respect of an International Group
- Rule 10E - Report from an accountant to be furnished under section 92E.
- Rule 10F to T - Advanced Pricing Agreement
- Rule 10TA to TG - Safe Harbour rules for International transaction
- Rule 10TH to THD- Safe Harbour rules for SDT

Concept of Transfer Pricing





Meaning of Associated enterprise(AE) Sec.92A(1)

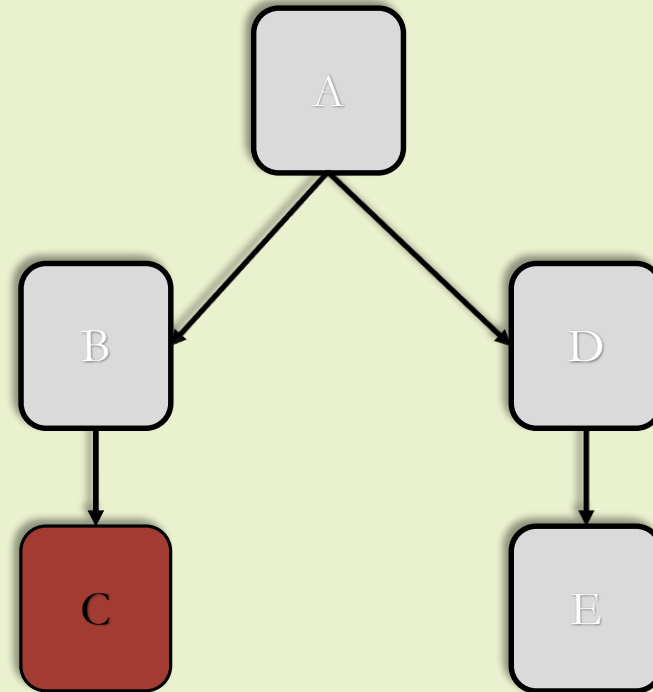
Direct or indirect participation, in management / control / capital of the other enterprise

OR

Direct or indirect participation of the same person(s), in management / control / capital of both enterprises



Both A & B are
AE's of C B -
Direct
A - Indirectly



D & E are also
AE's of C
Ultimate
parent (A)

Deemed AE - Sec.92A(2)

Holding

- $\geq 26\%$ Direct/ Indirect holding by enterprise (OR)
- By SAME PERSON in each enterprise
- LOAN $\geq 51\%$ of total assets
- GUARANTEES $\geq 10\%$ of debt
- $> 10\%$ INTEREST in Firm/ AOP/ BOI

Management

- Appointment $> 50\%$ of DIRECTORS / one or more Executive Director by an enterprise
- (OR)
- Appointment by same person in each enterprise

Activities

- 100% DEPENDENCE on use of Intangibles for manufacture / processing/ business
- Direct/ Indirect Supply Of $\geq 90\%$ RAW MATERIALS under influenced prices and conditions
- Sale under INFLUENCED prices and conditions

Control

- One enterprise controlled BY AN INDIVIDUAL and the other by himself or his relative or jointly
- One enterprise controlled BY HUF and the other by - a member of HUF his relative or Jointly by member and relative

WAIT & THINK!



Brat Inc. of U.K. holds 9% shares in Pit Ltd. of India. The total book value of Assets of Pit Ltd., is Rs. 57,25,000. Brat Inc. of U.K. has given a loan to Pit Ltd. of Rs. 30,00,000. Examine whether Brat Inc and Pit Ltd. are associated enterprises.

Transfer pricing provisions are applicable on transactions between

The loan amount is more than 51% of the book value of the total assets of the Indian company, Brat Inc. and Pit Ltd. are deemed to be Associated Enterprises.

- A- two group companies of same MNE
- B - a foreign company and its branch office
- C - an Indian company and its subsidiary availing tax holidays
- D - all of the above



International transaction Sec. 92B

- Between 2 AE's (either or both NR)
- Transaction involves :
 - Purchase/ sale/ lease of tangible/intangible property
 - Provision of services
 - Lending or borrowing money
 - Any other transaction having a bearing on profit/ income/ losses/ assets of the enterprise
 - Includes mutual agreement or arrangement for allocation or apportionment , or any contribution to, any cost or expense incurred
- Scope expanded in Finance Act, 2012 to include - intangibles like marketing intangibles, human capital, Business restructuring, inter-company guarantees, capital funding, etc.

International transaction Sec. 92B

Section 92B(1)- International transaction

“a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or lease

Section 92A(1) – Associated Enterprise

“AE in relation to another enterprise, means an enterprise which participates....in the management or control or capital of the other enterprise.....”

