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COST ACCOUNTANTS OF INDIA**

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Course on International Trade



THE CUSTOMS ACT, 1962

Regulation under Custom Act

Background

- The Custom duty derived its value from the word —custom, under which whenever a merchant entered a Kingdom with his merchandise, he had to give some gift to the king.
- Subsequently, this custom formalized into the levy of custom duty or tax on goods imported into and exported from the country was organized through various laws during the British period.
- After Independence the Sea Customs Act 1878, the Land Customs Act, 1924 and other allied enactments were repealed by a consolidating and amending legislation entitled the Customs Act, 1962.
- Similarly the Indian Customs Act, 1934 was repealed by the Customs Tariff Act, 1975(CTA).

Introduction

- Custom Duty is an indirect tax, imposed under the Customs Act formulated in 1962. The power to enact the law is provided under the Constitution of India under the Article 265.
- The Customs Act, 1962 is the basic statute which governs entry or exit of different categories of vessels, aircrafts, goods, passengers etc., into or outside the country. The Act extends to the whole of the India.
- Customs Act, 1962 just like any other tax law is primarily for the levy and collection of duties but at the same time it has the other and equally important purposes such as:
 - ✓ Regulation of imports and exports;
 - ✓ Protection of domestic industry;
 - ✓ Prevention of smuggling;
 - ✓ Conservation and augmentation of foreign exchange and so on.
- Section 12 of the Custom Act provides that duties of customs shall be levied at such rates as may be specified under the Customs Tariff Act, 1975 or other applicable Acts on goods imported into or exported from India

LEVY OF CUSTOM DUTY

- There are four stages in any tax structure, viz., levy, assessment, collection and postponement.
- The basis of levy of tax is specified in Section 12, charging section of the Customs Act. It identifies the person or properties in respect of which tax or duty is to be levied or charged.
- Under assessment, the liability for payment of duty is quantified and the last stage is the collection of duty which is may be postponed for administrative convenience.
- As per Section 12, customs duty is imposed on **goods imported into or exported out of India** as per the rates specified under the Customs Tariff Act, 1975 or any other law.

- On analysis of Section 12, we derive the following points:
 - (i) Customs duty is imposed on goods when such goods are imported into or exported out of India;
 - (ii) The levy is subject to other provisions of this Act or any other law;
 - (iii) The rates of Basic Custom Duty are as specified under the Tariff Act, 1975 or any other law;
 - (iv) Even goods belonging to Government are subject to levy, though they may be exempted by notification(s) under Section 25.

Custom Tariff Act, 1975 has two schedules.

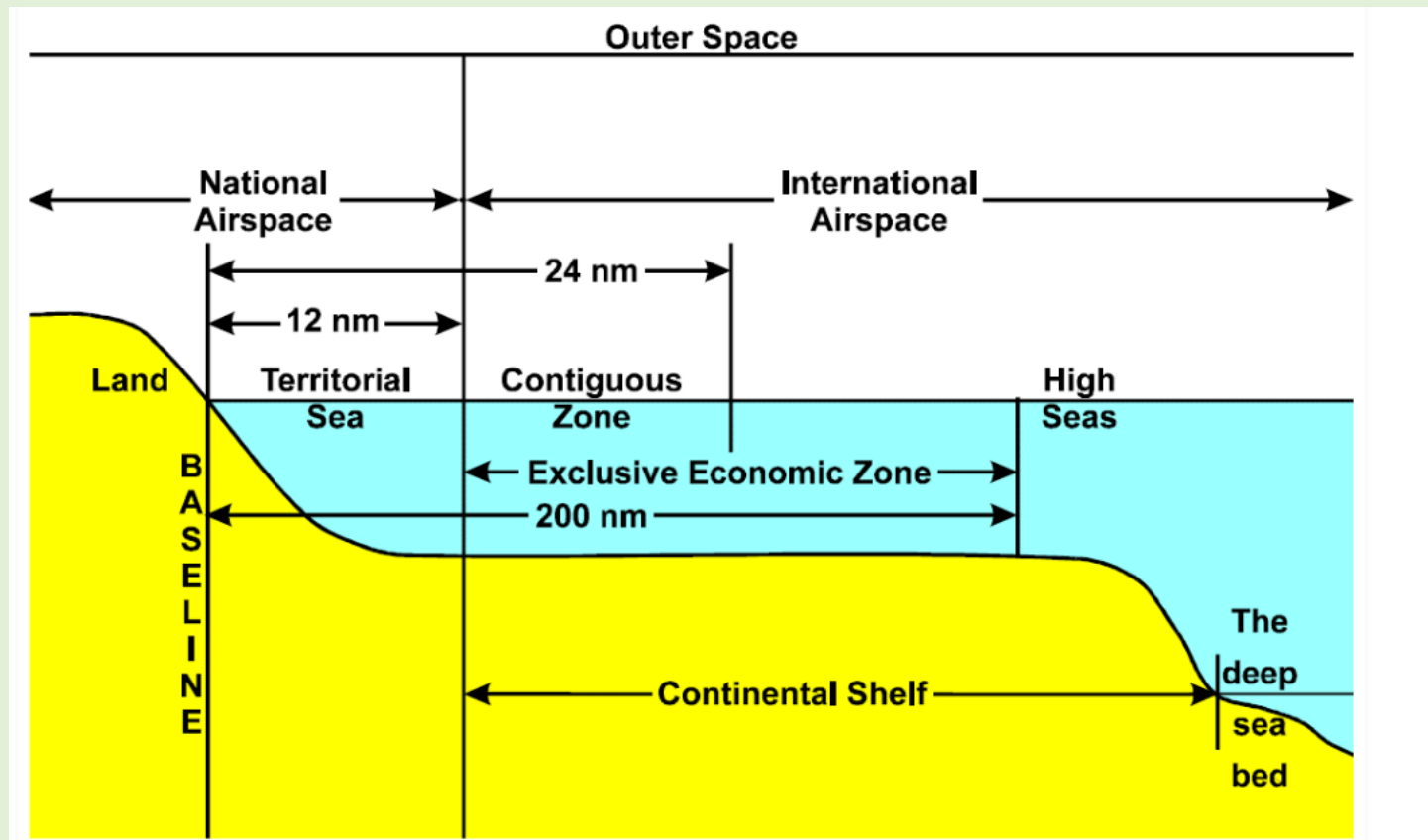
Schedule I prescribes tariff rates for imported goods, known as —Import Tariff and

Schedule II contains tariff for export goods known as —Export Tariff.

TAXABLE EVENT

- The basic condition for levy of customs duty is import/export of goods i.e. goods become liable to duty when there is import into or export from India.
- Import means bringing into India from a place outside India [Section 2(23)].
- Export means taking out of India to a place outside India [Section 2(18)].
- "India" includes the territorial waters of India [Section 2(27)]. The limit of the territorial waters is the line every point of which is at a distance of **twelve nautical miles** from the nearest point of the appropriate baseline.
- Though the taxable event is import/export yet it is difficult to determine the exact time of levy.
- Here in this part, we will discuss the types of duties leviable under Custom Tariff Act.
- As per section 12, Customs duties are levied on the goods imported into, or exported from, India at the rates specified in the schedules to the Customs Tariff Act, 1975.

Significance of Territorial Water



“Indian customs waters” means the waters extending into the sea up to the limit of contiguous zone of India under section 5 of the Territorial Waters, Continental Shelf, Exclusive Economic Zone and other Maritime Zones Act, 1976 (80 of 1976) and includes any bay, gulf, harbour, creek or tidal river [Section 2(28)];

The concept of territorial waters and Indian customs waters are highly relevant for customs law. **Territorial waters extend up to twelve nautical** miles from the baseline on the coast of India.

Indian customs waters extend up to contiguous zone of India which twenty four nautical miles from the nearest point of base line. Thus Indian customs waters extend up to twelve nautical miles beyond territorial waters.

The significance of Indian customs waters is that the Customs Officer has powers to arrest a person; to stop and search any vessel; to confiscate a vessel concealing goods; to search any person on board any vessel and; to confiscate goods in the these waters.

TYPES OF DUTIES UNDER CUSTOMS

1. BASIC CUSTOM DUTY
2. ADDITIONAL CUSTOM DUTY/COUNTERVAILING DUTY [Section 3(1)]
3. ADDITIONAL DUTY/SPECIAL ADDITIONAL DUTY (SAD) UNDER SECTION 3(5)
4. PROTECTIVE DUTY - SECTION 6 & 7 OF THE CUSTOMS TARIFF ACT, 1975
5. SAFEGUARD DUTY - SECTION 8B OF CUSTOMS TARIFF ACT, 1975
6. COUNTERVAILING DUTY ON SUBSIDIZED ARTICLES - SECTION 9 OF THE CUSTOMS TARIFF ACT
7. ANTI-DUMPING DUTY (ADD) ON DUMPED ARTICLES - SECTION 9A OF THE CUSTOMS TARIFF ACT, 1975

BASIC CUSTOM DUTY

- It is levied under Section 12 of Customs Act, 1962, and specified under Section 2 of the Customs Tariff Act, 1975. Normally, it is levied as a percentage of Value as determined under section 14(1). There are different rates for different goods.
- **Standard and Preferential Rates**
- Duty at the —Standard rate|| is charged where there is no provision for preferential treatment. To be eligible, for the preferential treatment the goods should be the one which are imported from any preferential area covered under the Government of India Agreements for charging preferential rate of duty. The Central Government has the power to increase or reduce or discontinue the preferential rate in respect of any article specified in the First Schedule provided it considers it to be necessary in the public interest. Preferential rate is applied only where the owner of the article (importer) claims at the time of importation, with supporting evidence, that the goods are chargeable with the preferential rate of duty.