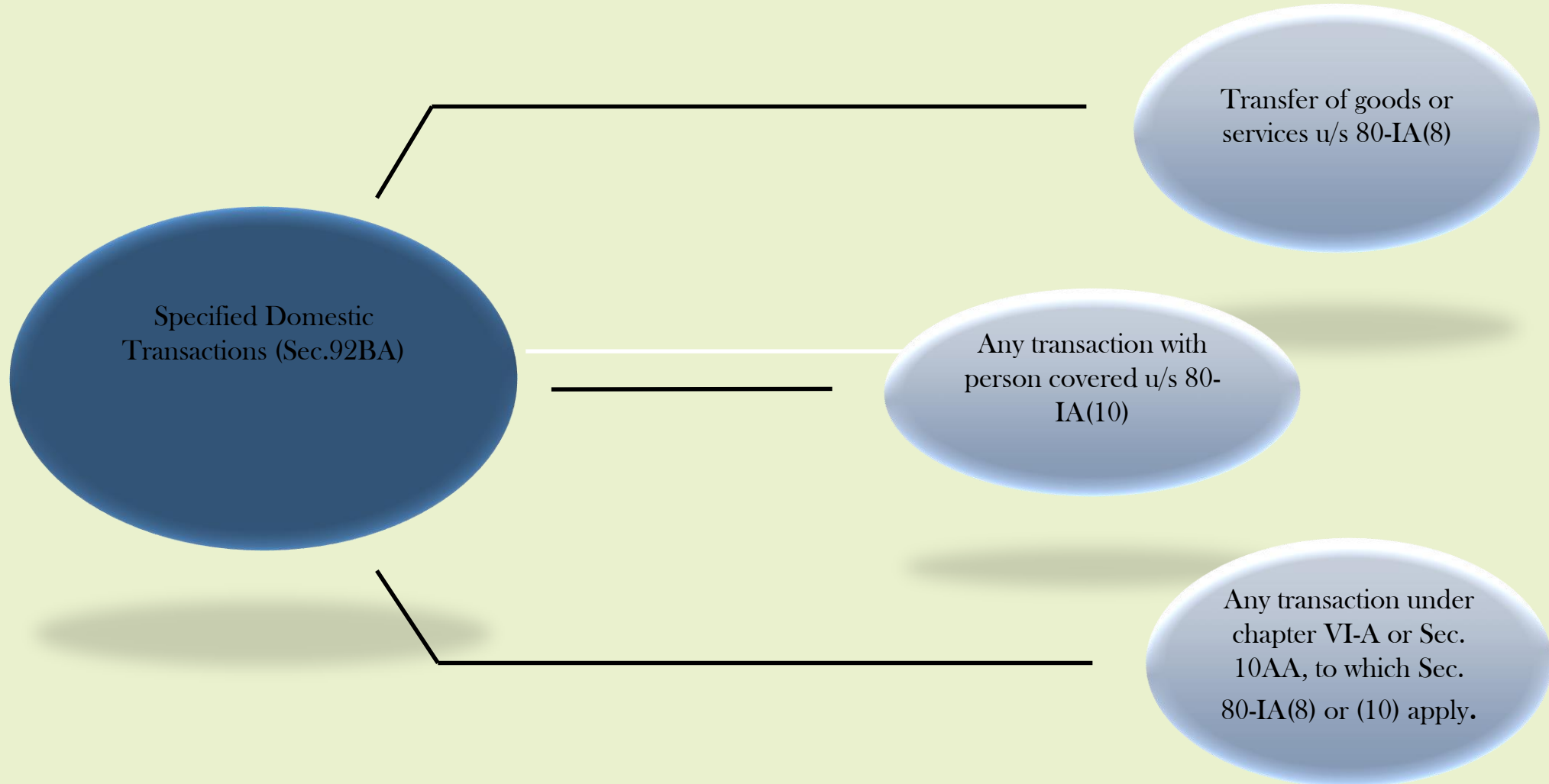
Section 92F(iii) – Enterprise

“enterprise means a person (including a permanent establishment of such person) who is, or has been, or is proposed to be, engaged in any activity....”

Deemed international transaction Sec.92B(2)

- Synopsis:
 - Transaction between enterprise and unrelated third party
 - But, there exists a agreement between AE and the third party (or) terms of such transaction are determined by AE and the third party
 - Either Enterprise or AE or both are Non-Residents
 - Third party can be Non-resident or Resident
 - Clarified by Finance Act 2014, that deemed international transactions would also cover cases where both the contracting parties are residents

Specified Domestic Transactions (Sec.92BA)



Arm's Length Price - ALP

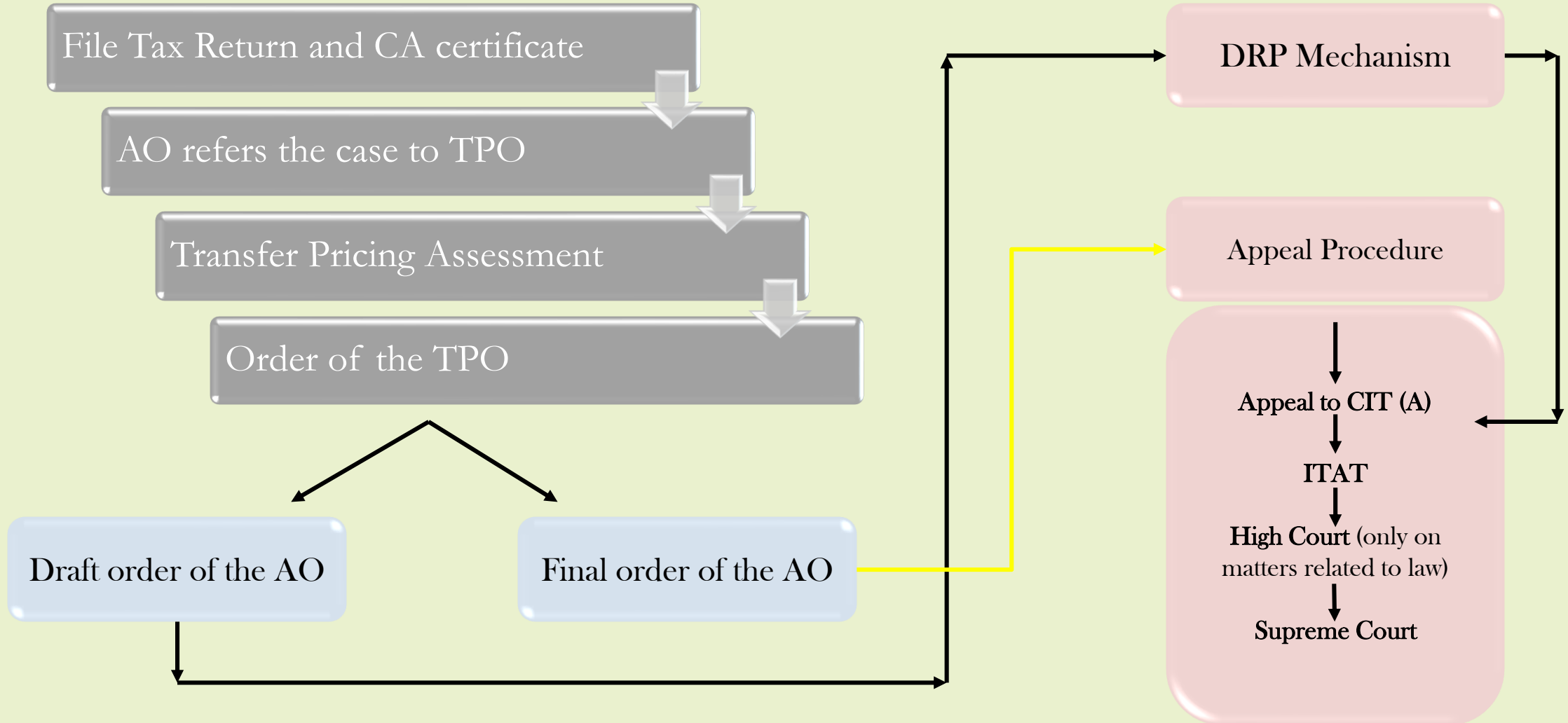
- Sec. 92F(ii) "arm's length price" means a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions;
- ALP is found in paragraph 1 of article 9 of the OECD MC which reads as under:
 - “[Where] conditions are made or imposed between the two [associated] enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.”
- The principle laid out above in the UN Model has also been reiterated in the OECD Model Tax Convention and the OECD Guidelines as supplemented and amended.