ADDITIONAL CUSTOM DUTY/COUNTERVAILING DUTY

- This is levied under Section 3(1) of the Customs Tariff Act, 1975. The amount of this duty is equivalent to the amount of excise duty payable on like goods manufactured or produced in India.
- Post GST regime, CVD is applicable only on non-GST products.

ADDITIONAL DUTY/SPECIAL ADDITIONAL DUTY (SAD) UNDER SECTION 3(5)

- Special Additional Duty is countervailing to Vat/sales tax, if the goods supposed to have manufacture in India.
- It is levied to offset the effect of sales tax, VAT, local tax or other charges leviable on articles on its sale, purchase or transaction in India. It is leviable on imported goods even if article was not sold in India
- Post GST regime, SAD is applicable only on non-GST products.

PROTECTIVE DUTY - SECTION 6 & 7 OF THE CUSTOMS TARIFF ACT, 1975

- Protective Duties, as the name suggests, these duties are meant to protect indigenous or nascent industries from foreign competition.
- The Indian Government usually prescribes these duties after thoroughly investigating the market dynamics, competitive landscape, and the potential impact on domestic industry.
- The protective duties should not be very stiff so as to discourage imports.
- It should be sufficiently attractive to encourage imports to bridge the gap between demand and supply of those articles in the market.

SAFEGUARD DUTY - SECTION 8B OF CUSTOMS TARIFF ACT, 1975

- Under Section 8B of the Customs Tariff Act, Safeguard Duty protects domestic industries from a sudden and unexpected import surge. This duty is a bulwark, providing the domestic industry time to adjust and stand tall against external market pressures.
- The Central Government may impose safeguard duty on specified imported goods, if it is satisfied that the goods are being imported in large quantities and they are causing serious injury to domestic industry
- However, the safeguard duty shall not be imposed in the following cases:
 - Articles originating from developing country (does not exceed 3% of the total imports of that article into India)
 - The articles imported by a 100% EOU or units in a Free Trade Zone or Special Economic Zone

COUNTERVAILING DUTY ON SUBSIDIZED ARTICLES - SECTION 9 OF THE CUSTOMS TARIFF ACT

- Countervailing Duties (CVDs) are tariffs levied on imported goods to offset subsidies made to producers of these goods in the exporting country.
- CVDs are meant to level the playing field between domestic producers of a product and foreign producers of the same product who can afford to sell it at a lower price because of the subsidy they receive from their government.

ANTI-DUMPING DUTY (ADD) ON DUMPED ARTICLES - SECTION 9A OF THE CUSTOMS TARIFF ACT, 1975

- Where any article is exported by an exporter or producer from any country or territory to India at less than its normal value, then, upon the importation of such article into India, the Central Government may, by notification in the Official Gazette, impose an anti-dumping duty not exceeding the margin of dumping in relation to such article. The anti dumping duty is dumping margin or injury margin whichever is lower.
- Dumping means exporting goods to India, at prices lower than the ones in the domestic market of the exporting country, subject to certain adjustments.

IGST (Section 3(7) of Custom Tariff Act

- GST is applicable on all imports into India in the form of levy of IGST. It is levied on the value of imported goods + any customs duty chargeable on the goods.
- Hence, IGST must be calculated after adding the applicable customs duty to the value of imported goods.
- Under GST, the input tax credit would be provided for IGST paid, and GST Compensation Cess paid. However, the input tax credit is not applicable for basics customs duty paid during imports. To avail input tax credit, the importer would have to obtain GST registration and quote the GSTIN on Bill of Entry. During the transitional period, provisional GSTIN can also be quoted instead of GSTIN.

Social Welfare Surcharge

- Social Welfare Surcharge is levied on the aggregate duties of customs, replacing the earlier Education Cess and Secondary and Higher Education Cess. This duty aims to raise revenue for the Government's social welfare initiatives, be it healthcare, education, or poverty alleviation.
- If aggregate customs duty payable is zero on account of an exemption, the SWS shall be computed as 10% of custom duty equal to 'Nil' (as aggregate amount of customs duties payable is zero).
- It is further stated that in the absence of any law, SWS cannot be computed on the notional customs duty calculated at tariff rate where applicable aggregate of duties of customs is zero.

Valuation Rules Under the Indian Customs Act

- Valuation of goods under the Indian Customs Act, 1962, is governed by Section 14 of the Act, which is aligned with the WTO's Agreement on Customs Valuation.
- The valuation rules are crucial as they determine the amount of customs duty payable on imported goods.
- The primary method for valuing imported goods is the "transaction value," which is the price actually paid or payable for the goods when sold for export to India.
- The transaction value includes: The cost of transport up to the place of importation. Loading, unloading, and handling charges associated with the delivery of goods to the place of importation and the cost of insurance.

Conditions for Accepting Transaction Value

- The transaction value is acceptable only if:
 - There are no restrictions on the buyer's ability to dispose of or use the goods, except those imposed by law, conditions of sale, or restrictions that do not substantially affect the value of the goods.
 - The sale or price is not subject to conditions or considerations for which a value cannot be determined.
 - No part of the proceeds of any subsequent resale, disposal, or use of the goods will accrue to the seller, unless an appropriate adjustment is made.
 - The buyer and seller are not related, or if related, the transaction value is acceptable for customs purposes.

Other Important aspects

- **Inclusion of Royalties and License Fees:** Royalties and license fees related to the imported goods, payable as a condition of sale, must be added to the transaction value if not already included.
- **Adjustment for Commissions and Brokerage:** **Commissions** and brokerage (except buying commissions) are also added to the transaction value if they have not been included.
- **Provisional Assessment:** In cases where the value cannot be determined at the time of import, a provisional assessment may be conducted. The final value is determined after additional information or documents are submitted.
- **Special Valuation Branch (SVB):** For cases involving related party transactions, the valuation is scrutinized by the Special Valuation Branch of the customs department to ensure that the declared value reflects the true market value.
- **Anti-Dumping Duty and Safeguard Duty:** The value determined under the above rules forms the basis for applying additional duties such as anti-dumping duty or safeguard duty if applicable.

Alternative Valuation Methods:

- If the transaction value cannot be determined, the following alternative methods are used sequentially:
 - **Transaction Value of Identical Goods:** Based on the transaction value of identical goods sold for export to India.
 - **Transaction Value of Similar Goods:** Based on the transaction value of similar goods sold for export to India.
 - **Deductive Value Method:** Based on the sale price in India of goods that are identical or similar, less certain costs.
 - **Computed Value Method:** Based on the cost of production, profit, and general expenses.
 - **Fallback Method:** A flexible approach using reasonable means consistent with the principles and general provisions of the Customs Valuation Agreement.





THANK YOU!



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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

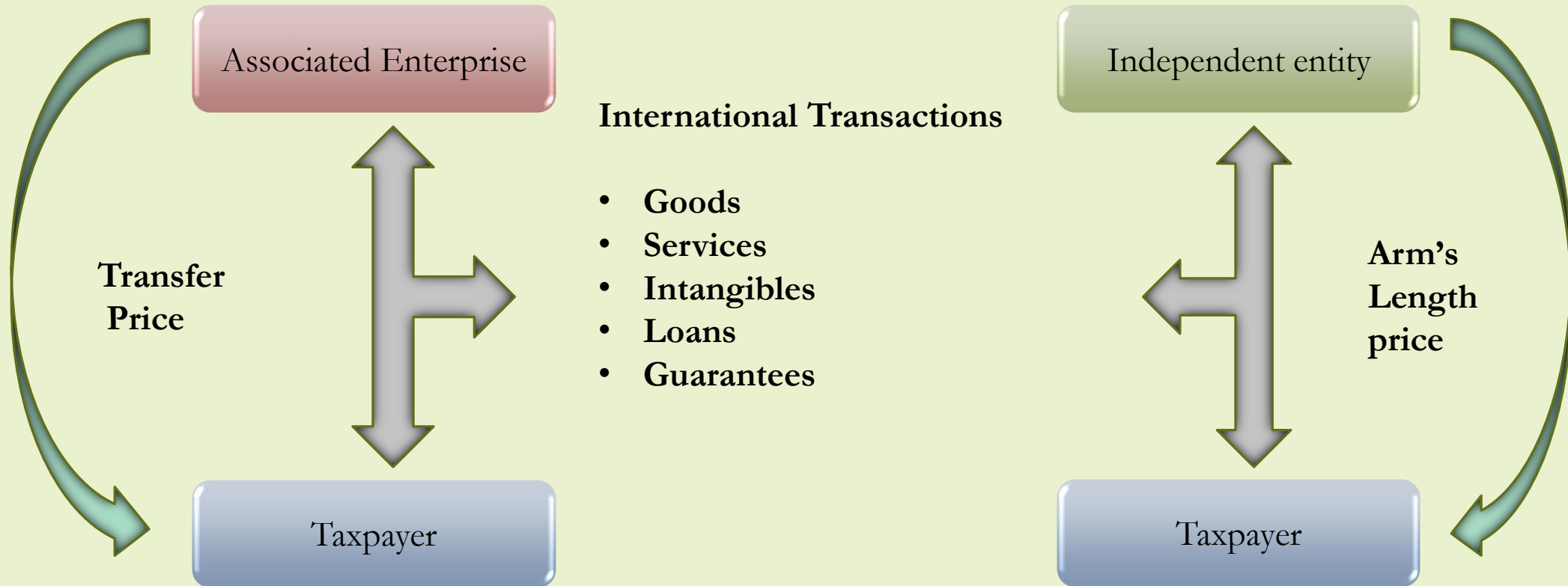
- Computation of Income from International Transaction having regard to ALP Sec.92
- Associated Enterprises Sec. 92A
- International Transaction Sec. 92B
- Specified Domestic Transactions Sec. 92BA
- Arm's Length Price - Sec. 92C + Rule 10B/ 10C
- Power of AO and TPO - Sec. 92CA
- Safe Harbour Sec. 92CB + 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