Why Arm's Length Pricing?

- The basic object of determining Arm's Length Price is to find out whether any addition to income is warranted or not, if the following situations arises:
- Selling Price of the Goods < Arm's Length Price
- Purchase Price > Arm's Length Price

Total Income as disclosed by an Assessee	XXX
Add: Understatement of profit due to overstatement of purchase price	XXX
Add: Understatement of profit due to understatement of selling price	XXX
Total Income after Assessment	XXX

Transfer Pricing Compliance



Determination of Arm's Length Price as per Sec.92C(1) of the Income Tax Act, 1961 (framed as per the OECD Guidelines)

- Methods:
 - – Comparable Uncontrolled Price - CUP
 - – Resale Price Method - RPM
 - – Cost Plus Method - CPM
 - – Profit Split Method - PSM
 - – Transactional Net Margin Method - TNMM
 - – Other method



OECD Stands for-
Organization for
Economic Co-
operation and
Development

CUP Method

- The CUP method requires comparison of the price charged in a controlled transaction vis-à-vis the price charged in a comparable uncontrolled transaction in comparable circumstances.
- High degree of comparability of products and functions are required.
- Differences are allowed if 1) they do not materially affect the price in the open market; 2) effect on price can be reliably measured & adjusted.
- In practice there are two types of comparable uncontrolled transactions 1) Internal Comparable; and 2) External comparable.

RPM Method

- The RPM begins with the price at which a product that has been purchased from an AE is resold to an independent enterprise
- **The resale price (the resale price) is reduced by an appropriate gross margin (the resale price margin) representing the amount out of which the reseller would seek to cover its selling and other operating expenses.** The result can be regarded as an **arm's length price of the transfer of goods between the associated enterprises**

Cost Plus Method

- The CPM determines the arm's length price of products manufactured / services rendered in a controlled transaction by comparing the gross profit margin applied to the direct and indirect costs incurred for production or for rendering services by the tested party against the margin earned by the party or by an independent party under uncontrolled similar conditions. This is a preferred method in case of Semi finished goods sold between related parties and Contract/ toll manufacturing agreement.

Profit Split Method

- The PSM is applicable in transactions involving transfer of unique intangibles or in multiple transactions, which are so interrelated that they cannot be evaluated separately for determining the arm's length price of any one transaction.
- Allocates the combined operating profits or losses from controlled transactions in proportion to the relative contributions made by each party **in creating the combined profits or losses**

Transaction Net Margin Method (TNMM)

- The TNMM uses net profitability levels from comparable transactions to establish an arm's length result against which the profitability of the tested party is compared. The net profit margin in relation to an appropriate base, i.e., cost, sales, assets, etc., from a controlled transaction is compared with the net profit margin on the similar base from an uncontrolled transaction of the taxpayer, or between two independent third parties. When functional analysis of the parties in controlled transaction and uncontrolled transactions result in any differences, necessary adjustments are required to be made to establish reliable results.

Other Method

- With the introduction of Rule 10AB(2) of the Rules, it is possible to use "any method" which takes into account (i) the price which has been charged or paid, or (ii) would have been charged or paid for the same or similar uncontrolled transactions, with or between non-AEs, under similar circumstances, considering all the relevant facts.
- It is relevant to note that the text of Rule 10AB of the Rules does not describe any methodology but only provides an enabling provision to use any method that has been used or may be used to arrive at the price of a transaction undertaken between non-AEs. Hence, it provides flexibility to determine the price in complex transactions where third party comparable prices or transactions may not exist.

Selection of Most Appropriate Method (MAM)

Relevant factors	Explanation
(a) The nature and class of international transactions	e.g., if a product is sold in controlled transactions is identified to have a close similarity to the product in uncontrolled transactions, the CUP method may be useful. Similarly, if a transaction concerns a retailer or distributor, the resale price method would be appropriate.
(b) Assets employed or risks assumed	The class or classes of associated enterprises entering into the transaction and the functions performed by them taking into account assets employed or to be employed and risk assumed by such enterprises.
(c) Availability, coverage and reliability of data necessary for application of the method	e.g., if the comparable data is not available in the public domain, in respect of comparable prices of uncontrolled transactions, the selection can be made from other methods.
(d) Degree of comparability	The degree of comparability existing between the international transaction and the uncontrolled transaction and between the enterprises entering into such transactions.
(e) Reliability and accuracy for adjustments	The extent to which reliable and accurate adjustments can be made to account for differences, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprises entering into such transactions.