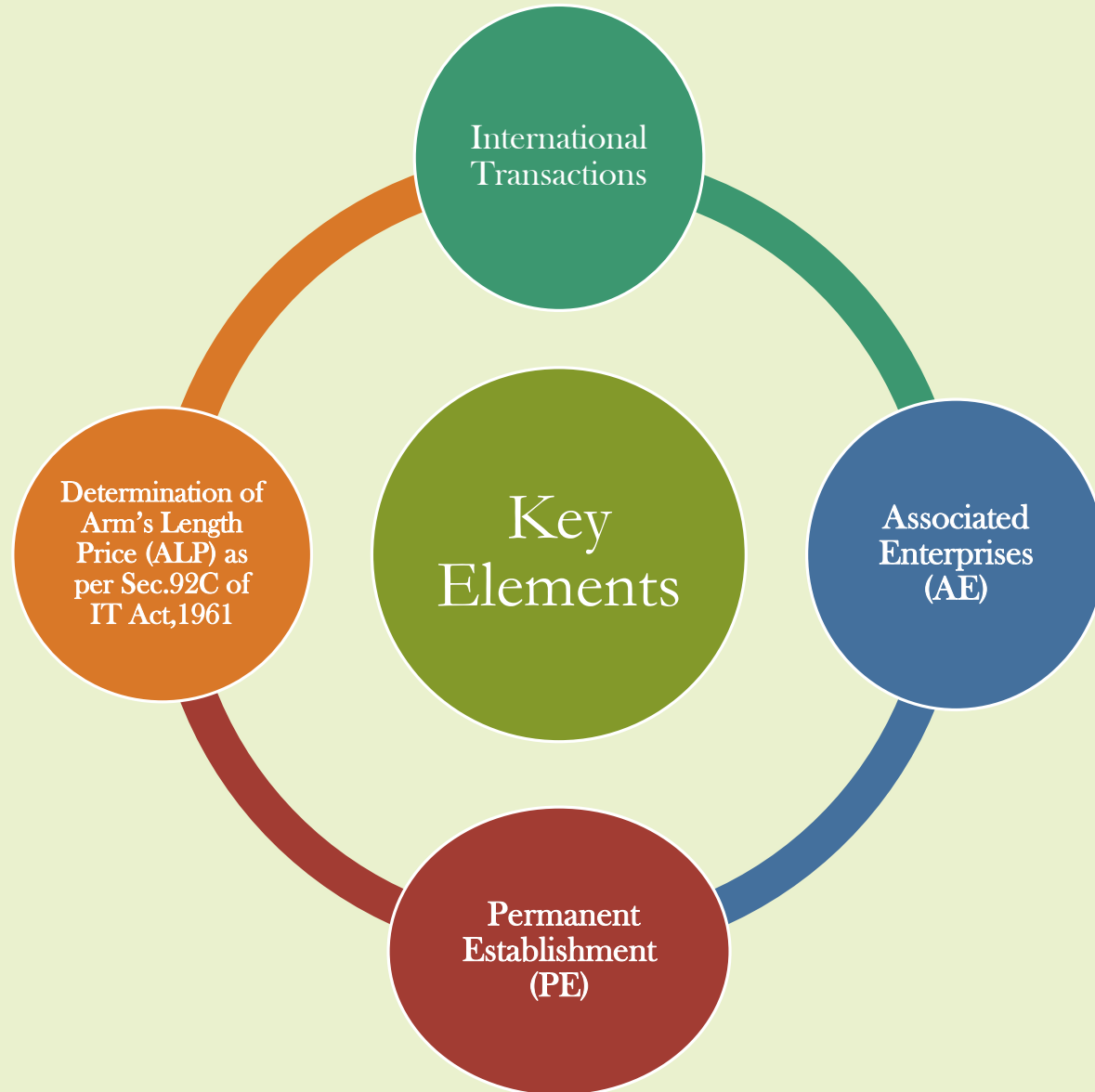
Scheme of TP regulations in India

- 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)

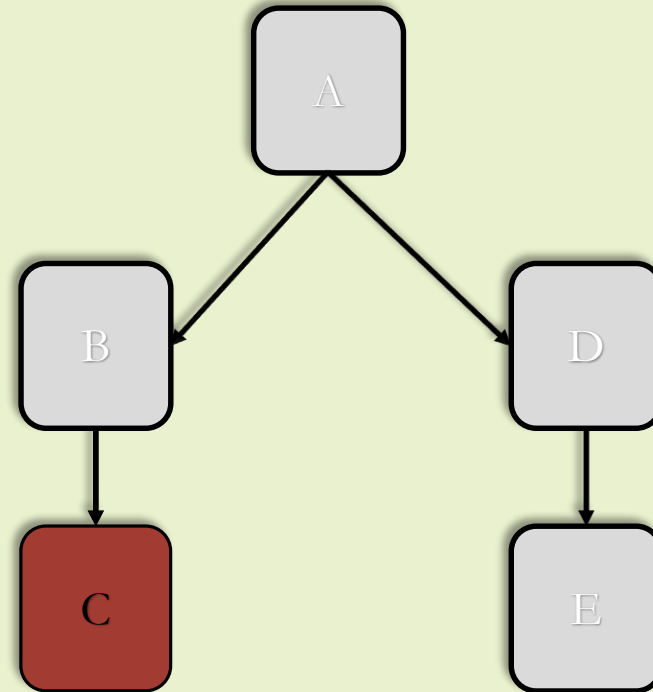
Direct or indirect participation, in management / control / capital of the other enterprise

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.....”

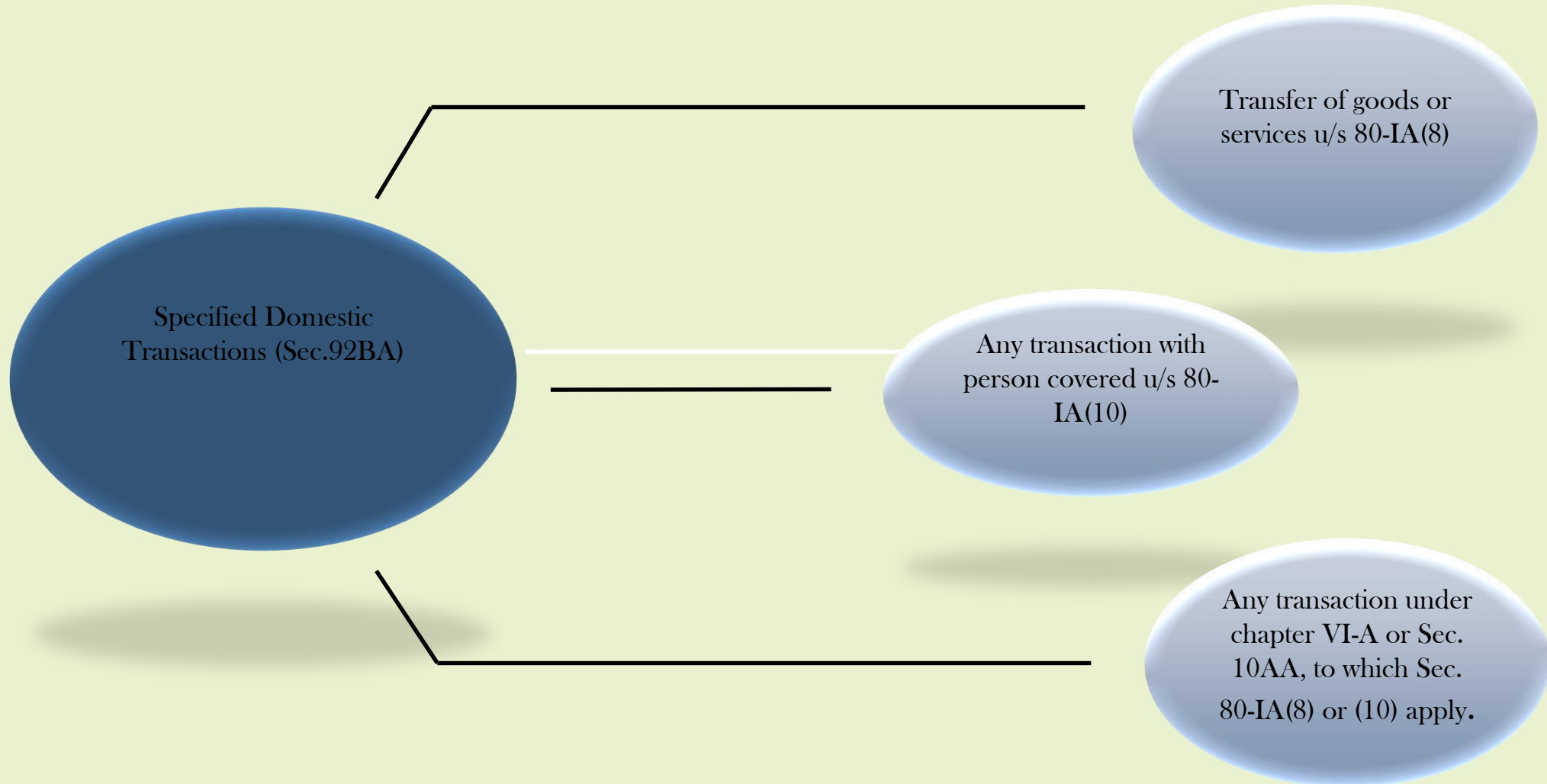
Section 92F(iii) – Enterprise

“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

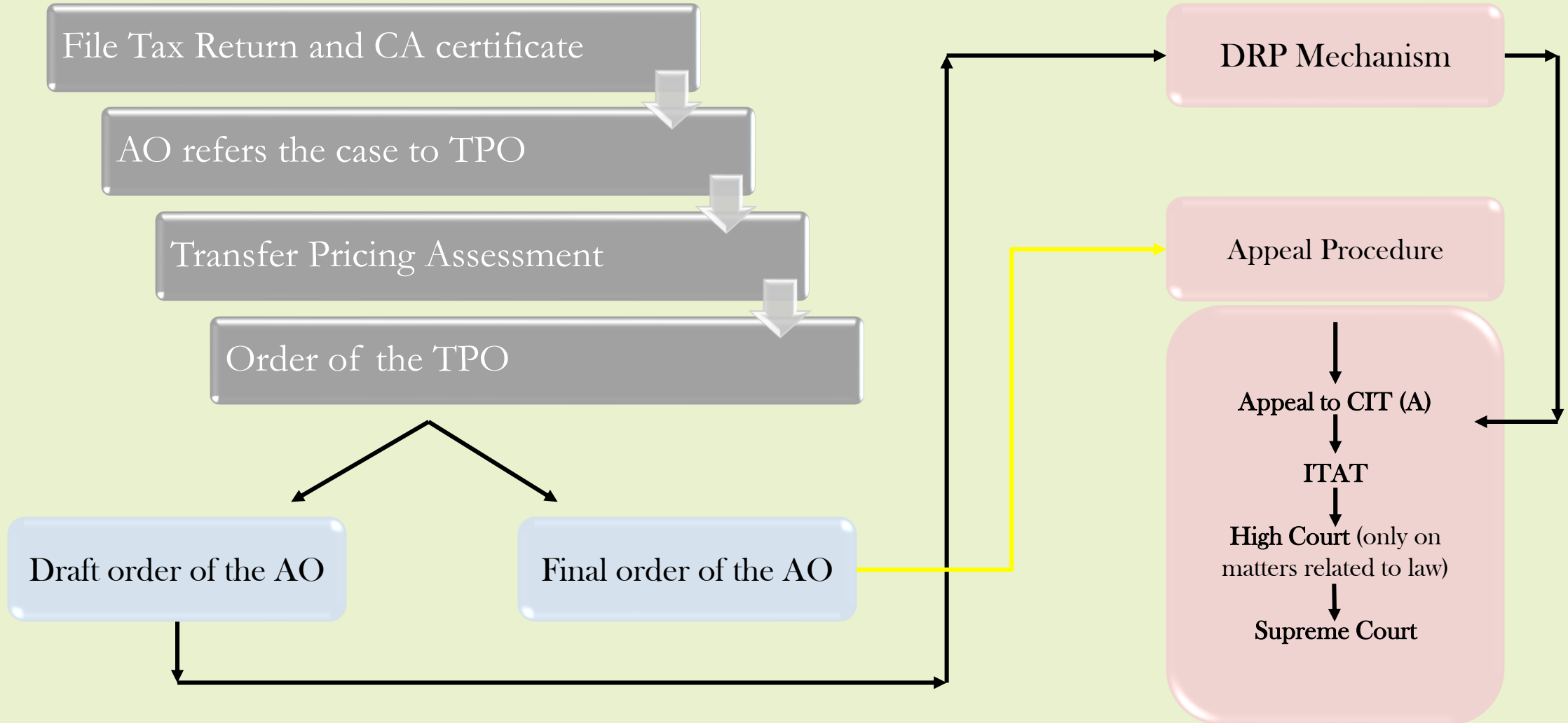
- Sec. 92F(ii) "arm's length price" means a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions;
- ALP is found in paragraph 1 of article 9 of the OECD MC which reads as under:
 - “[Where] conditions are made 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

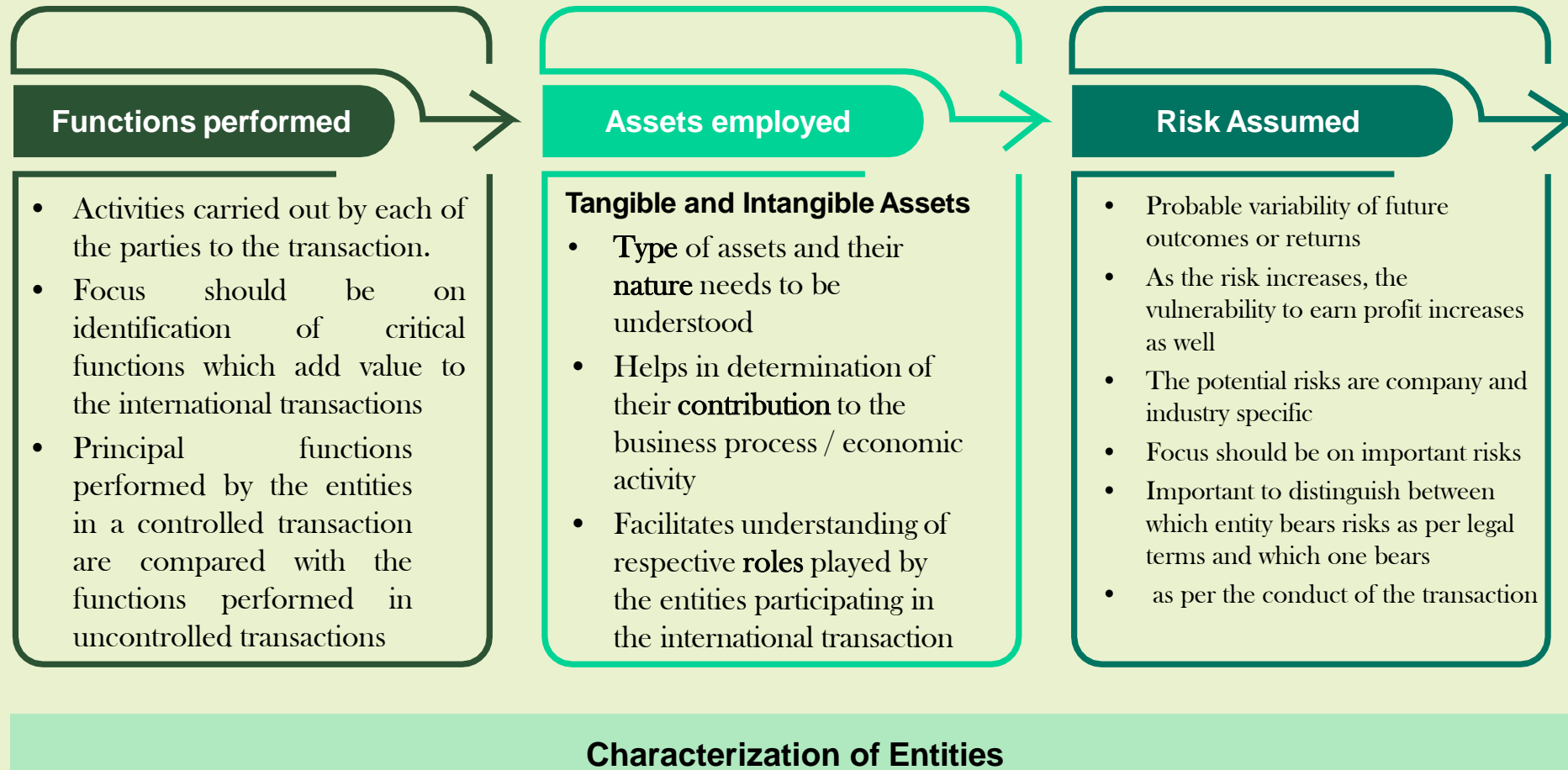
OECD Master File Considerations: Overview of The OECD Master File

- 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)

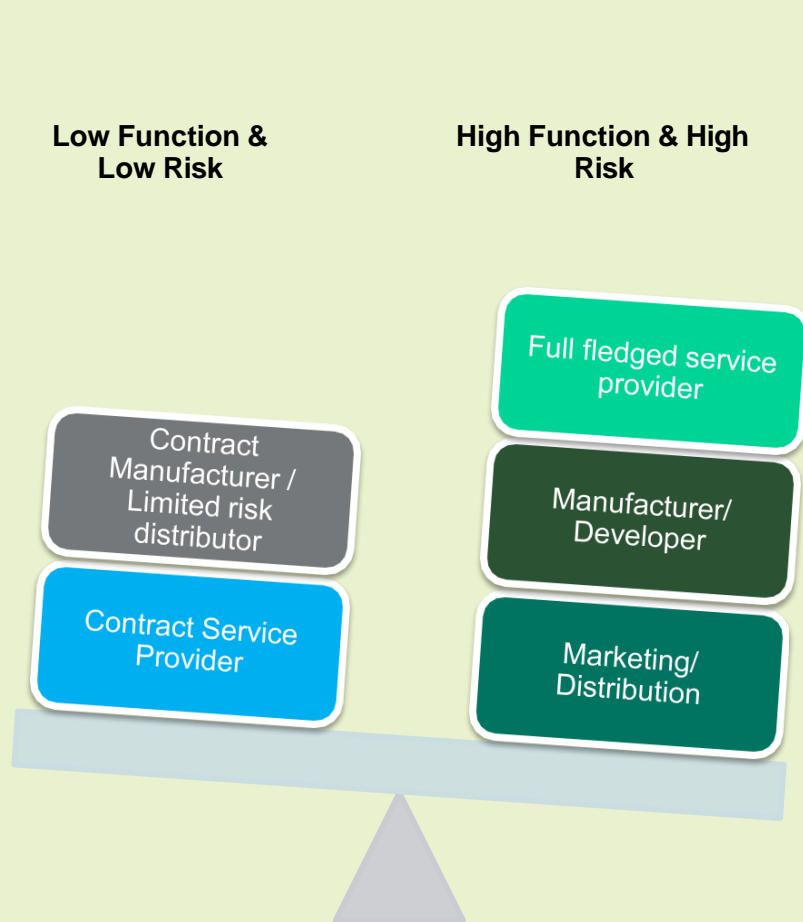
Components of Functional Analysis



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• • 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