TRANSFER PRICING PROCESS:
FAR ANALYSIS, DOCUMENTATION & FORM 3CEB

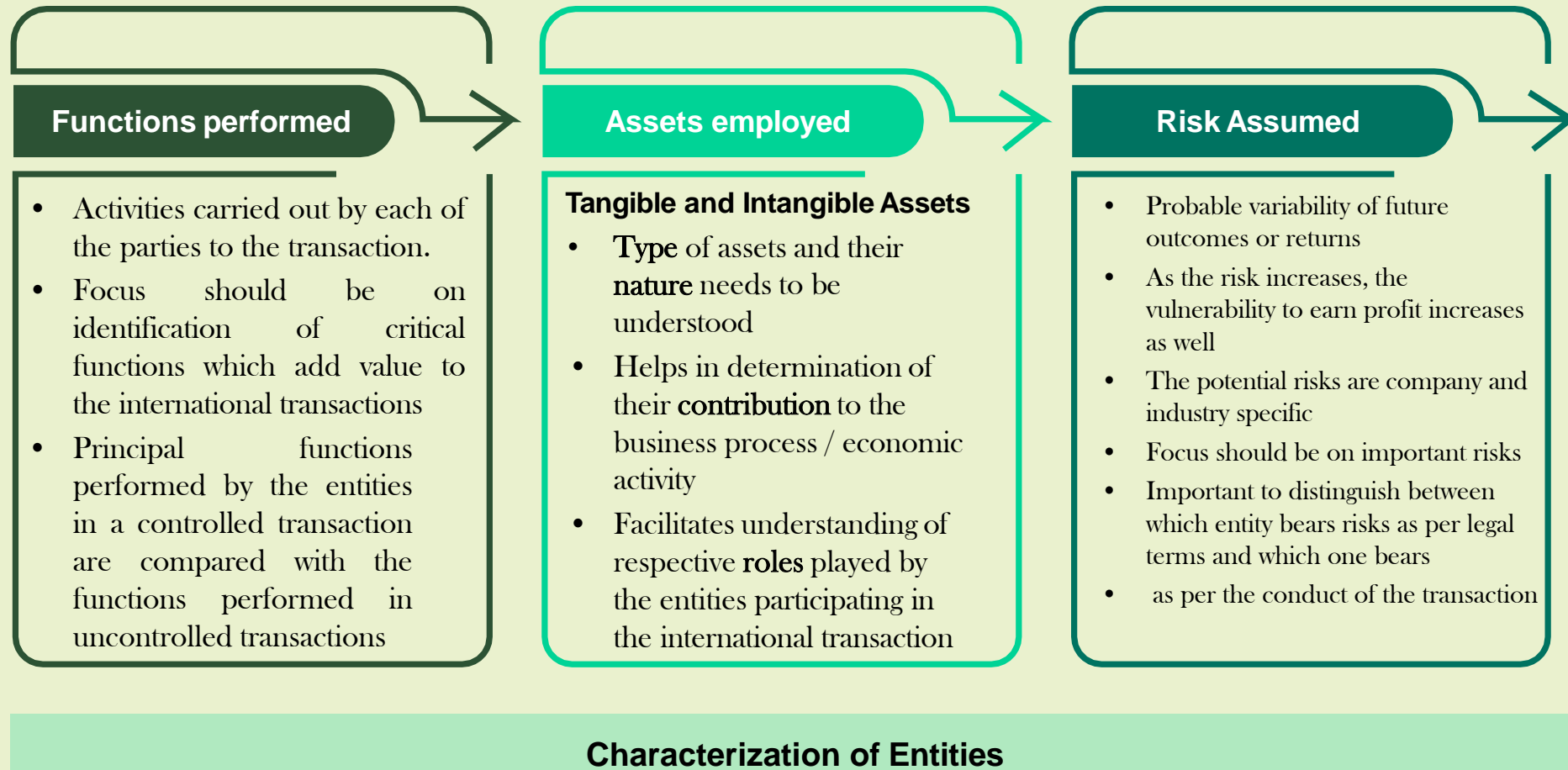
OECD Master File Considerations: Overview of The OECD Master File

- In October 2015, the Organization for Economic Co-operation and Development (OECD) released its final report on Action 13 of the Action Plan on Base Erosion and Profit Shifting (BEPS Action Plan)–Transfer Pricing Documentation and Country-by-Country Reporting.
- In response to the Action 13 mandate, the OECD created a three-tiered standardized approach to transfer pricing consisting of:
 - A Country-by-Country Report;
 - A Master File; and
 - Local Files

FAR Analysis – What?