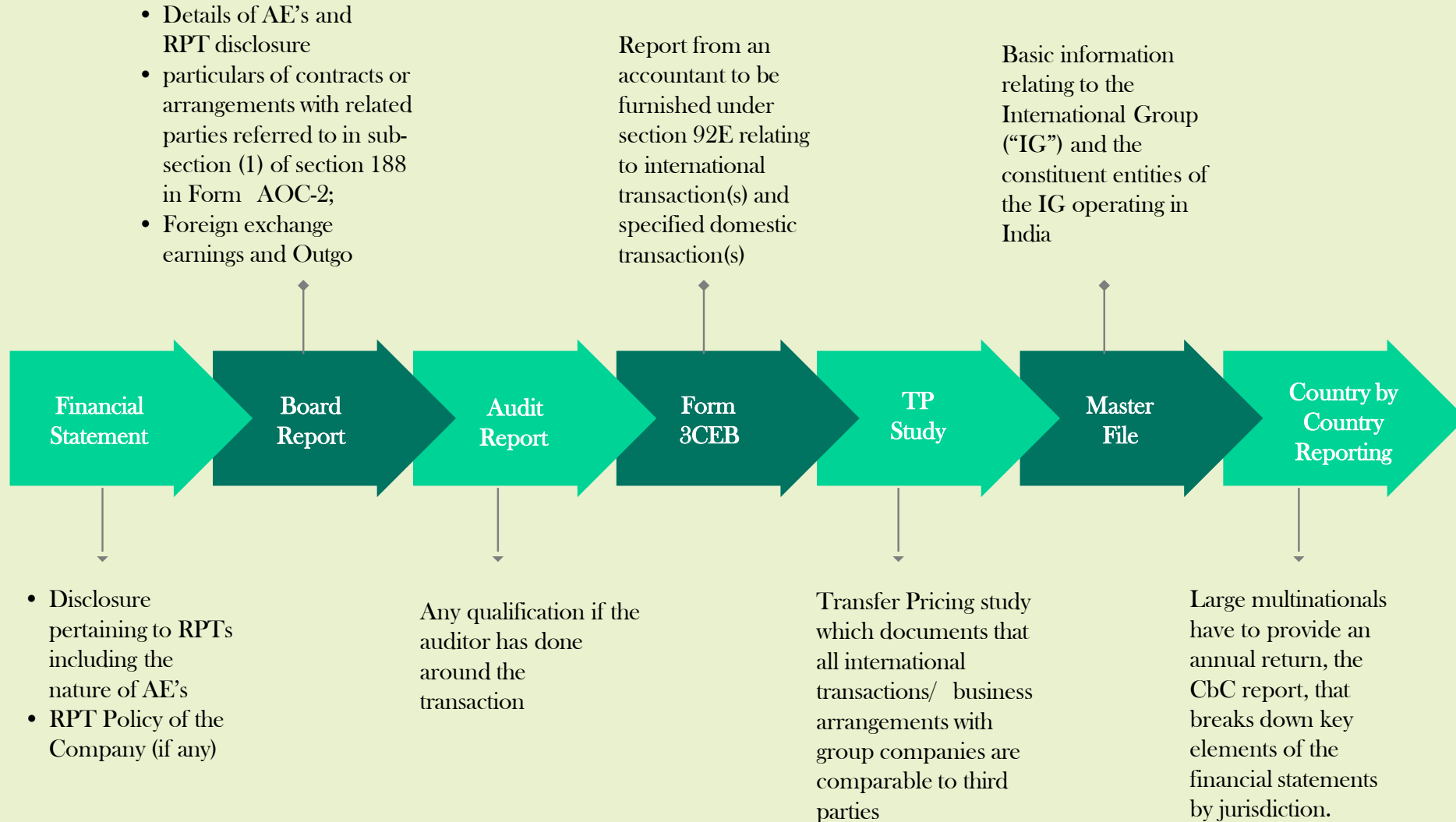
Intercompany agreement identify the parties and the scope of the services that is being rendered/availed. The scope mentioned in the agreement therefore should mirror in the RPT Policy, TP Policy and in the TP Study.

TP Study

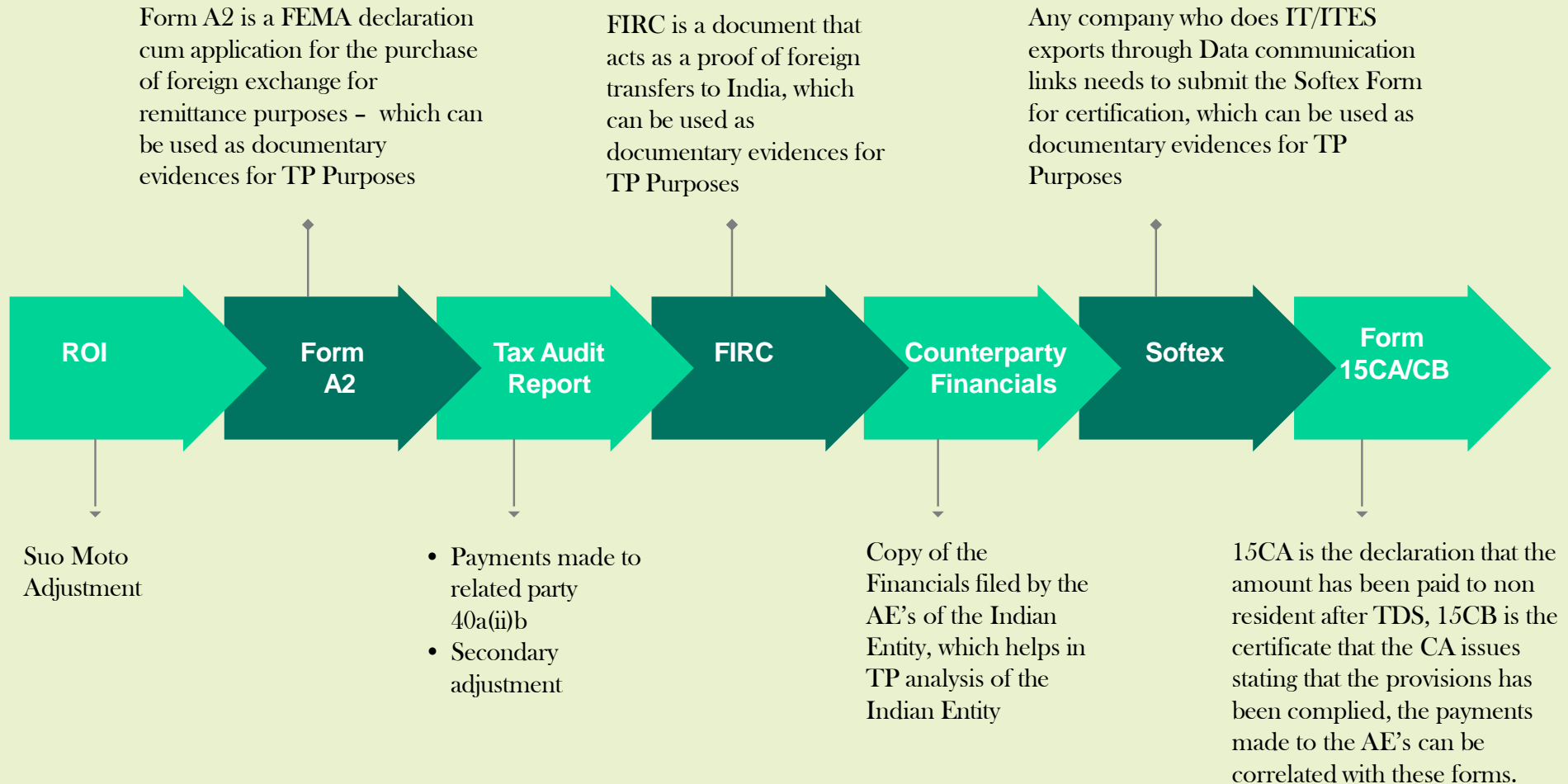


If a company maintains its documentation on a contemporaneous basis as required in the Indian Income Tax Act and the rules and the ALP for RPT's are determined accordingly, it appears that the requirement of RPT policy would be met.

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: <ul style="list-style-type: none"> • 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



A 3D paper speech bubble is centered on a solid blue background. The bubble is white with a subtle texture and a slight shadow beneath it, giving it a three-dimensional appearance. Inside the bubble, the words "THANK YOU!" are printed in a bold, blue, sans-serif font. The entire composition is set against a light green background.

THANK YOU!



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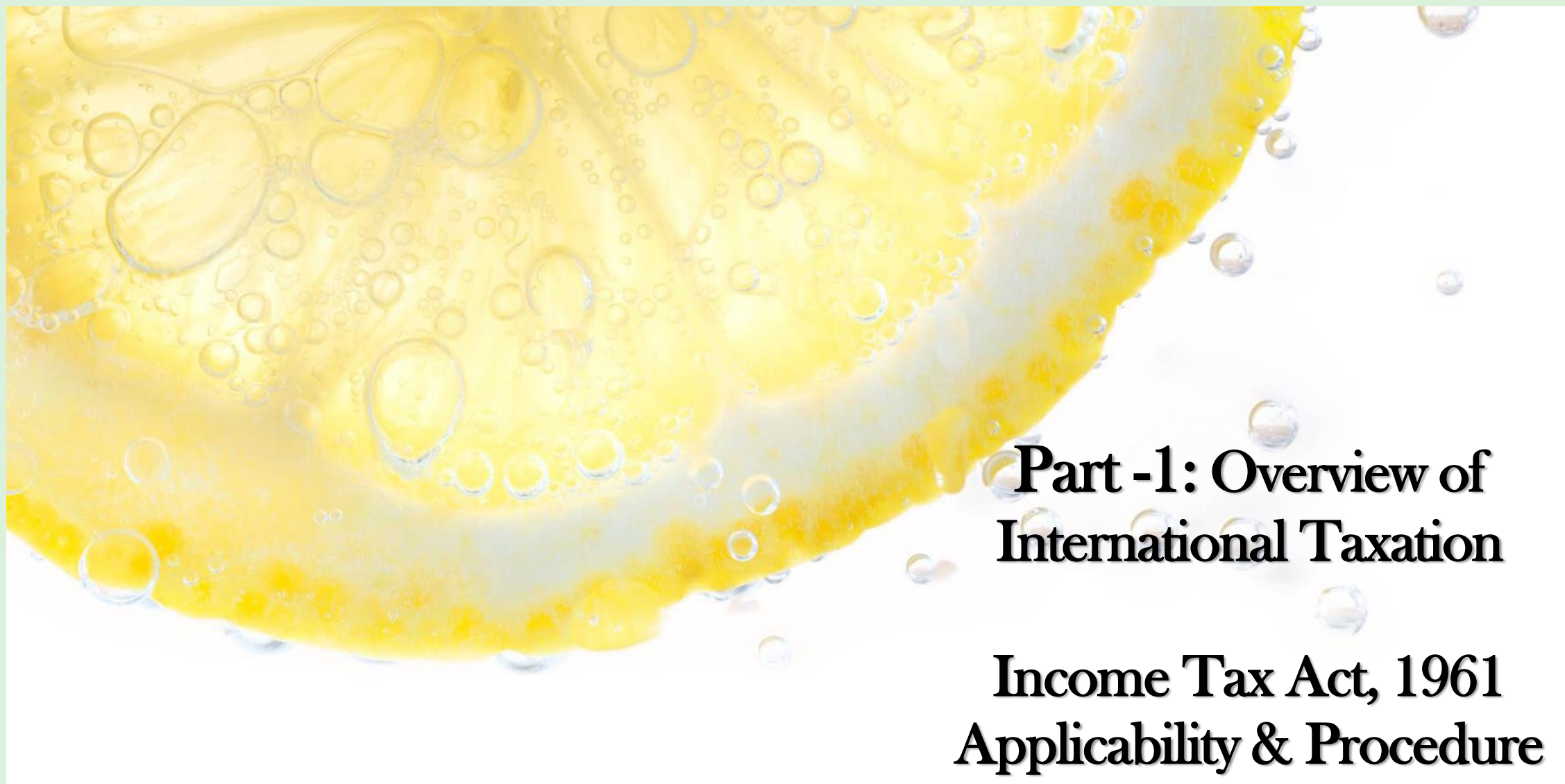
Course on International Trade

International Taxation & Cross Border Payments

CMA Pramod Kr. Agarwal

International Tax





Part -1: Overview of International Taxation

**Income Tax Act, 1961
Applicability & Procedure**

International Taxation

International taxation is the study or determination of tax on a person or business subject to the tax laws of different countries or the international aspects of an individual country's tax laws as the case may be.

Refers to tax levied on Cross Border Transactions. Transaction may take place between two or more entity of two or more tax jurisdictions.

Such a transaction may involve a person in one country with property and income flow in another.

Types of International Taxation

The global taxability is dependent on two basic principles:

Residence based Tax: A country can tax persons on their worldwide income, regardless of the source of income.

Source based Tax: only local income from the source inside the country is taxed, usually non-residents are taxed only on their local income.

When the transaction is carried on between persons of two different countries, the taxability in any country is determined as per provisions of the domestic law read with the Double Taxation Avoidance Agreement entered into between the Countries. In India, residence-based taxation rule is followed!

Categories of International Tax

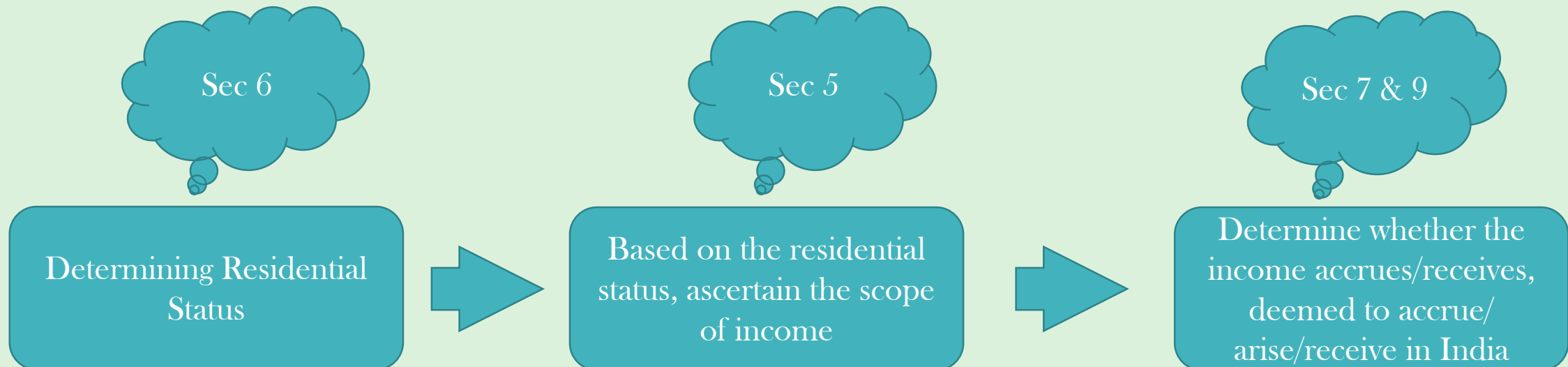
- Cross Border Trade in Goods and Services
- Cross Border Manufacturing by MNCs
- Cross Border Investments
- Taxation of Individuals working outside country

How relevant International Taxation for you

- Overseas presence of Indian company;
- Imports goods and services from various countries.
- Making cross border payments.

International Taxation Structure in India

As per the charging provision of Income Tax Act, the flow for determining taxability in hands of non-resident is as follows:



International Taxation Structure in India

Once the residential status is determined, the scope of taxability of income is as under:

| Nature of Income | Taxability in hands of Non-Resident |
|--|--|
| Income which accrues or arises in India | Taxed |
| Income which is deemed to accrue or arise in India | Taxed |
| Income which is received in India | Taxed |
| Income which is deemed to be received in India | Taxed |
| Income accruing outside India from a business controlled from India or from a profession set up in India | Not Taxed |
| Income other than above (i.e. income which has no relation with India) | Not Taxed |

International Taxation Structure in India

Sec 90 & 90A of the Act authorizes Central Government to enter into DTAA with other Countries/ ratify DTAA between other specified associations for granting relief in respect of income on which tax is payable

The relevant provisions under the Act and corresponding Articles under UN Model Convention are summarized in the following table -

| Nature of Income | Under the Act | Under the DTAA |
|--|------------------------------|-----------------------|
| Business/Profession | Sec 9(1)(i) | Article 5, 7 & 14 |
| Salary Income | Sec 9(1)(ii) | Article 15 |
| Dividend Income | Sec 9(1)(iv), Sec 115A | Article 10 |
| Interest Income | Sec 9(1)(v), Sec 115A | Article 11 |
| Royalties/ Fees for Technical Services (FTS) | Sec 9(1)(vi)/(vii), Sec 115° | Article 12 |
| Capital Gains | Sec 9(1)(i), Sec 45 | Article 13 |

Double Taxation Avoidance Agreement (DTAA)

Double taxation occurs when the same income is taxed in more than one jurisdiction. To mitigate double taxation, countries often have tax treaties or agreements with each other, allowing for credits or exemptions to be applied to taxes paid in one jurisdiction against taxes owed in another.

Why DTAA?

Every country has its own taxation structure according to which they determine the taxability of people residing there and also taxability of the people who do not belong to their country but with some means they are related to their nation in their form of assessee or deemed assessee. So, for recoverability of tax from the income generated in other nations by NRI's DTAA was formed and secondly, to ensure that this taxability of income does not lead to double taxation of same income in both the countries.

Objectives of DTAA

- ❑ Tax Credit / Relief
- ❑ Avoid Double Taxation
- ❑ Prevent Tax Discrimination Certainty of Tax Treatment to Investors
- ❑ Exchange of Information
- ❑ Ease in Recovery of Tax Dues
- ❑ Promote Investment & Mutual Relation
- ❑ Prevent Fiscal Evasion

Presently, India has the DTAA with more than 93 countries.

This states that if a NRI is a resident in any of those 93 countries and he/she is paying taxes on income earned then he will be eligible for a tax benefit in either of the following two ways: Exemption method: under this method, any one country will tax the income of NRI. Means if the income is taxed in India then the same income will not be taxed in his own country. Credit method: under this method, both the countries will tax the income of that person but the country where he is a resident will allow him deduction or give credit to the foreign tax.