- FAR Analysis is an exercise to determine and document significant economic activities performed by the enterprise and its associated enterprise('AEs') in an International Transaction
- Allocation of significant economic activities between those entities involved in the transaction, so each entity can be appropriately characterized
- Price charged in any transaction should reflect the functions performed (taking into account the risks assumed and assets used)

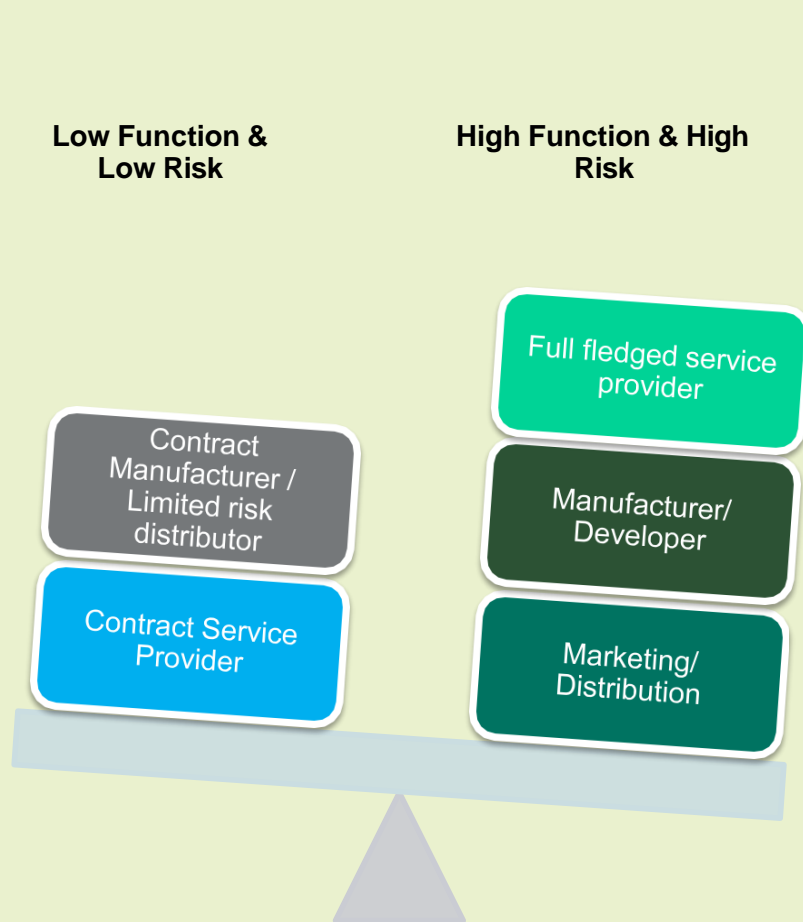
Components of Functional Analysis



FAR Analysis- Why?

- Rule 10B(2) of the Income Tax Rules, 1962 asserts on Importance of FAR Analysis:
- Comparability of an international transaction with an uncontrolled transaction shall be judged with reference to (among others):
 - Functions performed, taking into account assets employed and risks assumed, by both the parties to the transactions
- Para 1.36 (Chapter 1) of OECD TP Guidelines, 2017 lists functional analysis as one of the five factors for comparability analysis
- “The functions performed by each of the parties to the transaction, taking into account assets used and risks assumed, including how those functions relate to the wider generation of value by the MNE group to which the parties belong, the circumstances surrounding the transaction, and industry practices”

Why is FAR required in ALP analysis



Importance of FAR

Comprehensive FAR leads to in-depth understanding of the business and related commercial considerations

To identify any uncontrolled transaction involving one of the controlled parties

Allows appropriate characterization of the business. **This is one of the most important objective of a FAR**

Helps setting up of an appropriate pricing model for inter-company transactions

Robust FAR analysis - foundation of a sound value chain analysis and thereby a sound economic analysis

Documentation [Rule 10D]

Entity related	Price related	Analysis related	Supporting documents
<ul style="list-style-type: none">• Ownership structure• Profile of the MNC group• Description of business & the industry• Published F.S. of AE• Correspondence with AE	<ul style="list-style-type: none">• Nature & Terms (incl. prices)• FAR analysis• Economic and market analysis incl. forecasts and budgets	<ul style="list-style-type: none">• Record of uncontrolled transactions• Methods considered for ALP• Comparability analysis• Workings of ALP• the assumptions, policies and price negotiations – ALP• details of the adjustments, made<ul style="list-style-type: none">• any other information relevant for ALP	<ul style="list-style-type: none">• Official publications/ reports/ database – from govt. of AE• Market research reports by reputed institutions• Price publications incl. stock market quotations• Contracts with AE or unrelated parties w.r.t similar transactions• Documents normally issued

Report u/s 92E – Form 3CEB

- Opinion on maintenance of proper records w.r.t International and SDTs
- whether as per the transfer pricing documentation the prices of international transactions are at arm's length
- certifies the value of the international transactions as per the books of account and as per the transfer pricing documentation are “true and correct”
- Annexure –
 - Part A – Particulars of the assessee, incl. aggregate value of transactions
 - Part B & C – List of AE's , Specific details of international transactions & SDT incl. ALP & methods used.

TP policy, RPT policy, Intercompany Agreements and TP study – Similarities and Differences (1/2)

TP Policy



TP Policy provides guidelines on how prices are or will be set for RPT's within the group entities. Typically the transactions covered under TP policies are provision of management and technical services, secondment of staff, shared services, intercompany loans and guarantees, royalty, sale of goods or transfer of assets and so on.

RPT Policy



The listed entity is required to formulate a policy on materiality of related party transactions and on dealing with related party transactions (including clear threshold limits duly approved by the board).

Intercompany Agreements



An Intercompany Agreements are commercial agreements for transactions such as sale of goods, financing or intangible property made between companies related through ownership, under common control or part of the same group of companies.

TP Study



A transfer pricing study examines the pricing of international transactions entered between related two or more associates. By applying and documenting various test methods, it is determined whether the transactions are conducted under market conditions.

TP policy, RPT policy, Intercompany Agreements and TP study – Similarities and Differences (2/2)

TP Policy



The said policy, if implemented appropriately and being justified to be complied with the income-tax transfer pricing provisions, should serve a great piece of documentation that the GST authorities/MCA authorities can rely upon.

RPT Policy



The differing definitions of the term 'Related Party' under different accounting standards together with concept of 'control' is a matter of judgement. Hence interplay of the policy with TP requires careful consideration and analysis.