Relief to the Taxpayer

Bilateral Relief through Double Taxation Avoidance Agreement (DTAA)

As per Section 90(2) of the IT Act, the taxability in case of non-resident shall be more beneficial of Double Taxation Avoidance Agreement (DTAA) entered into with Government of the other Country, or

Provisions of IT Act

Considering provisions of both the domestic laws and the DTAA, if the taxability falls under the scope of Indian Laws, the payment to non-resident shall be done after withholding tax as per applicable provisions.

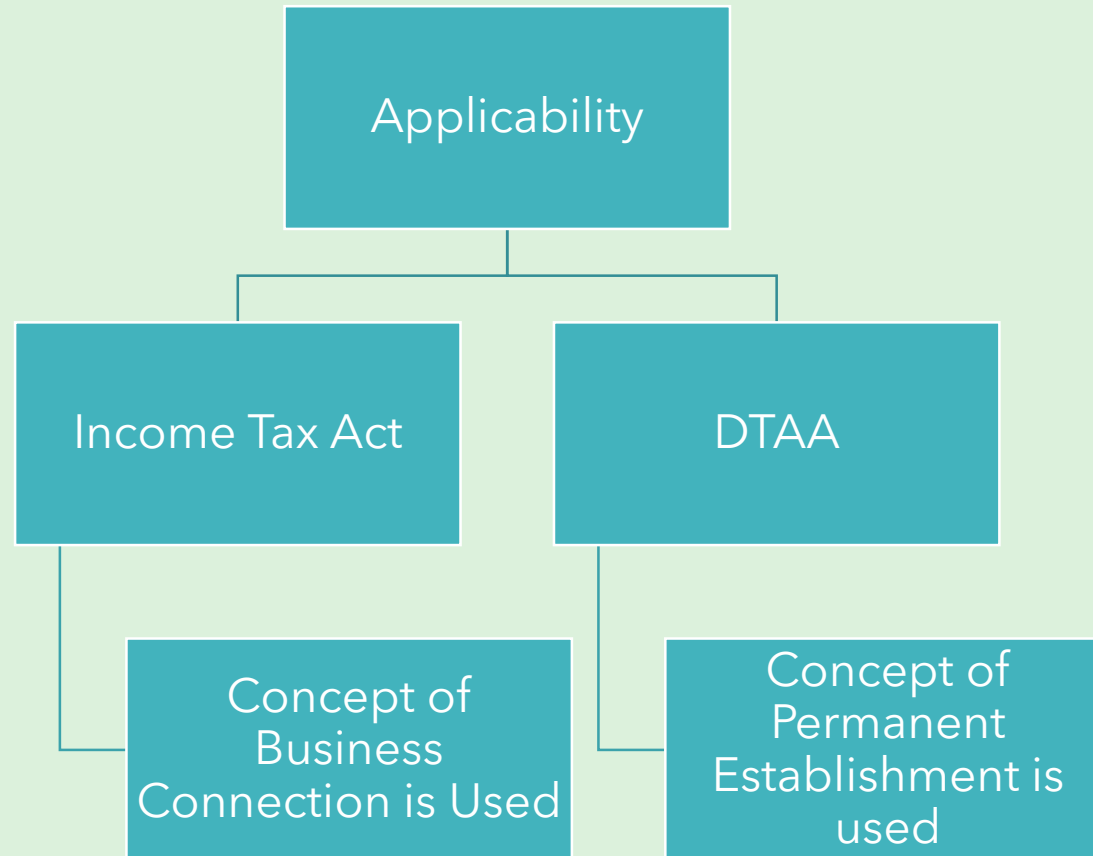
Unilateral Relief

Relief to taxpayer who has paid tax in a country with which India has not signed DTAA by way of deduction or otherwise.

Tax Treaties and Their Role in Preventing Double Taxation

Tax treaties, also known as double taxation agreements (DTAs), play a vital role in preventing the same income from being taxed twice. DTAs are bilateral agreements between two countries that define which taxes are covered, who is a resident, and how taxing rights on different types of income get divided between the countries. They provide clarity, predictability, and often contain provisions to resolve disputes, making cross-border trade and investments more feasible and less risky.

Permanent Establishment Vs. Business Connection



Permanent Establishment Vs. Business Connection

- ❑ When a resident of one country earns income from a source in another country, the possibility of double taxation arises because one country may tax that income on the source principle whereas the other country may tax it on the residence principle.
- ❑ **This is where the international tax concepts of PE and profit attribution come into play.**
- ❑ These determine the right of a country to tax the profits of a company that is the resident of another country.
- ❑ Permanent Establishment (PE) means having a taxable presence outside your company's state of residence.
- ❑ Tax authorities are now going beyond the “bricks and mortar” definition, identifying PEs caused by overseas contractors, presence of personnel, warehouse space, digital activity and more.
- ❑ Taxable presence of a company in a country may attract the tax liability in the source country.

Concept of Business Connection

A business connection is a continuous and intimate relationship between two businesses resulting in a profit to a non-resident entity. Unless such a business connection is established, it cannot be held that the profit earned by a non-resident business entity is taxable in India

The following incomes shall be deemed to accrue or arise in India (Section 9)

- through or from any business connection in India, or
- through or from any property-in India, or
- through or from any asset or source of income in India, or
- through the transfer of a capital asset situated in India



Part -2: Cross Border Payments

Analysis of Section 195(1)

Section 195(1) of the Income Tax Act, 1961 in India pertains to the requirement of withholding tax (also known as tax deduction at source or TDS) on payments made to non-residents. Here's an analysis of this section

Who is responsible to deduct?

- a) Any person - including individuals, HUF, Companies, Partnership Firm
- b) Whether resident or non-resident

-Payment to whom?

- a) Non-resident and Foreign Companies
- b) It doesn't include Resident but Not Ordinary Resident

-Nature of payment

- a) Interest(excluding interest under Section 194LB, 194LC and 194LD) or any other sum chargeable to tax
- b) Salaries are excluded

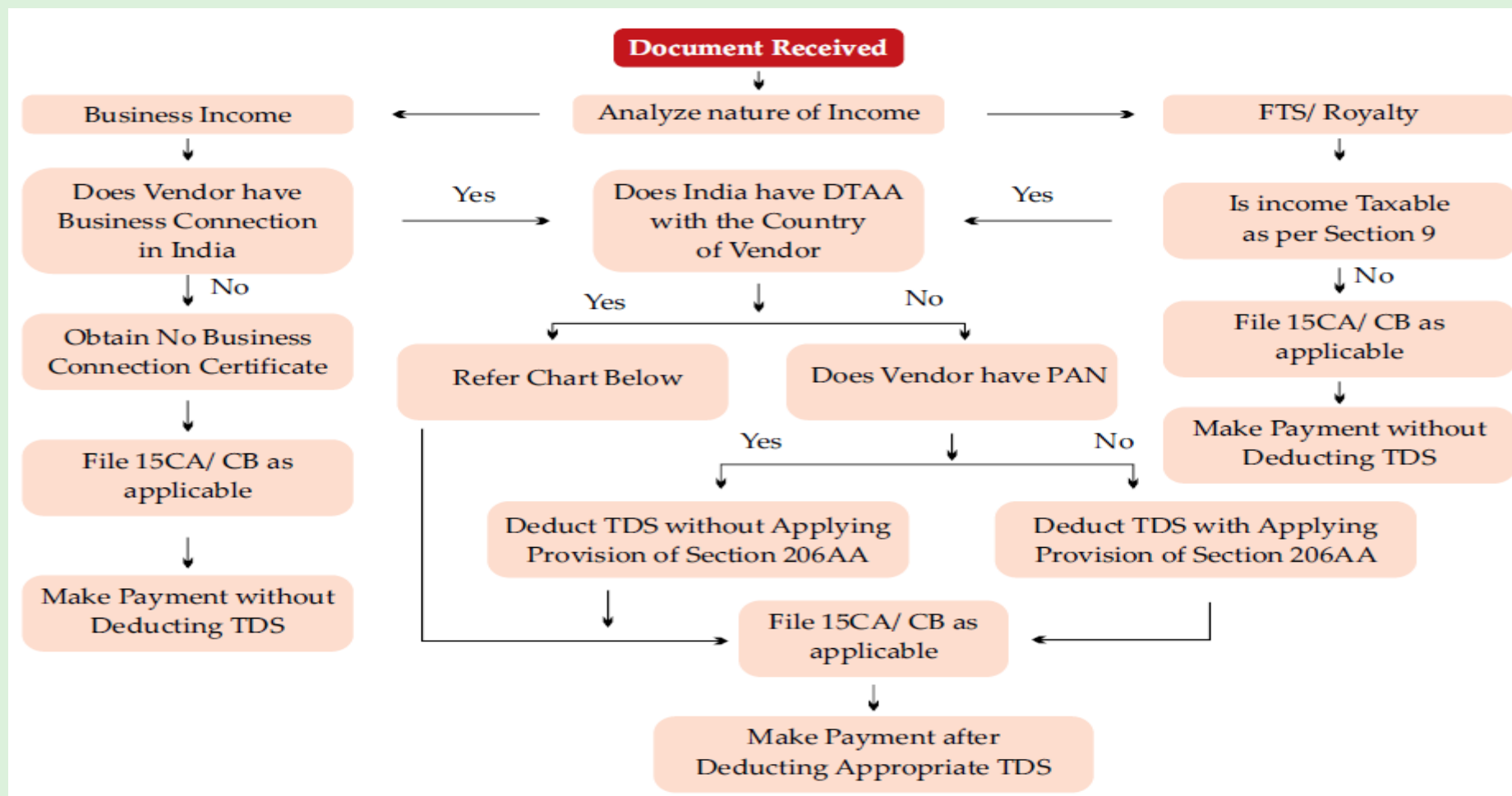
-What rate to apply

- a) Deduct tax at the rates in force (as provided in the Finance Act)
- b) If DTAA available, rates of income tax specified in the Finance Act or the rates specified in the DTAA, whichever is more beneficial shall apply.