Intercompany Agreements



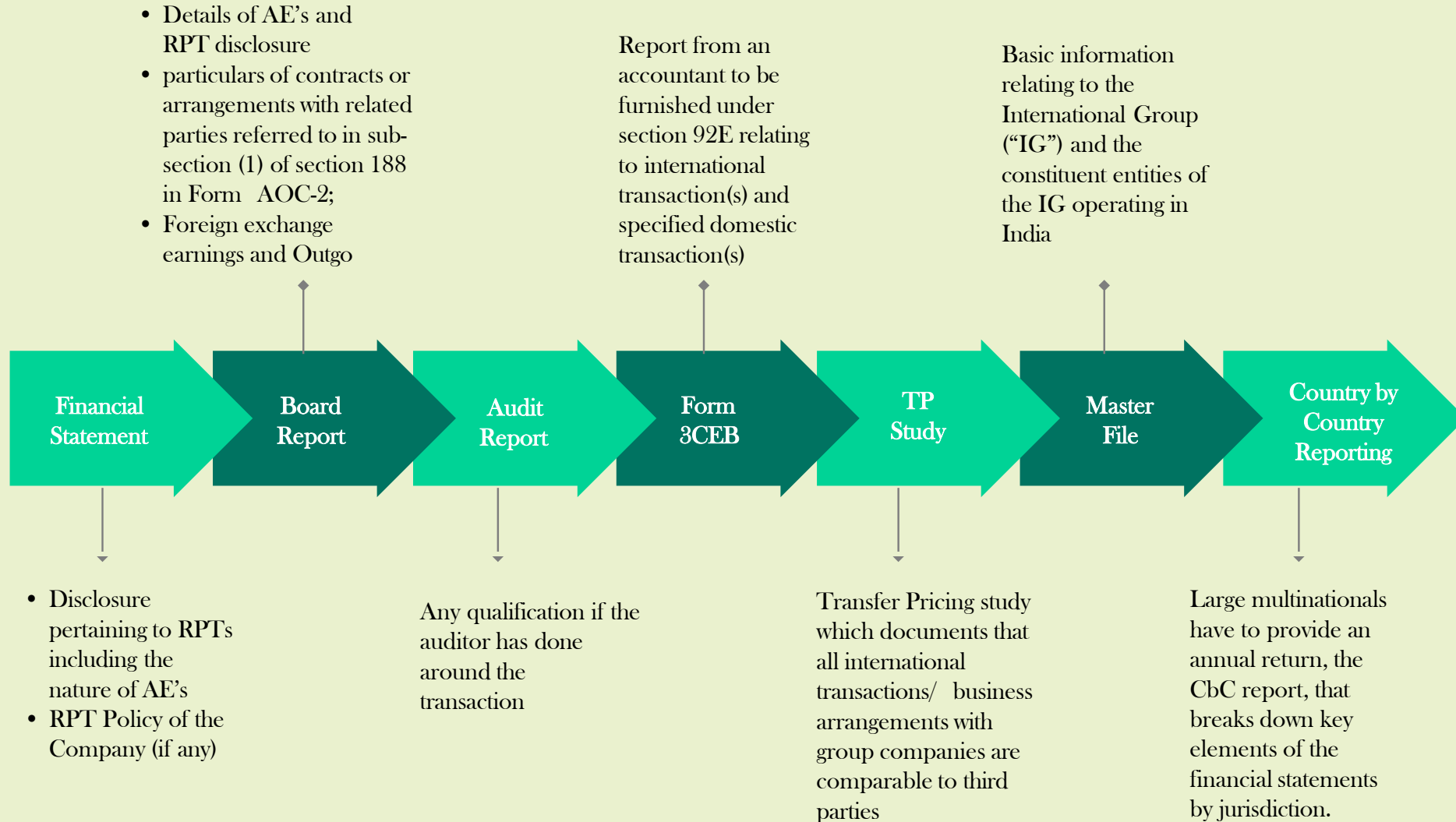
Intercompany agreement identify the parties and the scope of the services that is being rendered/availed. The scope mentioned in the agreement therefore should mirror in the RPT Policy, TP Policy and in the TP Study.