-When to deduct

- a) The Act: At the time of payment or credit of income to the account of the payee, whichever is earlier (Explanation to the Section provides an exception to the Government, Public Sector Bank & Public Financial Institution -Deduction only on payment)
- b) Tax Treaty: Any specific requirement in the treaty to deduct tax needs to be adhered with if treaty provisions are followed.

Analysis of Section 195(1)



Who should deduct tax under Section 195?

Any person who makes any payment (other than salary or interest referred to in sections 194LB, 194LC, and 194LD) that is taxable in India to a non-resident must deduct tax under this section.

The payer, one who pays the NRI or remits the payment, can be a resident or a non-resident, an individual, Hindu Undivided Families (HUFs), partnership firms, other NRIs, foreign companies, or an artificial juridical person (for example, a corporation, government agency or non-profit organization).

Is there a threshold limit to deduct TDS u/s 195?

No, there is no threshold limit to deduct TDS under Section 195. However, the payer must deduct tax only when the payment made to a non-resident is taxable in India. Therefore, no tax is to be deducted in case of exempt income or any other income that is not taxable as per the Income Tax Act unless the government notifies explicitly.

At what rate is the tax deducted under section 195?

TDS is deducted at either of the following rates, whichever is beneficial to the payee:

Rates as per the Finance Act of the given year

Rates contained in the Double Taxation Avoidance Agreement (DTAA) between India and the country of residence of such non-resident

Note: The rates given under the Finance Act are to be increased by the applicable surcharge and education cess of 4%.

However, surcharge and cess are not required to be added to the rates given under DTAA.

Payment of TDS under Section 195

Below are the ways to deduct TDS under Section 195:

Person making payment to non resident (Deductor / Buyers) should obtain a TAN (Tax Deduction Account Number) under section 203A of the Income Tax Act before deducting the TDS. Deductor should also have their PAN number and PAN number of the NRI.

The deductor must deduct TDS at the time of making payment to NRIs.

TDS deducted by the buyer should be deposited through challan for TDS payment on or before the 7th of next month in which the TDS is deducted.

TDS can be deposited online or through banks that are authorised by the government or the Income Tax Department to collect direct taxes using challan 281.

After depositing the TDS, the buyer should electronically file a TDS return by filing Form 27Q. TDS returns are filed quarterly within the below due date.

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Application for nil or lower TDS deduction certificate by the Non-Resident (NRI)

When the recipient non-resident believes that no amount or only a partial amount (other than salary) is taxable in India or that TDS is to be done at a lower rate, then he may make an application under Form 13 to the Assessing Officer (AO) for obtaining a lower or nil deduction certificate. The assessing office will issue a lower withholding tax certificate u/s 197, which will enable the deductor or payer to deduct the TDS at a much lower rate.

Consequences of Not Paying TDS Under Section 195

Following are the consequences when individuals do not fulfill the provisions of Section 195:

In case the tax deducted is not withheld or submitted for a given time, the expenditure will be disallowed in case of business and will be allowed only in the year of such payment.

When the payer deducts the TDS but fails to submit it within the due date, he/she will be charged with a 1.5% interest from the date of deduction to the date of deposit.

If TDS is deducted but not paid, a penalty equal to the TDS amount will be levied.

In case of short tax deduction, a penalty equal to the difference between the actual amount deductible and actually deducted would be levied.



Part-3 :Procedure of Foreign Remittance

**Compliance with tax
deduction**

A. TAX

To Check :

Lower Deduction Certificate

Amount on which tax has to be deducted

Section 195A - Grossing up

Section 206AA - Requirement to withhold tax at the higher of the following rates if deductee fails to provide its PAN to the deductor:

Rate specified in the relevant provision of the Act (i.e. specified rates in Chapter XVII-B);or

Withholding tax rate specified in Finance Act; or

Rate of 20%

Rule 37BC provides relaxation from deduction of tax at higher rate under section 206AA. Section 206AA shall not apply on the following payments to non-resident Deductees who don't have PAN in India, subject to deductee furnishing the specified details and documents to the deductor:

Interest

Royalty;

Fees for Technical Services; and

Payment on transfer of any capital asset

In respect of the above, the deductee shall be required to furnish some of the details like mail, contact no, address and TIN.

Consequences of Non-Deduction



B. REMITTANCE OF FUNDS ABROAD

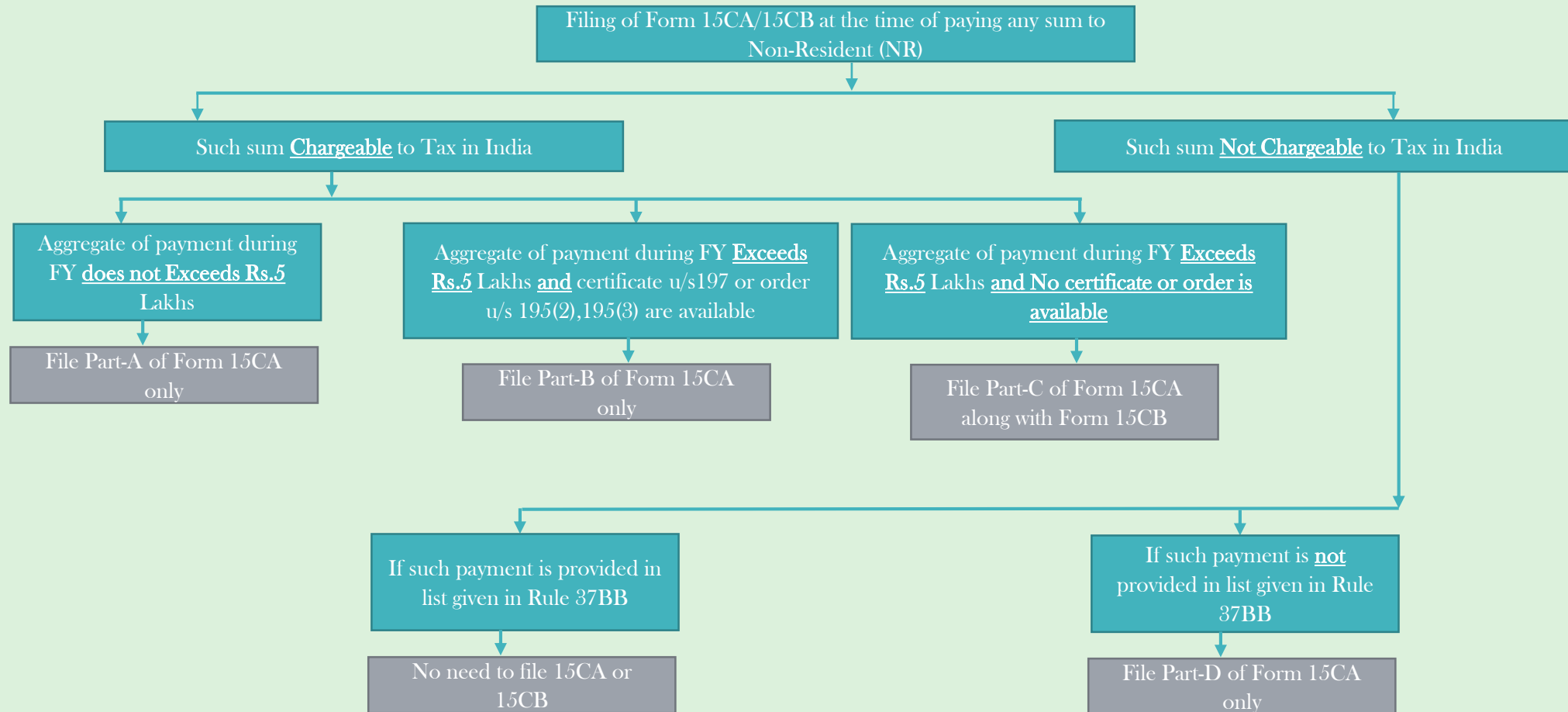
Certificate furnished by Chartered Accountant

The CBDT vide Notification No. 30/2009 dated 25th March, 2009 issued Income-tax (Seventh Amendment) Rules, 2009 and prescribed following formats through insertion of Rule 37BB -

Form 15CA - Format for furnishing prescribed information and verification by the payee

Form 15CB - Format for certificate from Chartered Accountant

Form 15CA/15CB



C. Electronic Submission of Form 10F

As per Sec 90(5) read with Rule 21AB(1), for the purpose of claiming/granting relief under DTAA, duly verified & signed Form 10F is to be obtained from Non-Resident/Foreign Company.

CBDT Vide Notification No 03/2022 dt 16.07.2022 specified that form 10F be furnished electronically by Non-Resident/Foreign Company who have Indian PAN.

Now, deductors need to obtain electronically submitted Form 10F for granting DTAA benefit in place of physically signed Form 10F.

However, pending clarification from CBDT, we may accept the Manual Form-10F in exceptional cases only and obtain a declaration from the overseas vendor confirming reasons because of which e-filed Form 10F cannot be furnished.



Part -4: Case Studies

A. Fee for Technical Services (FTS)

- Means any consideration for the rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel) but does not include consideration for any construction, assembly, mining or like project or consideration which would chargeable under the head "Salaries".
- FTS also includes make available technical knowledge, experience, skill, know-how, or processes, or consist of the development and transfer of a technical plan or technical design.



Thank you