TP Study

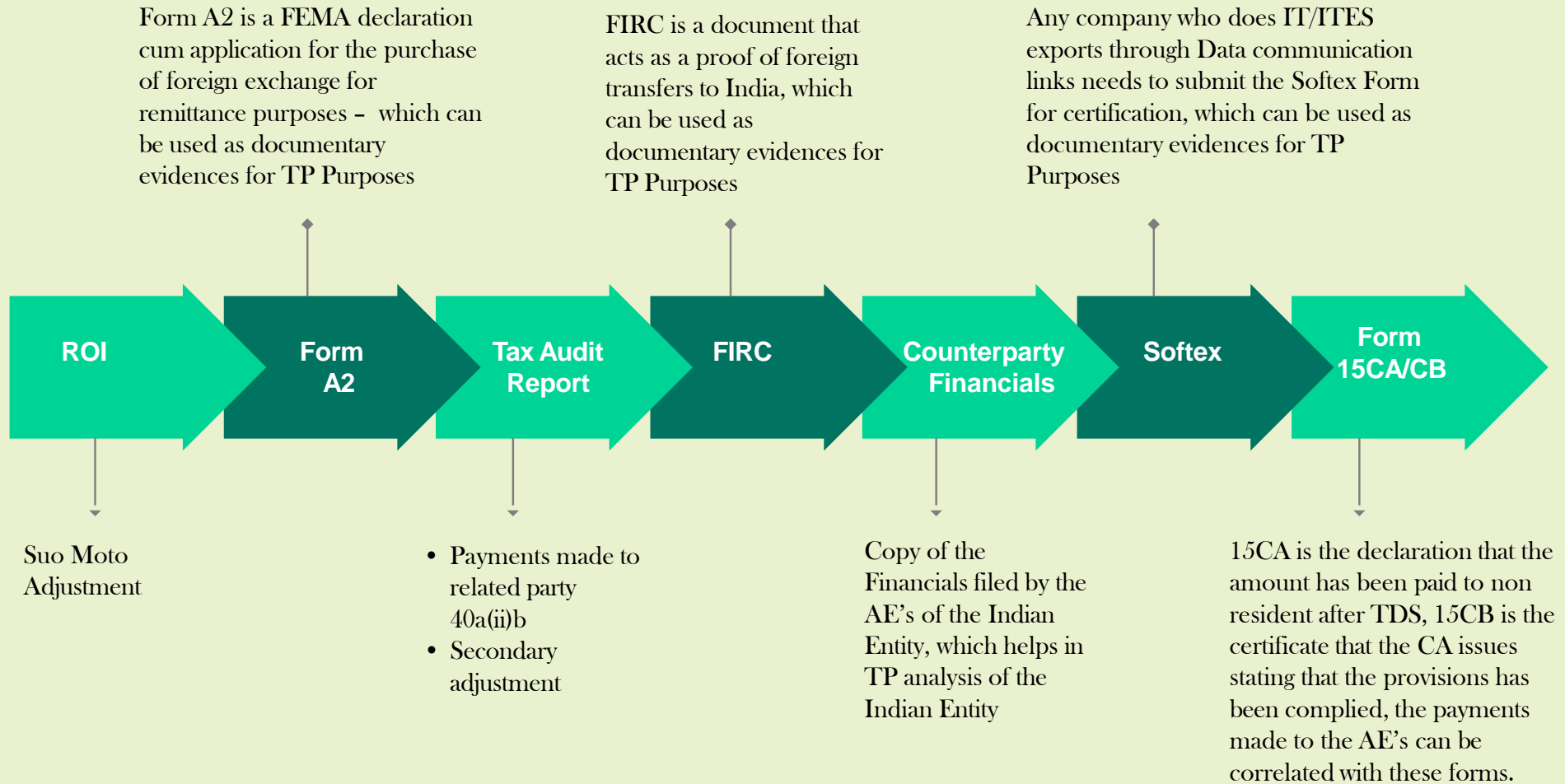


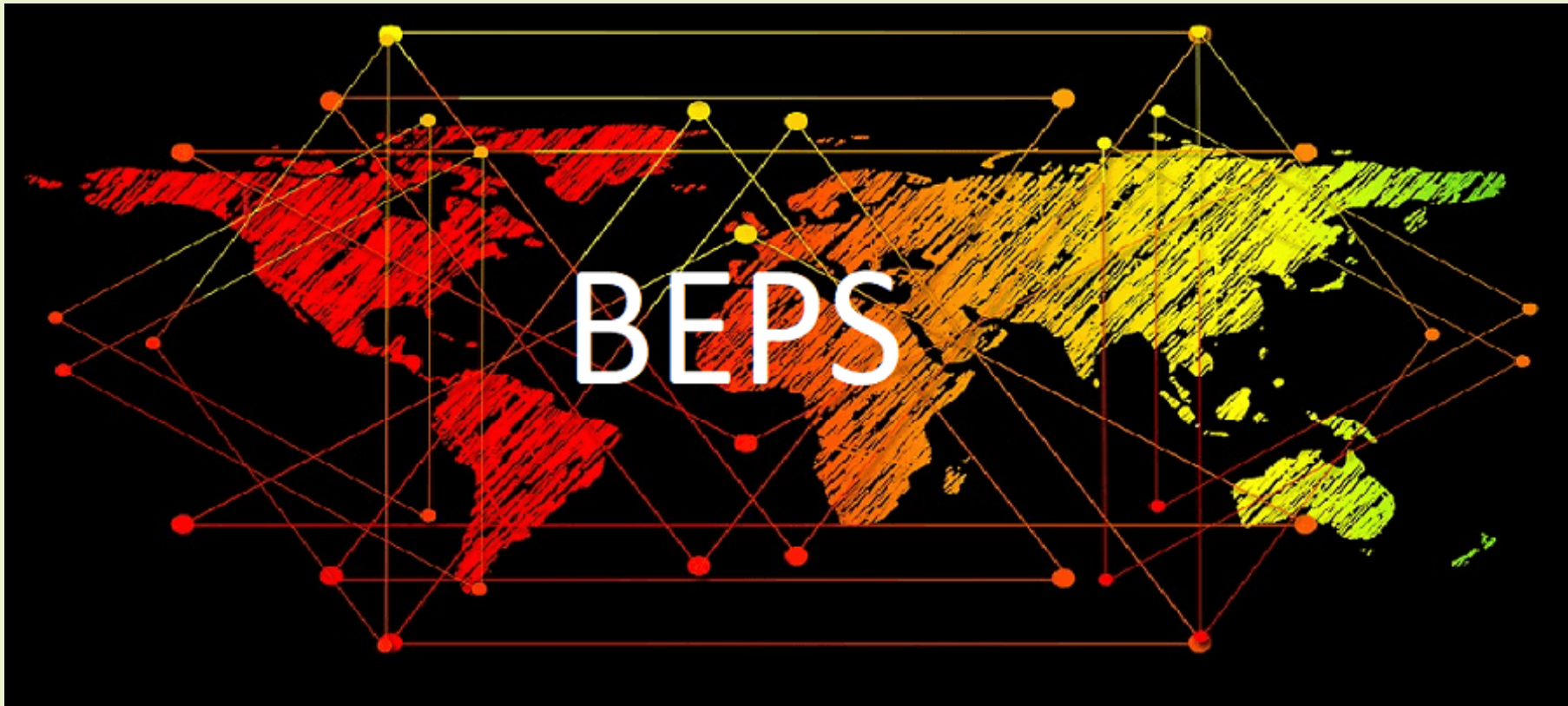
If a company maintains its documentation on a contemporaneous basis as required in the Indian Income Tax Act and the rules and the ALP for RPT's are determined accordingly, it appears that the requirement of RPT policy would be met.

Threads of Reporting



Threads of Reporting





Alignment of Indian TP regulations with **BEPS**

Indian Regulations aligning with BEPS

Action Plan 13

Master File - A global consistent overview

- Group organizational structure
- Description of global value chain
- Intangibles
- Financing activities
- Global Transfer pricing policies

Local File - Specific to country analysis

- Description of Intercompany transactions
- Comparability analysis
- Selection and Application of TP Method(s)
- Financial information

CBCR - key data points for each group entity

- Main business activity
- Capital & Assets
- Revenue (AE & NonAE), Profits, Taxes
- Number of Employees
- Tax jurisdiction

Master File and CBCR

- Master File & Local File to be filed with each tax jurisdiction
- CBCR to be filed with tax jurisdiction of ultimate parent
- CBCR mandatory if consolidated turnover > EUR 750 mn (approx. INR 5,632 Cr.)
- CBCR to be used only for risk assessment; not for concluding audits

Amendments

- New compliance by Finance act, 2016 In response to BEPS action plan 13
- New Sec. (Sec. 286) inserted - for CBCR
- Sec. 92D amended to include Master File
- Rule 10DA - Master File
- Rule 10DB - CBCR

Master File – Rule 10DA

- Applicability [10DA(1)]:
 - Group revenue exceeds Rs. 500/- Cr AND
 - the aggregate value of international transactions -
 - during the accounting year, as per the books of account, exceeds fifty crore rupees, or
OR
 - in respect of purchase, sale, transfer, lease or use of intangible property during the accounting year, as per the books of accounts, exceeds ten crore rupees
- File form 3CEAA (part A & part B) – on or before due date u/s 139(1).

CBCR– Sec.286 r.w. Rule 10DB

- Applicability:
 - Group revenue > Rs.6,400/- Cr
- Parent Co. in India ?
 - Yes
 - File Form 3CEAD
 - No
 - File Form 3CEAC
- Else: subject to conditions in 286(4) Resident Co. Files – Form 3CEAD
- If more than one Resident Co. – designate one – Form 3CEAE

Master file & CBCR - Summary

Particulars	Purpose	Form No.	Applicable to
Master File related forms	Filing of the Master File	3CEAA	Part A – Every constituent entity of an IG (no threshold) Part B – Every constituent entity of an IG meeting the threshold discussed above
	Intimation of designated Indian constituent entity of an IG	3CEAB	IGs having multiple constituent entities resident in India
CbC reporting related forms	CbC report notification	3CEAC	Every Indian constituent entity of a foreign IG
	Filing of CbC Report	3CEAD	Indian- headquartered IG Indian constituent entity of a foreign IG designated as Alternate Parent entity
			Indian constituent entity of a foreign IG required to submit CbC report in India under the specified circumstances
	Intimation of designated Indian constituent entity of foreign IG for filing CbC report in India under specified circumstances	3CEAE	Foreign IG having multiple constituent entities resident in India

PENALTIES

Section	Penalty	Quantum of penalty
271(1)(c)	Penalty for concealing particulars of income or furnishing inaccurate particulars of income	100% to 300% of tax sought to be evaded on account of transfer pricing adjustments made
271AA(1)	Penalty for: • failure to maintain documentation prescribed under Section 92D of the Act, • failure to report a transaction, or • maintaining or furnishing incorrect information/ document	2% of the value of international transaction or specified domestic transaction
271AA(2)	Penalty for failure to keep and maintain Master File	INR 500,000
271BA	Penalty for failure to furnish Accountant's Report in Form 3CEB	INR 100,000
271G	Penalty for failure to furnish documentation prescribed under Section 92D of the Act	2% of the value of international transaction or specified domestic transaction
271GB	For failure to furnish CBCR u/s286(2)	a. INR 5,000 per day up to one month; or b. INR 15,000 per day beyond one month Failure continues after penalty order, INR 50,000 per day
271GB	For non-furnishing information asked for u/s286(6)	INR 5,000 per day; Failure continues after penalty order INR 50,000 per day
271GB	Inaccurate report/ information	INR 500,000



Advanced Pricing Agreement

Advanced Pricing Agreement (APA)

- Agreement between a tax payer and tax authority determining the transfer pricing methodology for pricing the tax payer's international transactions for future years.
- Applied for a certain period of time based on the fulfillment of certain terms and conditions (called critical assumptions).
- Types:
 - Unilateral – tax payer and tax authority
 - Bilateral – tax payer, foreign AE, and respective tax authorities
- Salient Features –
 - To provide assurance of certainty and unanimity in transfer pricing approach
 - Valid up to five subsequent years and four previous years
 - Binding on tax authorities as well as taxpayers unless there is a change in the law or facts of the case
 - Pre-consultation process (anonymous application option)
- Important points to be considered:
 - Each year Annual Compliance Report in Form No. 3CEF needs to be filed before DGIT (IT)
 - – The APA can be cancelled/revised if critical assumptions are violated or conditions are not met
 - If the Compliance Audit results in a finding that the assessee has failed to comply with the terms of the agreement, the agreement can be cancelled
 - – Non filing of Compliance Report or the report contains material errors, it may result in cancellation of the agreement





THANK YOU!